

From APA –President Signs Tax Relief Act

AMERICAN PAYROLL ASSOCIATION Compliance Update

President Obama Signs Tax Relief Bill With 2% Employee Social Security Tax Reduction; IRS Issues 2011 Withholding Tables

On December 17, President Barack Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Tax Relief Act of 2010). The new law continues the Bush-era tax rates, which were set to expire on December 31, 2010, for two years, through December 31, 2012, thus avoiding a sharp increase in income tax withholding for most employees.

The law also reduces the social security tax rate paid by employees from 6.2% to 4.2% for wages paid in 2011 and continues several expiring payroll-related tax breaks, including non-job-related employer-provided educational assistance, adoption assistance, qualified mass transit and van pool benefit parity with employer-provided parking, and the Work Opportunity Tax Credit.

Also on December 17, the IRS released Notice 1036, which contains the percentage method tables for federal income tax withholding from wages paid in 2011. In a news release, the IRS said it recognizes that the late enactment of the Tax Relief Act makes it difficult for many employers to update their withholding systems for the first payroll of 2011. Therefore, the IRS is asking employers to update their payroll systems as soon as possible, but not later than January 31, 2011. For any social security tax overwithheld during January because of the rate change, employers should make an adjustment in employees' pay as soon as possible, but not later than March 31, 2011.

Tax rates for Individuals

Under the Tax Relief Act of 2010 (TRA 2010), the current tax rates of 10%, 15%, 25%, 28%, 33%, and 35% will stay in effect beyond their expiration date of December 31, 2010, for two years, through December 31, 2012. Had TRA 2010 not been enacted, the 10% rate would have been eliminated and the other rates would have been set at 15%, 28%, 31%, 36%, and 39.6%, beginning January 1, 2011. TRA 2010 also extends marriage penalty relief that set the standard deduction for married individuals filing jointly at double that for single individuals and widened the 15% tax bracket to twice the size for joint filers that it is for single individuals.

Having certainty as to the tax rates, brackets, and standard deduction amounts for 2011 should allow the IRS to issue income tax withholding tables and Form W-4 for 2011 very soon after TRA 2010 is signed into law, so that payroll professionals, payroll service providers, and payroll software vendors can prepare for the first payroll of 2011. The new tables and forms will be made available on APA's website as soon as they are released by the IRS. It should also allow the IRS to issue Publication 1494, *Tables for Figuring Amount Exempt from Levy on Wages, Salary, and Other Income*.

Reduction in employee social security tax rate

TRA 2010 makes a major change in the withholding of social security taxes from employees' wages by reducing the employee share of social security tax from 6.2% to

4.2% for the first \$106,800 of wages paid in 2011. The maximum that can be withheld will be \$4,485.60, a \$2,136 decrease from the 2010 maximum of \$6,621.60.

Employers will continue to pay the full 6.2% of their employees' covered wages paid in 2011 for their share of social security taxes. Remember that the HIRE Act, which exempted employers from paying their share of social security taxes on the wages of certain employees who were newly hired after February 3, 2010, and before January 1, 2011, does not apply to wages paid after December 31, 2010.

Self-employed individuals, who currently pay 12.4% of their income in social security taxes, will pay 10.4% up to the \$106,800 wage base. Also, employees covered by the Railroad Retirement Tax Act will see a reduction in their Tier I withholding tax from 6.2% to 4.2%.

Other expiring provisions extended

TRA 2010 also provides for the extension of several other payroll-related provisions that were set to expire on December 31, 2010, or sometime during 2011:

- *Employer-provided educational assistance* – The income exclusion for up to \$5,250 of employer-provided undergraduate and graduate educational assistance under IRC §127 is extended for two years, through December 31, 2012.
- *Parity for mass transit benefits* – The increase in the maximum monthly income exclusion for employer-provided mass transit and vanpool benefits to the same amount as employer-provided parking benefits (\$230 for 2010) is extended for one year, through December 31, 2011. The IRS should announce the 2011 monthly maximum for both benefits very soon.
- *Adoption assistance* – The income exclusion for up to \$13,170 of employer-provided adoption assistance in 2010 (\$13,360 in 2011) is extended for one year, through December 31, 2012.
- *Child tax credit* – The increase in the maximum child tax credit for individuals with income below certain thresholds from \$500 to \$1,000 is extended for two years, through December 31, 2012. Employees can claim additional allowances on Form W-4 based on their eligibility for the credit.
- *Dependent care credit* – The increase in the maximum child care expenses that qualify for the dependent care tax credit from \$2,400 for one child and \$4,800 for two or more to \$3,000 and \$6,000 respectively is extended for two years, through December 31, 2012. Employees can claim additional allowances on Form W-4 based on their eligibility for the credit.
- *Work Opportunity Tax Credit* – The Work Opportunity Tax Credit is extended for four months, through December 31, 2011, and is effective for employees hired after the date TRA 2010 is enacted.

No more HIRE Act or Making Work Pay Credit

Under the Hiring Incentives to Restore Employment (HIRE) Act, which was enacted in March 2010, employers get a social security tax exemption for the employer share of social security tax on wages paid to new employees from March 19-December 31, 2010, who were hired from February 4-December 31, 2010, after having been employed for no more than 40 hours in the previous 60 days. The HIRE Act's social security exemption has not been extended, so it does not apply to any wages paid after December 31, 2010.

In February 2009, the American Recovery and Reinvestment Act (ARRA) provided for the Making Work Pay Credit – an income tax credit of \$400 for single individuals and \$800 for married couples filing jointly – that was paid out through reduced federal income tax withholding for 2009 and 2010. The MWP credit expires on December 31, 2010, and the tax tables for 2011 will reflect that expiration with a slight increase in withholding.

► **APA OFFERS WEBINAR TO EXPLAIN TAX RELIEF ACT** – The APA will present a live 60-minute webinar, “How Will the Tax Relief Act of 2010 Impact Your Payroll Processing,” on December 23 at 1:00 p.m. ET. Get the details on the payroll impact of all the changes contained in the Tax Relief Act of 2010 and what you’ll need to communicate about the Act to your employees. Go to APA’s website at www.americanpayroll.org/product/?cid=49&gid=119 for registration information.