CCH Tax Briefing

CCH a Wolters Kluwer business

MIDDLE CLASS TAX RELIEF AND JOB CREATION ACT OF 2012

February 22, 2012

Special Report

HIGHLIGHTS

- Two-Percentage Point Cut For Wage Earners
- Comparable Benefit For Self-Employed Individuals
- Recapture Rules In Previous Extension Repealed
- IRS Ready To Implement Extension Without Delay
- Repeal Of Corporate Estimated Tax Timing Shifts

INSIDE

President Signs 2012 Payroll Tax Holiday Extension

President Obama on February 22, 2012, signed into law a much-anticipated extension of the employee-side payroll tax cut through the end of 2012. After weeks of uncertainty over whether an agreement could be reached, the House passed the Middle Class Tax Relief and Job Creation Act of 2012 (H.R. 3630) by a vote of 293 to 132 on February 17, 2012. Senate approval quickly followed, also on February 17, by a vote of 60 to 36. Lawmakers agreed not to require the $93.2 billion estimated cost for the payroll tax cut extension to be offset by revenue-raising provisions. A potential impasse over revenue increases was avoided entirely when both parties agreed to offset costs of the full-year, two percentage point payroll tax cut through transfers from the general fund of the Treasury to the OASDI trust fund. In a revenue neutral provision, however, the new law eliminates a timing-shift in the estimated tax payments that had been required of certain large corporations under previous laws. Non-tax provisions within the new law extend unemployment benefits and implement a "doc fix" for Medicare. President Obama signed the bill as soon as it reached the White House.

IMPACT: *The Joint Committee on Taxation (JCT) has estimated that approximately 170 million wage earners and self-employed individuals will benefit from the payroll tax reduction in 2012. The White House figures that taxpayers on average will see a $1,000 increase in take-home pay in 2012. The extension benefits both employees and those self-employed. In January, the IRS indicated it would be ready to quickly implement a full-year extension of the payroll tax cut.*

IMPACT: *To offset the payroll tax extension, Democrats had proposed a surtax on millionaires, which met with strong Republican resistance. Failure to include that provision in the new law—possibly the last tax-related bill to be passed by Congress in the near future—significantly lowers the likelihood of any new tax on higher income individuals being approved by Congress before the November elections.*

FULL-YEAR EXTENSION

The Temporary Payroll Tax Cut Continuation Act of 2011 (2011 Payroll Continuation Act) had extended the employee-side payroll tax rate reduction of two percentage points through the end of February 2012. The new law extends the employee-side payroll tax holiday through the end of 2012.

Under the new law, individuals who receive wages and salaries will pay Old-Age, Survivors, and Disability Insurance (OASDI) taxes at a rate of 4.2 percent for calendar year 2012. The OASDI tax rate for self-employed individuals for 2012 similarly has been extended at a reduced 10.4 percent level through the end of 2012.

IMPACT: *All wage earners and individuals who are self-employed share in the two percentage point payroll tax cut extension, up to the Social Security earnings cap of $110,100 for 2012. Taxpayers earning more than $110,100, benefit from the two percentage point reduction up to the $110,100 wage base. Workers under the Railroad Retirement System also benefit from a* *similar reduction in 2012 (as they did for 2011) with respect to the rate of withholding, from 6.2 percent down to 4.2 percent.*

IMPACT: *Reduced OASDI withholding has no effect on an individual's future Social Security benefits.*

OASDI. Individuals contribute to Social Security through payroll taxes (the Federal Insurance Contributions Act (FICA)) or self-employment taxes (Self-Employment Contributions Act (SECA)). Both FICA and SECA are composed of two parts: (1) the Old-Age, Survivors, and Disability Insurance (OASDI) tax and (2) the Medicare Hospital Insurance (HI) tax. The OASDI tax normally requires employers and employees each to pay 6.2 percent of wages up to the maximum taxable wage base ($110,100 for 2012). Self-employed individuals pay both portions (normally equal to 12.4 percent). The new law reduces those rates to 4.2 percent and 10.4 percent, respectively, for 2012.

COMMENT: *Starting in 2013, the Patient Protection and Affordable Care Act (PPACA) is set to impose an additional 0.9 percent Medicare tax on wages in excess of $200,000 ($250,000 in the case of a joint return, $125,000 in the case of a married taxpayer filing separately).*

RECAPTURE REPEALED

When Congress passed the two-month extension of the payroll tax cut, the extension included a recapture provision, which was intended to apply to individuals who receive more than $18,350 in remuneration in January and February 2012. The recapture tax would have been payable in 2013 when the individual filed his or her income tax return for the 2012 tax year. The House Ways and Means Committee explained that the recapture provision would not apply when Congress approved a full-year extension of the payroll tax cut for 2012. The new law holds true to that promise by amending the definition of "Payroll Tax Holiday Period" in the 2010 Tax Relief Act to mean calendar years 2011 and 2012, and by repealing the January-February recapture provisions.

COMMENT: *On February 16, Treasury Secretary Timothy Geithner told the Senate Budget Committee that he does not anticipate the payroll tax cut would be extended for a third year (into 2013). "This has to be a temporary tax cut. I don't see any reason to consider supporting its extension."*

> "All wage earners and individuals who are self-employed share in the two percentage point payroll tax cut extension, up to the Social Security earnings cap of $110,100 for 2012."

