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July 20, 2020

How Quickly Could a Limited Social Security Payroll Tax Cut be Implemented?

Background: Employees pay a 6.2% Social Security tax on wages up to an annual limit ($137,700 in 2020), so someone earning $137,700 or more would pay $8,537.40 in 2020. Medicare tax of 1.45% is also assessed with no taxable wage limit, and an additional 0.9% is withheld on Medicare wages over $200,000 annually.

Policymakers have asked whether a Social Security tax suspension could be implemented quickly, with the added provision that the suspension would only apply to up to $75,000 in wages. The suspension would NOT have retroactive effect. It would only apply to 2020 wages paid after September 30. Medicare taxes and employer Social Security taxes are unaffected.

Conclusions in Summary

- An effective date of October 1 would be feasible for some employers but not all.
    - The IRS would need to advise of the impact to Forms 941 and W-2 by mid-August.
- Any effective date other than the first day of a calendar quarter would not be feasible.
- A retroactive effective date of January 1, 2020 would not be feasible.
- It would be necessary to reconcile and recapture excess tax savings on the annual IRS Form 1040.
    - This would optionally permit others who qualify for the tax suspension to benefit; e.g., employees with most or all annual earnings under $75,000 prior to October.

Explanation and Discussion

Proposal: <u>Suspend Social Security taxes on wages paid after September 30, up to $75,000 in annual earnings</u>. Examples:

- An employee earning $75,000 annually (and $56,750 through September 30) would receive tax savings of $1,163 (6.2% times October-December wages of $18,750).
- An employee earning $75,000 annually, but who only works until September would receive no tax savings, assuming the suspension is effective October 1.
- An employee earning $100,000 annually (and $75,000 through September 30) would receive no benefit.
- An employee earning $200,000 annually (and $150,000 through September 30), but who starts a new job on October 1, would receive tax savings of $3,100 (6.2% times wages of $50,000 with the new employer.) Wages paid by prior employers are not considered in Social Security tax calculations; however, this could be subject to recapture on Form 1040.

The answer depends on the effective date and retroactive effect:

As background, payroll systems are designed to store wage and tax totals separately by calendar quarter, to accommodate government reporting requirements. Payroll systems also calculate Social Security taxes on a year-to-date basis with every payroll[1]. These systems presume that the Social Security tax rate is effective for the full calendar year and will automatically adjust current Social Security tax withholding if full-year wages multiplied by the current tax rate does not equal the Social Security taxes withheld for the full year.

Any Social Security tax rate change applied to part of a year would require substantial programming changes (i.e., to suspend the automatic recalculation feature). However, such changes could be accommodated relatively quickly if effective on the first day of a quarter.

- **<u>A retroactive effective date of January 1, 2020 would be infeasible.</u>** Theoretically it is possible to reduce the tax rate retroactively; e.g., to January 1, 2020, but this would be more complex given that it would affect prior quarter employment tax returns, which could imply amending all such returns, IRS refunds, etc. However, such a change would not be feasible for most systems; i.e., could not be made prior to 2021.

- **<u>An effective date of September 1 would be infeasible.</u>** Any effective date other than the first day of a calendar quarter would require substantial programming to create new database fields and separately calculate and store wages paid during and prior to the tax-suspension period. This would require **at least six months** of lead time.

- **<u>An effective date of October 1 would be feasible for some employers and systems but not all.</u>** New database fields would not be necessary, but programming would still be necessary to suspend the automatic tax recalculation feature. The IRS would need to announce (at least in draft) the effect to tax forms and any related guidance in early August to provide a bare minimum of time for systems changes.

    - 6 – 7 million employers use hundreds of different commercial software systems, or in-house software, and/or service providers. Not all systems would likely be updated by October (or even December). Consequently, it would be necessary to provide for an alternative tax benefit which would be claimed via Form 1040.

October 1 Implications

- The tax benefit will only accrue to employees that are paid less than $75,000 annually. In some cases, employees earning under $75,000 would receive no tax reduction based on the timing of their income; e.g., if they are not employed after September 2020.

