



National Payroll Reporting Consortium

PO Box 850 ★ Henrietta, NY 14467-0850 ★ www.NPRC-Inc.org

December 19, 2011

Representative Dave Camp
Chairman, Committee on Ways and Means.
United States House of Representatives
1102 Longworth House Office Building
Washington D.C. 20515

Senator Max Baucus
Chairman, Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510-6200

Representative Sander Levin
Ranking Member, Committee on Ways and Means.
United States House of Representatives
1106 Longworth House Office Building
Washington D.C. 20515

Senator Orrin G. Hatch
Ranking Member, Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510-6200

Re: H.R. 3630 Payroll Tax Relief Proposals

Dear Chairman Camp, Chairman Baucus, Ranking Member Levin and Ranking Member Hatch:

We are writing to express concerns regarding Section 101 of H.R. 3630, which would establish a new Social Security Taxable Wage limit of \$18,350, to which a reduced 4.2% rate would apply through February 29, 2012. Wages over \$18,350 paid during the first two months of 2012 would be subject to a 6.2% Social Security tax rate.

The National Payroll Reporting Consortium (NPRC) is a non-profit trade association whose member organizations provide payroll processing and related services, including electronic payment and filing of employment taxes, and related information returns, to over 1.5 million employers nationwide, covering over one-third of the private sector work force. 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.

As mentioned in our correspondence to the tax-writing committees in July, the NPRC is strictly neutral on virtually all policy matters, such as whether a reduced Social Security tax rate is necessary or desirable. The organization serves largely to advise policymakers as to the administrative implications of proposals affecting payroll and payroll tax administration.



Accordingly, NPRC advises policymakers that we believe there is insufficient lead time to accommodate the proposal embodied in H.R. 3630. In our opinion enactment of HR 3630 as written could create substantial problems, confusion and costs affecting a significant percentage of U.S. employers and employees.

The difficulty is in establishing a new Social Security Taxable Wage limit of \$18,350 for the two-month extension period. More than ten percent of the workforce¹ is likely to meet that limit, and would be subject to the higher 6.2% tax rate for earnings over that amount. However, many payroll systems are not likely to be able to make such a substantial programming change before January or even February. The systems affected tend to be highly complex, normally requiring at least ninety days for a change of this magnitude for software testing alone; not to mention analysis, design, coding and implementation.

As we commented to the Treasury Department concerning the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), which was enacted on December 17, 2010 and effective on January 1, 2011, payroll service providers are probably the best equipped of those affected to handle last-minute tax law changes. However, programming to support the new taxable wage limit might not be available to employers that do not use a payroll service provider until well after the effective date. Affected employees could be confused by payroll adjustments seeking to collect additional taxes late in the year for wages paid in January or February.

Given a two month extension, policymakers may feel they have no alternative than to establish a new Social Security Taxable Wage limit of \$18,350; i.e., to do otherwise may invite criticism because highly compensated employees could meet their entire 2012 Social Security obligation at the reduced 4.2% tax rate, whereas others would (assuming the reduced rate is not further extended by subsequent legislation) enjoy the 4.2% rate only in the first two months.

NPRC understands Congress' concern that highly compensated employees not enjoy the full benefit of the 2% tax break because of bonuses or other high compensation falling into the first two months of the year. Nevertheless with the first of January now only two weeks away and payroll departments trying to meet year-end compliance mandates and reconciliation, there simply is insufficient time to implement this major change in withholding requirements. It would also necessary to await IRS regulatory guidance for further details concerning the change.

If the 4.2% rate is later extended for the full year, the \$18,350 taxable limit for the first two months would be unnecessary. However, even if subsequent legislation extends the 4.2% rate for the full year, employers would still have to make costly programming changes to accommodate the 6.2% tax rate on wages in excess of \$18,350 paid prior to March.

Recommendations:

1. We recommend that Congress omit Section 101 from H.R. 3630 and not prospectively extend the reduced tax rate for the first two months of 2012. Instead, we would suggest that the Congress enact the reduced tax rate at a later date, but make the change retroactive to January 1. For example, a 4.2% employee Social Security tax rate enacted

¹ IRS Statistics of Income, 2008



on February 15, 2012 should still be retroactively effective on January 1, 2012. Virtually all payroll systems are built to self-correct Social Security taxes, so employers would automatically accommodate a late but retroactive change, automatically refunding to each employee any over-withholding from early 2012 payrolls. The same tax rate and taxable wage limit should apply for the full calendar year.

2. If this is not feasible, we recommend that the Social Security Taxable Wage limit of \$18,350 be removed from H.R. 3630. If the reduced tax rate is later extended through 2012, this would likely avoid the substantial reprogramming of payroll systems that would otherwise be necessary. If the reduced tax rate is not subsequently extended, the proposed taxable wage limit of \$18,350 could be established in later legislation. This would require a recalculation and collection of additional tax later in the year, but given the lack of time permitted for reprogramming systems, most employers will already need to collect any additional tax through adjustments later in the year.
3. If neither of the options is feasible, it would mitigate the difficulty moderately to apply the reduced rate to the entire calendar quarter; i.e., through March 31. We recognize that this would represent a substantial change, and its impact in facilitating programming would be relatively minor.