IRS RESPONSE

In a February 15, 2012 letter to the Joint Committee on Taxation, IRS Commissioner Douglas Shulman reported that the IRS had taken measure to prepare for the expiration of the two-month extension, including revising forms and instructions and programming systems. He further wrote that the IRS will be making "small modifications to certain notices to, and publications for, employers" but that no new guidance would be required and only minimal impact on IRS training and the Internal Revenue Manual would take place because of the full-year extension.

IMPACT: *Shulman concluded that, as an extension of current law (except for the recapture repeal), the full-year extension of the payroll tax holiday "should not add significant burden to taxpayers and the public in general." Shulman added, "computer software providers and large employers may have programmed their systems for current law and would need to make … adjustments."*

EMPLOYERS

The employer's share of OASDI taxes is not reduced to 4.2 percent but remains at 6.2 percent for all of 2012. That 6.2 percent "half" of OASDI taxes on self-employment income is effectively built into the 10.4 percent rate for 2012.

COMMENT: *For tax years beginning in 2009 and 2010, a less generous Making Work Pay credit was available for workers, capped at $400 ($800 for a joint return) and a phase out for modified adjusted gross income above $75,000 ($150,000 for joint returns). An employer-side payroll tax holiday was also available for wages paid from March 19, 2010 through December 31, 2010, to qualified workers hired after February 3, 2010, and subject to certain limitations.*

ELEVENTH-HOUR ADDITIONS/DELETIONS

House Republicans introduced the Payroll Tax Cut Continuation Act of 2012 as a stand-alone payroll tax cut bill without an extension of unemployment benefits and a Medicare "doc fix." Last-minute negotiations added an extension of unemployment benefits and the Medicare "doc fix" (as well as a name-change for the bill to the Middle Class Tax Relief and Job Creation Act of 2012).

The GOP dropped a proposal to require claimants for the earned income credit to have a Social Security number. Also dropped was a proposal to extend 100 percent bonus depreciation one more year, through 2012. The so-called "tax extenders" provisions were tabled. These include the research tax credit, the state and local sales tax deduction, the higher education tuition deduction, and many more.

CORPORATE ESTIMATED TAX PAYMENTS

Generally, a corporation is required to make quarterly estimated tax payments during its tax year based on its income tax liability. For a corporation whose tax year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15. A fiscal year corporation pays estimated tax installments for a tax year on the 15th day of the fourth, sixth, ninth, and twelfth months of the year.

A number of recent laws have accelerated the estimated tax payment required to be made by certain large corporations (those with assets of at least $1 billion) from one quarter into the previous quarter. Congress had enacted these changes solely as accounting maneuvers designed to make certain budgetary requirements over shifting budget windows from one fiscal year to another. For example, such shifts were required under the trade agreements with Colombia, Korea and Panama enacted in 2011; the Hiring Incentives to Restore Employment Act of 2010; and the Corporate Estimated Tax Shift Act of 2009. Under this regime, the next required installment of estimated tax would be reduced accordingly to reflect the increase. None of these shifts has yet to take place.

The new law provides that these recently enacted timing shifts are repealed. The regular payment schedule that applied prior to the enactment of the timing shifts is restored.

IMPACT: *According to the Joint Committee on Taxation, repeal has no revenue effect over 2012-2021.*

TAX RATES – 2012

Program	Employee	Employer	Self-Employed
OASDI	4.2%	6.2%	10.40%
HI	1.45%	1.45%	2.90%

COMMENT: *President Obama called for repeal of these timing shifts in his fiscal year (FY) 2013 budget proposals.*

WHAT'S NEXT

AMT Patch. President Obama has proposed abolishing the AMT and recouping at least some of the lost revenue with the so-called Buffett Rule. Until (and if) Congress should enact the Buffett Rule, President Obama has proposed to provide for AMT patch for 2012 and subsequent years. The AMT patch provides taxpayers with increased exemption amounts.

Corporate Tax Reform. There is a growing groundswell among tax professionals that tax reform is necessary both to reduce complexity and streamline economic competitiveness. The administration unveiled a "framework" for corporate tax reform on February 22, 2012. Administration officials have said that the corporate tax rate could be reduced in exchange for the closing of tax preferences, incentives, benefits and loopholes. The framework also includes the President's proposed minimum tax on overseas profits, which like the Buffett Rule has not yet been described in detail by the administration.

Carried Interest. As part of his FY 2013 budget, President Obama proposed to designate a carried interest in an investment partnership as a services partnership interest (SPI). A partner's share of income from an SPI that is not attributable to invested capital would be taxed as ordinary income. Self-employment tax would attach to that income. The President's proposal has been described as a non-starter by the GOP.

Bonus Depreciation. One hundred percent bonus depreciation generally expired at the end of 2011. President Obama and many lawmakers support extending 100 percent bonus depreciation through the end of 2012.

Extenders. A host of temporary individual, business and energy tax incentives expired at the end of 2011. President Obama has indicated his support for extending the extenders as have many lawmakers. However, the cost of extending the expired provisions could be an obstacle to their passage.

COMMENT: *While the tax extenders could be retroactively reinstated by Congress to January 1, 2012, if passed even late in 2012, proponents argue that their effectiveness is significantly diminished the later they are taken up by Congress.*

Sunsetting of the Bush-Era Tax Cuts. President Obama and the GOP remain far apart over the fate of the Bush-era tax cuts. The President has frequently reiterated his proposal to allow the Bush-era tax cuts to expire for higher income taxpayers after 2012, most recently in his State of the Union address and FY 2013 budget proposals. Both sides expect little progress over the fate of the Bush-era tax cuts until after the November elections.