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## Higher Income Workers Face Extra Medicare Tax Next Year

On June 11, the Internal Revenue Service (IRS) issued the first set of guidance, in the form of 20 FAQs posted on its website, regarding the additional Medicare Tax that is effective beginning January 1, 2013 under new Code section 3101(b).

<http://www.irs.gov/businesses/small/article/0,,id=258201,00.html>. This informal guidance is designed to facilitate system changes and payroll compliance, and provides some limited relief with regard to the withholding requirements. Below is a brief summary of the tax, and the responsibilities imposed on employers and employees to comply with the new provisions. We note that, in 2013, higher income taxpayers may also face the additional 3.8% tax (new Code sec. 1411) on certain "net investment income." Both of these new taxes were created under the 2010 health care reform law.

### Summary of the Rule:

- **Rate:** An additional .9% of wages (with no cap). Therefore, the Medicare tax rate for certain workers increases from 1.45% to 2.35% for the employee's portion of the tax. The employer's rate remains at 1.45%.
- **Impacted Workers:** The tax is imposed if the individual's wages and other compensation or self-employment income (together with his or her spouse if filing a joint return) exceed the applicable threshold (\$125,000 for married filing separately, \$200,000 for single and head of household, and \$250,000 for married filing jointly and qualifying widow with dependent child). There is no exception for nonresident aliens or U.S. citizens working abroad.

### Duties of Employer:

- **Report on Form W-2:** We understand that the pending 2013 Form W-2 will explain that the additional tax will be aggregated on line 6 (Medicare Tax Withheld), but no other changes are anticipated.
- **Withhold the Tax:** The employer must withhold the tax on wages or compensation it pays to an employee in excess of \$200,000 in a calendar year. For this purpose, the IRS clarified that
  - there is no obligation to notify the employee of the extra withholding,
  - the withholding must begin in the pay period in which the employer pays wages in excess of \$200,000 to an employee,

- if a single payment of wages exceeds the \$200,000 threshold, the employer must only withhold on the portion of the payment that exceeds the \$200,000 threshold,
- the withholding applies to noncash fringe benefits (subject to flexibility under the existing employment tax rules),
- the withholding applies to reported tips,
- the withholding applies to imputed income from group-term life insurance (along with the special rules for retirees and other former employees,
- the withholding applies to third-party sick pay when the aggregate wages from the employer and the sick pay provider exceed the threshold, following the regular rules for sick-pay reporting, and
- the withholding applies to nonqualified deferred compensation ("NQDC") (presumably when the wage threshold is met by counting the employer wages and any third-party agent payments), following the complex rules for NQDC reporting under Code section 3121(v). In this regard, it may be desirable to subject NQDC to FICA this year instead of waiting until the resolution date (in the case of SERP amounts) or following the "lag method" (for hard to value items) when the higher rate applies.

If an employee works for more than one entity in a controlled group, each employer has its own withholding threshold, unless the employee is paid through a common paymaster arrangement (in which case, aggregation is required to determine if the threshold has been met). Similarly, wages paid by an agent under Form 2678, acting for multiple employers, to the same employee are not aggregated for purposes of the withholding threshold. We understand that the IRS is still finalizing the changes to Forms 941/943 (and the correction forms) to reflect the additional Medicare tax, but a new line will be added to the form.

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