



*National Payroll Reporting Consortium*

---

PO Box 850 ★ Henrietta, NY 14467-0850 ★ [www.NPRC-Inc.org](http://www.NPRC-Inc.org)

January 24, 2011

Mr. Allen Lerman  
Department of the Treasury  
1500 Pennsylvania Ave. NW  
Room 4051-A, Main Treasury  
Washington, DC 20220

Dear Mr. Lerman:

We are writing to respond to questions you raised about the implementation of H.R. 4853, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), (the "Act") which was enacted on December 17, 2010 to become effective January 1, 2011. The Act affected every U.S. worker and employer, and is notable due to its late enactment relative to its effective date. As such, the Treasury Department should be aware of a number of compliance issues arising as a result of the short implementation period.

The National Payroll Reporting Consortium (NPRC) is a non-profit trade association whose member organizations provide payroll processing and related services, including electronic filing of quarterly employment tax reports, to over 1.4 million employers nationwide, covering over one-third of the private sector workforce. Payroll service providers serve an important role in our nation's tax collection system as a conduit between employers and government authorities, improving the efficiency of tax collection through electronic filing and improving compliance.

We are aware that the IRS and Treasury expressed the need to conclude legislative considerations well before the effective date, and that members of Congress and congressional staff worked tirelessly to resolve the issues as quickly as possible. This discussion is not intended to criticize any person or organization. We understand that the process takes time, and is sometimes unavoidably delayed. The purpose of this letter is to provide preliminary feedback to interested parties as to the experience of those who implemented the Act, and the costs and practical implications of the abbreviated lead time for implementation.

NPRC is strictly neutral on all policy questions such as *whether* tax cuts or other changes are warranted; however we do consult with interested parties in the legislative and executive branches of government regarding the administrative feasibility of proposals affecting payroll and payroll taxes. For example, NPRC members discussed the notion of a "Social Security tax holiday" with Treasury Department officials in December 2009, and concluded that a full-year rate cut was the easiest alternative in terms of payroll implementation.

The Tax Rate Cut Was Optimally Designed. Strictly from an implementation perspective, the full-year two percent cut in the employee's share of FICA tax for 2011 provided by the Act



was perfect in design. It was critically important and helpful that the rate change was effective for the full year of 2011, and that existing definitions were used without exception; i.e., that the rate cut applies to every employee who pays Social Security taxes.

With regard to the short time between enactment of the Act and its effective date, the Treasury Department should understand that large payroll service providers are probably the single population that is best equipped to handle last-minute tax law changes. We estimate that at least thirty-five to forty percent of the U.S. workforce is paid through a payroll service provider. You asked whether the industry was able to make the necessary programming changes in the short time permitted. The consensus response of the members of the NPRC is that, despite significant challenges, the payroll services industry successfully implemented the tax changes required by the Act in time for January payrolls. The change was largely seamless to employer clients of payroll service providers, and their employees.

#### Remaining and Potential Problem Areas

Large payroll service providers do not process payroll for all employers. Employers who rely on older payroll software systems that aren't automatically updated, or who calculate their payroll withholding manually, may not have the same ability to implement these changes as the large payroll service providers do. The timing of the change was also undoubtedly difficult for very large employers who maintain their own payroll systems, including government entities. Like those of payroll service providers, these systems tend to be highly complex, normally requiring at least ninety days just for software testing; not to mention analysis and design, coding and implementation. Depending on the payroll systems used, some employers may not have been able to implement these changes in time for the first payroll of 2011.

Time Available to Implement Changes. Although there appeared to be fifteen calendar days, (including nine business days, counting the day of enactment) before the effective date of the Act, there was less time available for implementation than may have been recognized by the legislators. Payroll involves a lag period of a few days between the end of a payroll period and the date of payment ("pay date"), and payrolls are typically processed shortly after the pay period cutoff date. For example, a payroll dated Wednesday, January 5<sup>th</sup> could be based on a payroll period which ended December 29<sup>th</sup> for a weekly payroll, or December 23<sup>rd</sup> for a biweekly payroll. A few January payrolls were already processed before the law was even signed. In a practical sense, service providers did not even have fifteen days to make the change: They were processing January payrolls during the week of December 20, and in high volume during the week of the 27<sup>th</sup>.

Employer-Employee Social Security Tax Rate Parity. Payroll systems are designed to permit frequent adjustments to *income tax* rates, but not Social Security tax rates, which have been relatively fixed over time. In particular, the employer and employee share of such taxes have been at parity since 1937, according to the Social Security Administration, so these rates have been "hard coded" into many payroll systems, which makes it more difficult to change.

Many of our member companies maintain multiple payroll systems. One member company maintains a system which already had separate fields for employer and employee Social Security tax rates, but another system had only a single Social Security tax rate field for both



the employer and employee share, and needed to create new fields. The addition of new database fields is considered a major project which normally takes more time to complete.

The changes were also more complex and substantial than might be apparent to a casual observer. One member company identified 42 distinct mainframe programs that potentially needed modifications; e.g., systems affecting the immediate calculation of paychecks and withholding; and separate editing, balancing, payment and reporting systems, some of which will not be invoked until quarter-end (i.e., April) or year-end (i.e., January 2012).

Reliance on Third Party Software. Some payroll service providers, particularly smaller organizations, rely on third party software and could not even begin to implement changes to their systems until they received updated software from their software developer. These arrangements cover varying degrees of the affected systems, so in some cases the comparatively greater development effort could not even begin until the third party had completed its work.

Additional Risk to Service Providers. The principal concern that we heard from members is that the timing of the Act imposed substantial risks and potential costs on service providers. The fact that only a few days were allowed to reprogram computer systems meant that normal software development control structures and cycles had to be circumvented. As mentioned above, at least ninety days are normally required for software quality assurance testing, which is a standard for large scale software development control environments. Exceptions may be noted in audit reports such as those required by the Sarbanes-Oxley Act (Section 404 – Management’s Assessment of Internal Controls). For example, payroll programs changed on an emergency basis might fail to collect the appropriate amount of tax from certain payees and in certain circumstances due to an undetected programming error. This could result in substantial tax deficiencies and IRS penalties.

Payroll processing companies generally assume responsibility for any penalties assessed due to incorrect or late deposits that are caused by an error or oversight of the payroll service provider. The IRS can not be expected to broadly grant relief based on the timing of legislation, so this may be a difficult issue for years to come. However, it would be appropriate if the IRS would recognize the issue and conduct internal training to permit removal of resulting penalties in circumstances in which an employer or service provider exercised appropriate due diligence in implementing the tax calculation changes in the short time allowed.

Lastly, it was very helpful that the IRS and Treasury published withholding tables simultaneously as the Act was signed. We recognize and appreciate the extraordinary efforts of those involved. Notice 1036 permitted employers to implement the 4.2% employee Social Security tax rate “as soon as possible, but not later than January 31, 2011.” It also directed employers to correct any over withholding by March 31. Most payroll systems will automatically recalculate Social Security taxes with each payroll, so affected workers will receive any over-withheld taxes on the first payroll processed with the revised 2011 tax rate. However, employers that rely on payroll software which is not frequently updated with tax law changes, or that handle payroll calculations manually, may not meet the deadlines.

We appreciate this opportunity to provide preliminary feedback as to the practical



implications of the abbreviated lead time for implementation of the Act. Please let us know if you have any questions.

Sincerely,

A handwritten signature in blue ink, appearing to read "Pete Isberg", is positioned to the right of the word "Sincerely,".

Pete Isberg  
National Payroll Reporting Consortium, Inc.