

How Quickly Can Employers Respond to Changes to the Additional Medicare tax?

One issue raised by proposed changes to the ACA is the impact of immediate and/or retroactive repeal of certain ACA tax provisions. In particular, the Additional Medicare tax, under which employers are required to withhold 0.9% of wages over \$200,000, could cause disproportionately high administrative costs if repealed with an immediate effective date. Congressional staff will need to know how quickly employer payroll systems can implement such a change, and the answers may vary depending on the effective date of the repeal (e.g., January 1, mid-February or some future date).

One example of a potential complication is that applying such a change retroactively would raise questions as to whether employers will be required to refund taxes that have already been withheld. Other possible complications from retroactive or mid-quarter effective dates include such questions as:

- What would employers be expected to do with previously withheld taxes when the amounts have already been deposited with the IRS, or are pending deposit?
- Would employers be expected to offset “overpayments” resulting from repeal against other federal taxes? Doing so could be complex and costly, especially if the offset was against Social Security/Medicare taxes, which have complex daily recalculation routines that would need to be modified.

Adjustments such as these, could force employers to incur disproportionate costs to modify payroll and tax software systems to accommodate a one-time adjustment that affects very few employees, and could cause employers to make mistakes and incur penalties in their well-intentioned efforts to comply.

A possible solution to these issues would be for legislation to specify that any amounts already withheld should be left unadjusted (i.e., displayed on Form W-2 as Medicare tax withheld), which the employee could then claim on their annual personal income tax return. (Those who want to receive the benefit during the year could adjust their Form W-4 withholdings or estimated payments.)

Additionally, certain prospective effective dates likely would be less burdensome to employers and employees than others. For example, any mid-quarter effective date may require employers to adjust payroll systems to establish new database fields for wages paid through the effective date, which could be very costly. Therefore, effective dates for any change to the 0.9% Additional Medicare tax should optimally be at the beginning of a year or quarter.

While this is admittedly a relatively minor matter in the context of the ACA Repeal/ Replacement effort, if left unaddressed it might result in disproportionately high costs to the employer community, especially on small employers. The National Payroll Reporting Consortium would be happy to discuss feasible alternatives with staff if it would be helpful. Some attention to this area may make a big difference in terms of easing the impact on employers and affected employees.

As discussed, we also would be happy to consult with staff as to potential simplifications to employer health coverage reporting, which will likely remain necessary (e.g., as a firewall to tax credits to help fund health coverage, which may be subject to improper payments without an appropriate verification of eligibility).

Thanks – Pete

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