

## Payroll Tax Cut Extension

At the eleventh hour, Congress approved a two-month extension of the employee-side payroll tax cut in the Temporary Payroll Tax Cut Continuation Act of 2011. The two-month extension, for January and February 2012, is intended to give lawmakers additional time to negotiate a full-year extension of the payroll tax cut through the end of 2012.

**OASDI tax rate.** Social Security's Old-Age, Survivors, and Disability Insurance (OASDI) program and Medicare's Hospital Insurance (HI) program are financed primarily by employment taxes. Prior to 2011, the OASDI tax rate was 6.2 percent for employees and employers, each; and the OASDI tax rate for self-employment income was 12.4 percent.

OASDI limits the amount of earnings subject to taxation for a given year. This limit changes each year with changes in the national average wage index. For 2011, the OASDI wage base was \$106,800. The OASDI wage base is \$110,100 for 2012. There is no limitation on HI-taxable earnings.

**2011 temporary reduction.** The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 reduced, for wages and salaries paid in 2011 and self-employment income in 2011, the OASDI tax by two percentage points, applied to the portion of the tax paid by the employee and the self-employed individual (4.2 percent and 10.4 percent, respectively). The employee-side payroll tax cut under the 2010 Tax Relief Act was scheduled to expire after December 31, 2011.

**Two-month extension.** On December 23, 2011, Congress approved and President Obama signed a two-month extension of the employee-side payroll tax cut. The Temporary Payroll Tax Cut Continuation Act of 2011 extends the two percentage point employee-side payroll tax cut through the end of February 2012.

**Recapture.** Shortly after President Obama signed the Temporary Payroll Tax Cut Continuation Act, the IRS explained that the new law includes a recapture provision, which applies to individuals who receive more than \$18,350 during the two-month extension period. The OASDI wage base for 2012 is \$110,100, and \$18,350 represents two-months of the full-year amount. The recapture tax would be payable in 2013 when the employee files his or her income tax return for the 2012 tax year. The House Ways and Means Committee reported that the recapture provision will only apply if the payroll tax reduction is not extended for the remainder of 2012.

**Implementation.** The IRS instructed employers to implement the reduced payroll tax rate as soon as possible in 2012 but no later than January 31, 2012. For any Social Security tax over-withheld during January, employers should make an offsetting adjustment in employees' pay as soon as possible but no later than March 31, 2012, the IRS advised.

If you have any questions about the two-month extension of the payroll tax cut, please contact our office.