A more detailed explanation of the difficulties inherent in the current Section 101 is attached. Please contact me at (909) 971-7670 or Pete_Isberg@nprc-inc.org if you have any questions or if we can be of service. We appreciate this opportunity to advise congressional policymakers as to the impact of H.R. 3630.

Sincerely,

A handwritten signature in blue ink, appearing to read "Pete Isberg", is positioned above the typed name.

Pete Isberg
President
National Payroll Reporting Consortium, Inc.



Taxpayer Impact

As a ballpark number, according to IRS Statistics of Income, over 18 million returns were filed for Tax Year 2008 with more than \$100,000 in Adjusted Gross Income, or about 13 percent of all returns. Individuals earning over \$110,100 annually are likely to be affected by the 6.2% Social Security rate for January and February.

Taxpayers who are paid more than \$18,350 in the first two months of the year could be confused or upset by application of the higher tax rate. For example, an individual who is laid off in January may receive a lump-sum severance payout of \$50,000, which may be the bulk of their income in 2012. Nevertheless, they would pay \$633 more in Social Security taxes than had they simply received the same income over a six month period, or later in the year.

If the OASDI rate of 4.2% is ultimately extended through 2012, those who are paid over \$18,350 prior to March will have paid at the higher rate due to the timing of their compensation, whereas someone who earns the same amount for 2012 but receives less than \$18,350 in the first two months of the year would pay at the 4.2% rate through 2012.

Timing of Compensation

The limitation creates new incentives for employers and employees to shift compensation earlier or later in the year (depending on their guess as to whether the 4.2% OASDI rate may be extended for the full year). Some taxpayers receive significant bonuses, commissions or other lump-sum compensation in January. Some employers and/or employees may have discretion over when such compensation is paid (e.g., exercise of stock options).

If employers and/or taxpayers believe that a reduced OASDI rate of 4.2% will ultimately be extended, they may defer wages over \$18,350 until after February. If the IRS sought to challenge such a result, they would need to ask the employer for details as to the timing of wages paid.

Employer Impact

To accommodate a new Social Security Taxable Wage limit of \$18,350, to which a reduced 4.2% rate would apply through February 29, 2012, payroll systems would need to be modified to calculate, withhold and store separately:

- Social Security Wages paid through February 29th up to \$18,350
- Social Security Wages paid through February 29th over \$18,350 but less than \$110,100
- Social Security Wages paid after February 29th up to \$110,100
- Social Security tax on wages paid through February 29th up to \$18,350 (x 4.2%)
- Social Security tax on wages paid through February 29th over \$18,350 but less than \$110,100 (x 6.2%)
- Social Security tax on wages paid after February 29th up to \$110,100 (x TBD%)

Issues:



The separate reporting implied would require businesses to expand payroll databases and modify programs with insufficient lead time. January 2012 payrolls are already being processed in late December. It is likely that many software developers, service providers and employers would not be able to modify payroll software in time for January or February payrolls. This could lead to difficult situations later in the year as employers sort out what should have been collected, and in some cases collect additional taxes, and determine how to amend employment tax returns.

Employers might not be able to collect additional taxes from workers who have subsequently changed jobs, and could also be subject to substantial IRS underpayment penalties if they are unable to calculate, withhold and pay the higher OASDI amounts in January and February.

Impact to the Internal Revenue Service and the Social Security Administration:

The IRS may not be able to quickly produce guidance necessary to enable appropriate design of such systems. Businesses and software developers may have to guess as to what the IRS may require in terms of recordkeeping and reporting. It would be very costly if developers made assumptions as to what reporting the IRS might require, and the IRS announced something different. The IRS would likely need to change Forms 941 and W-2 to require separate reporting of the same information:

- Social Security Wages paid through February 29th up to \$18,350
- Social Security Wages paid through February 29th over \$18,350 but less than \$110,100
- Social Security Wages paid after February 29th up to \$110,100
- Social Security tax on wages paid through February 29th up to \$18,350 (x 4.2%)
- Social Security tax on wages paid through February 29th over \$18,350 but less than \$110,100 (x 6.2%)
- Social Security tax on wages paid after February 29th up to \$110,100 (x TBD%)

Issues:

The IRS may not be able to change Form 941 for the quarter ended March 31 in time. If this occurs, businesses may need to amend their returns, or the IRS may need to modify subsequent tax forms to permit adjustments, further complicating tax forms and reconciliation systems.

There is also insufficient space on Form W-2 for such information. Consequently, Form W-2 would need to be significantly expanded, complicating the 2012 tax season (in 2013) for taxpayers and tax preparers.