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## IRS Guidance on Additional Medicare Tax on High Earners

The IRS and Treasury recently issued proposed regulations that spell out the rules for imposing the new additional .9% Medicare Tax starting next year. [REG-130074-11] The proposed regulations provide detailed rules for the assessment, collection, and refund of such taxes, and may be relied upon until the final regulations are issued. The proposed rules are briefly summarized below, and are generally consistent with the FAQs IRS issued for employers back in June. (See <http://www.groom.com/resources-688.html>.)

**Taxes Impacted:** The additional .9% tax – which applies only to the employee's share of FICA – applies to wages under Federal Insurance Contribution Act (FICA) (with no cap), compensation subject to Railroad Retirement Tax Act (RRTA), and earned income subject to Self-Employment Contributions Act (SECA). However, the SECA income thresholds are reduced (not below zero) to the extent that the taxpayer also received FICA wages for the year. The proposed regulations provide helpful examples of this coordination rule.

**Employer Obligation to Withhold:** The employer must withhold the additional .9% tax from wages/compensation that exceeds the \$200,000 wages threshold – even though only married couples with combined AGI of \$250,000 or over are subject to the tax. To the extent that the employer fails to withhold such amount, the employer is liable (along with the employee) for the missed withholding (unless actually paid by the employee on his or her Form 1040). However, even if the employee pays the tax, the employer may still be liable for related penalties and interest for failure to properly withhold (and pay over).

The following rules apply with regard to the \$200,000 withholding threshold:

- The \$200,000 withholding threshold applies to each single employer; however, amounts disbursed by a common paymaster are treated as paid by a single employer.
- The employer may not deduct and withhold the tax on wages of \$200,000 or less, even if requested by the employee.
- An interest-free adjustment of an underpayment of the additional tax can only be paid within the same year as the wages/compensation is paid, unless attributable to (1) administrative error, (2) Code section 3509 worker misclassification, or (3) adjustment as a result of an IRS examination. In general, the error must be ascertained within the same calendar year that the wages/compensation was paid, collected from the employee on or before the last day of the calendar year by deducting the amount from remuneration of the employee, and Form 941-X must be filed (with the applicable tax) by the due date for filing a quarterly return for the quarter in which the error is ascertained.

- An adjustment of overpaid additional tax can only be made if the employer ascertains the error in the same year and reimburses the employee the amount of the overcollection prior to the end of such calendar year. For this purpose, the employer must obtain and retain the written receipt of the employee showing the date and amount of the repayment to the employee or retain evidence of reimbursement. After year-end, the employee generally claims the overpayment refund on his or her Form 1040. The employer can only claim a refund for overpaid additional tax if the employer did not deduct and withhold the overpaid tax from the employee's wages.

**Employee Obligation to Pay and Report:** The employee is required to:

- report the additional .9% tax on his or her Form 1040 (including Forms 1040-SS and 1040-PR),
- take credit for any amount withheld for the year (even if it was an overpayment of the taxes), and
- pay any such tax due (*i.e.*, not previously paid through withholding or estimated tax).

Therefore, to the extent that the \$200,000 withholding threshold prevents an employer from withholding the appropriate tax (e.g., the employee and spouse each make \$150,000), the employee may either (1) request additional federal income tax withholding on Form W-4, or (2) take the additional tax into account when making estimated tax payments.

Note that if an overpayment is later discovered, the employee must file a Form 1040X to seek a refund of the additional tax. Of course, no refund is available if the employee received repayment or reimbursement from the employer.

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Comments on the proposed regulations – including ways that the rules can be made easier to understand – are due March 5, 2013, and a public hearing has been set for April 4, 2013.