Payroll Tax Cut Temporarily Extended into 2012

New law signed to keep payroll tax cut in place through February of 2012

In a win for nearly 160 million workers, Congress passed H.R. 3765, the "Temporary Payroll Tax Cut Continuation Act of 2011" (the "TTCA") on Dec. 23. The TTCA, which was signed into law by President Obama, will extend the payroll tax rates that have been in effect for 2011 for an additional two months.

Specifically, the TTCA extends the 2% payroll-tax cut for employees, continuing the reduction of their Social Security ("OASDI") tax withholding rate from 6.2% to 4.2% of wages paid through Feb. 29, 2012, and provides for a similar extension of a lower Self-Employment Contributions Act ("SECA") tax rate on self-employment income.

For employers, the new payroll tax rate should be implemented as soon as possible in 2012 but not later than Jan. 31, 2012, according to the IRS. Also, for any Social Security tax over-withheld during January, employers should make an offsetting adjustment in workers' pay as soon as possible but not later than March 31, 2012. Workers should not need to take any additional action based on the extension.

Background of 2011 Tax Cut. For remuneration received during 2011, 2010's tax relief act reduced the employee OASDI tax rate by two percentage points to 4.2%. Similarly, for self-employment income for tax years beginning in 2011, the 2010 law reduced the OASDI tax rate under the SECA tax by 2% to 10.4%. As a result, for 2011, employees pay only 4.2% Social Security tax on wages up to $106,800, and self-employed individuals pay only 10.4% Social Security self-employment taxes on self-employment income up to $106,800.

TTCA's Recapture Provision. Besides the reduced employee OASDI tax rate provided by the TTCA for the first two months of 2012, the TTCA also includes a new "recapture" provision, which applies only to those employees who receive more than $18,350 in wages during the two-month period (the Social Security wage base for 2012 is $110,100, and $18,350 represents two months of the full-year amount). The recapture is accomplished by imposing an additional income tax on these higher-income employees of 2% of the amount of wages they receive during the two-month period in excess of $18,350 (and not greater than $110,100).

This additional tax is added to the individual's tax liability that he or she would otherwise pay for 2012 and is not subject to reduction by credits or deductions. The tax would be payable in 2013 when the employee files his or her income tax return for the 2012 tax year.

Note that with the possibility of a full-year extension of the payroll tax cut being discussed for 2012, the recapture provision seems to apply only if the temporary payroll tax cut ends on Feb. 29, 2012. A House-Senate Conference will convene soon to consider extending the temporary payroll tax cut for the remainder of 2012.