Legal Alert: Social Security Tax Break Temporarily Extended

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Executive Summary: On December 23, 2011, the President signed a bill that extends the tax break on the employee portion of the Social Security Old-Age, Survivor and Disability Insurance (OASDI) for the first two months of 2012.

Background

For 2011, the employee portion of the OASDI tax has been limited to 4.2% of wages up to the taxable wage base ($108,000), as opposed to the "standard" 6.2% of wages. The employer portion has remained at 6.2% of the first $108,000 of wages, and the Hospital Insurance (Medicare) portion has remained at 1.45% of all wages for both employer and employee. The 2% reduction in employee OASDI tax was scheduled to expire at the end of 2011, and, though Congress was considering extending the cut, there had been a stalemate in negotiations.

New Bill

Late on December 22, the House and Senate reached agreement on extending the tax break – at least for a portion of next year. Under the agreement, the reduced 4.2% rate would continue to apply for the first two months of 2012, reverting to 6.2% thereafter. During that two-month period, House and Senate conferees would work towards a more permanent provision. The bill was approved by both houses on December 23, and signed by President Obama the same day.

However, one aspect of the law bears noting. There is no cap on the amount that is subject to the reduced 4.2% withholding rate during January and February, other than the 2012 annual wage base ($110,100). So employers will not have to insert a new limitation in their payroll systems. However, if an employee's wages during January and February exceed $18,350 (i.e., two-twelfths of $110,100), then, unless the payroll tax reduction is further extended for the remainder of the year, the reduction in the amount withheld with respect to those excess wages (i.e., 2%) will be added to the employee's income tax liability on his or her 2012 tax return.

Self-employed persons receive the same benefit. The rate of self-employment tax remains at 13.3% (instead of 15.3%) for 2012, but only as to the first $18,350 of self-employment income, reduced by any amount of wages received by the self-employed individual during January and February, which would already have been subject to the reduced tax rate. It should be noted, however, that self-employment earnings can be subject to the reduced rate even if not earned in January or February, though the reduced rate would still apply to no more than $18,350 of self- employment income, which is the equivalent of two months' share of the annual maximum.

If you have any questions regarding this extension, please feel free to contact the author of this Legal Alert, Jeffrey Ashendorf, jashendorf@fordharrison.com, any member of Ford & Harrison's Employee Benefits Practice Group or the Ford & Harrison attorney with whom you usually work.