[1] In contrast, income tax withholding calculations are only applied to annualized wages in the immediate (e.g., 2 week) payroll period, so income tax rates can change any time during a year without causing a recalculation and adjustment of full-year taxes versus full-year wages.

- Employees that have already earned $75,000 or more by October 1 will already have paid their full-year Social Security tax obligation. Absent a specific legislative provision, such employees would receive no benefit from a rate reduction (no adjustment or refund).

    - If policymakers wish to extend the tax suspension to employees that have already paid the full-year Social Security tax at the 6.2% rate or should otherwise qualify but for the timing of their income, it should be offered as a credit on the annual Form 1040.

        - Offering any accommodation through payroll withholding for this circumstance would be quite difficult and would require at least six months of lead time to implement.

- Conversely, highly paid employees that start a new job after September could earn up to $75,000 in the fourth quarter, saving $4,650 in S.S. tax.

    - Currently, some taxpayers overpay Social Security taxes if they work for more than one employer during a year and earn over $137,700 from all employers combined. These people claim refunds of overpaid taxes on their annual form 1040. Similarly, if desired, policymakers could limit or recapture excess tax savings through the IRS Form 1040.

    - This would generally be necessary given that employees may work for many employers within a year, and employers do not know of wages paid by other employers, either concurrently or previously.

    - Some employees that have already earned over $75,000 with a prior employer may ask their new employer to block the tax suspension (i.e., apply the full 6.2% tax rate to their present earnings). Some employers/payroll systems may be able to accommodate this, but others may not.

Tax Forms and Reconciliation

October 1 Effective Date

- IRS Form 941/944 (Employers Federal Employment Tax Return)

    - An October 1 effective date would require a new line on the IRS Form 941 to report Social Security taxable wages that qualify for the suspension.

    - The annual Form 944 would require a separate line to report Social Security taxable wages that qualify for the suspension.

- IRS Form W-2
    - Form W-2 would require a separate box/data field to report Social Security taxable wages that qualify for the suspension (0% tax rate).
    - In light of the temporary nature of the program, the IRS could require reporting of fourth quarter Social Security taxable wages as a coded entry in Box 12, rather than creating a new box on the form W-2.

Other Considerations

- Any rate change should have no effect on the calculation and accumulation of taxable Social Security wages. It is important to preserve the calculation and reporting of Social Security wages to establish eligibility for Social Security benefits.
    - For example, if an employee had earned $100,000 by September 30 and earned $40,000 from October 1 through December 31, their taxable Social Security wages reported on their 2020 Form W-2 should be $137,700 (the taxable wage limit for 2020), even if the tax rate in effect for the fourth quarter was zero.
- With any change, it would take time for communication and training to notify all employers of the change; time for the IRS and SSA to develop and publish rules and tax forms and modify their own processing systems. Increased complexity would require more time. Systems cannot be reprogrammed until the IRS issues related rules and forms, which would need to be expedited; e.g., to mid-August.
- National payroll service providers are likely best able to respond to substantial changes quickly, but there are thousands of payroll service and software providers and employers that may not be able to accommodate such a change as quickly. Simplicity and rapid availability of details from the IRS will determine how quickly such changes can be implemented.

Railroad Retirement Tax Act

- The implications are thought to be similar for Railroad employers, which are subject to a distinct Railroad Retirement Tax Act system. The RRTA system has similar calendar-year based taxable wage limits and rates.

Self-Employment Contributions Act (SECA)

- Forms 1040 may need to separately account for Self-Employment earnings received during the regular and reduced-rate periods. There may be more opportunity to shift earnings into any reduced-rate period for self-employed persons.

Thank you for the opportunity to comment on this important proposal.

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[2] The National Payroll Reporting Consortium ("NPRC") is a non-profit trade association whose member organizations provide payroll processing and related services to nearly two million U.S. employers, representing over 36% of the private sector workforce. Payroll service providers have long served an important role in our nation's tax collection system as a conduit between employers and government authorities.