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IRS Issues Q&As on the Additional Medicare Tax under the Affordable Care Act

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Social Security and Medicare are funded in large part through payroll taxes imposed by the Federal Insurance Contributions Act or "FICA." FICA imposes a tax of 15.3% on "wages," which is paid by the employer and by employees, each party paying half. Before 2013, the employer portion of the tax (the so-called "hospital insurance" or "HI" portion) was 1.45% and the employee portion was also 1.45%.[1] The Patient Protection and Affordable Care Act (the "Act") imposes an additional tax — referred to as the "Additional Hospital Insurance Tax on High-Income Taxpayers and Unearned Income" or, simply the "Additional Medicare Tax" — that increases the *employee* portion of the HI tax by 0.9% of wages on workers with incomes of over $200,000 for single filers and $250,000 for joint filers effective for taxable years commencing after December 31, 2012.

Employers are responsible for withholding the Additional Medicare Tax. The tax is also levied on self-employed individuals whose incomes exceed the specified thresholds. (Self-employed individuals are not permitted to deduct this additional tax as a business expense.) Liability for the Additional Medicare Tax is on the employee only — there is no employer match.

On June 11, 2012, the IRS issued guidance in the form of "questions and answers" (Q&As) that explain and expand upon the Additional Medicare Tax. The Q&As are intended to assist employers and payroll-service providers in adapting systems and processes that may be affected by the new tax. Set out below are some of the highlights of the Q&As.

Threshold Amounts

An individual is liable for the Additional Medicare Tax if the individual's wages, other compensation, or self-employment income (when combined with that of his or her spouse if filing a joint return) exceed the "threshold amount." Threshold amounts, which are based on an individual's filing status, are as follows:

- Married filing jointly $250,000
- Married filing separately $125,000
- Single $200,000
- Head of household (with qualifying person) $200,000
- Qualifying widow(er) with dependent child $200,000

Employer's obligation to withhold

Employers must withhold the Additional Medicare Tax on wages or compensation paid to an employee in excess of $200,000 in a calendar year. This rule applies:

- Without regard to marital status as claimed on an employee's Form W-4;

- Irrespective of whether an employee is liable for the tax, e.g., in instances where the employee's wages or other compensation together with that of his or her spouse (when filing a joint return) does not exceed the $250,000 liability threshold. (Any excess will be credited against the employee's total tax liability); and
- To employees who are non-resident aliens and US citizens living abroad.

In instances where an employee's annual Medicare wages are expected to be over $200,000, the employer's withholding obligation begins in the pay period in which it pays wages in excess of $200,000 to an employee. Where a single payment of wages exceeds the $200,000 withholding threshold, the employer is not required to withhold the tax on the entire payment. (This rule differs from the rules governing income tax withholding that apply to supplemental wages in excess of $1,000,000.)

Where an employee performs services for multiple subsidiaries of a single employer, each subsidiary is an employer of the employee with regard to the services the employee performs for that subsidiary. The wages paid by each subsidiary are combined if the payor is a "common paymaster." Under the common paymaster rules, each subsidiary must pay its own part of the employment taxes and may deduct only its own part of the wages. But an agent for two or more employers may not combine the wages paid on behalf of the separate employers.

The employer is not required to notify employees that it is going to begin collecting the Additional Medicare Tax.

Withholding on non-cash wages

Where wages in excess of $200,000 include noncash fringe benefits, the determination of the Additional Medicare Tax is unaffected. The value of noncash fringe benefits is included in wages, and the employer must withhold and deposit the tax under the rules for employment tax withholding and deposits that apply to noncash fringe benefits. To the extent that tips and wages exceed $200,000, an employer applies the same withholding rules for Additional Medicare Tax as it does currently for the Medicare tax. If there is a shortfall, the employee may need to make estimated tax payments to cover any shortage.

Group-term life insurance coverage in excess of $50,000

If a former employee receives group-term life insurance coverage in excess of $50,000, the imputed cost of coverage in excess of $50,000 is subject to social security and Medicare taxes. To the extent that these amounts in combination with other wages exceed $200,000, they are subject to the Additional Medicare Tax. Where coverage is provided to a former employee (e.g., following termination), the employee share of social security and Medicare taxes (including the Additional Medicare Tax) must be paid by the former employee with his or her income tax return and is *not* collected by the employer. An employer must, nevertheless, report this income as wages on Form 941. (But unlike the uncollected portion of the regular Medicare tax, an employer does not report the uncollected Additional Medicare Tax in box 12 of Form W-2 with code N.)

Third-party sick pay

Wages paid by a third party are aggregated to determine whether the $200,000 withholding threshold has been met.

Non-qualified deferred compensation

Where an employee has amounts deferred under a nonqualified deferred compensation plan, the employer calculates wages for purposes of withholding the Additional Medicare Tax in the same way that it calculates wages for withholding the existing Medicare tax from non-qualified deferred compensation. Withholding under these circumstances is generally subject to the "special timing rule" set out in Treas. Reg. § 31.3121(v)(2)-1(a)(2), under which deferred amounts are taken into account as FICA wages as of the later of (i) when the services are performed, or (ii) when there is no substantial risk of forfeiture of the rights to such amount. (A separate non-duplication rule provides that if an amount deferred is taken into account as FICA wages under the special timing rule, neither the deferral nor the related income is included in FICA wages when benefits attributable to that amount are paid.)

Reporting/Forms

The IRS plans to issue updated Forms 941 and 943, among others.

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For further information on how the Act impacts employers and employer-sponsored group health plans, as well updates and other information pertaining to legal developments in all areas of Labor, Employment, and Benefits, please subscribe to the Mintz Levin ***Employment Matters*** Blog, which may be accessed at www.employmentmattersblog.com.

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Endnotes

[1] *See* the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, Pub. L. 111-312 (Dec. 17, 2010) (reducing temporarily the employee portion of the Social Security tax to 4.2% from 6.2%). This relief was extended to 2011 and 2012 by H.R. 3765 and H.R. 3630. Commencing in 2013, the employee-portion of the Social Security tax will revert back to 6.2%.