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LEGISLATIVE UPDATE

Eye on Washington

UPDATE: TAX CHANGES AFFECTING 2013 PAYROLLS SIGNED INTO LAW

On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012 (ATRA), which includes several changes to tax laws affecting payroll and employment tax administration in 2013.

Income Tax Rates

The American Taxpayer Relief Act effectively maintains the reduced income tax rates adopted in 2001 and 2003 for individuals with incomes up to \$400,000 and families with incomes up to \$450,000. Income above those levels will be taxed at 39.6%, up from 35%. The expanded 15% bracket for joint filers, commonly referred to as the marriage penalty relief, has also been extended.

For payroll withholding purposes, these tax rates have been extended permanently for wages paid after December 31, 2012.

Employee Social Security Tax Rate Returns to 6.2%

The reduced 4.2% rate for employee Social Security taxes that was in effect for 2011 and 2012 has expired. The employee Social Security tax rate will return to 6.2% for 2013 wages up to the taxable wage limit of \$113,700. Consequently, employees' net pay under the taxable wage limit will decrease accordingly. The maximum Social Security tax that an employee would pay will be \$7,049.40 for 2013.

The Employer Social Security tax rate is unaffected, and remains 6.2% of Social Security taxable wages paid. The maximum that an employer would pay for an employee will be \$7,049.40 for 2013.

	Employee Social Security Tax Rate	Employer Social Security Tax Rate	Social Security Taxable Wage Base Rate	Maximum Employee Social Security Tax Paid
2012	4.2%	6.2%	\$110,100	\$4,624.20
2013	6.2%	6.2%	\$113,700	\$7,049.40

These Social Security tax changes have been implemented by ADP and automatically applied to all 2013 payrolls.

Transition to 2013 Withholding Calculations

Some 2013 payrolls were already produced prior to the enactment of the American Taxpayer Relief Act, and some payrolls produced shortly after enactment may be calculated using 2012 income tax withholding rates. This is permitted under recent IRS guidance, which instructs employers to implement 2013 withholding rates no later than February 15, 2013, and to "use 2012 withholding tables until you implement the 2013 withholding tables."

However, because the American Taxpayer Relief Act generally restored the income tax rates in effect in 2012, tax withholding amounts on 2013 payrolls processed prior to enactment are expected to be correct, with the exception of individuals earning annualized amounts over \$400,000, as explained above. There may be



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minor withholding differences due to inflation adjustments in the 2013 withholding tables issued by the Treasury Department.

Supplemental Wage Withholding Rate

The optional flat withholding rate for 2013 “supplemental wages,” such as bonuses of \$1 million or less, is now 25%. For supplemental wage payments over \$1 million in a year after 12/31/2012, the mandatory withholding rate is increased from 35% to 39.6%.

Revised withholding calculations will be implemented by ADP in early January and effective for payrolls processed after implementation.

Additional Medicare Tax for Earnings over \$200,000

Although not affected by the ATRA, the Patient Protection and Affordable Care Act established a new “Additional Medicare Tax” of 0.9% which also goes into effect in 2013. The new Additional Medicare Tax applies to single individuals earning over \$200,000 and married couples filing jointly who earn over \$250,000. However, employers must withhold the Additional Medicare Tax from all workers, regardless of marital status, on wages exceeding \$200,000. Thus, the employee Medicare tax rate, normally 1.45%, will rise to 2.35% on earnings over \$200,000, regardless of filing status. The employer Medicare tax rate remains 1.45%. There is no taxable wage limit for Medicare taxes.

The Additional Medicare Tax has been implemented by ADP and automatically applied to all 2013 payrolls. For additional information on the Additional Medicare Tax, please see our previous Eye on Washington [here](#).

Parity for Exclusion from Income for Employer-Provided Mass Transit and Parking Benefits

Prior to 2012, employers could withhold up to \$230 a month on a pre-tax basis for mass transit benefits for workers. The amount decreased to \$125 on January 1, 2012, while a similar provision for parking expenses increased to \$240. Parity for pre-tax treatment of employer-provided mass transit and parking benefits was retroactively extended by the ATRA from January 1, 2012 through December 31, 2013. It is important to note that the limit is adjusted for inflation annually and the Internal Revenue Service has yet to announce the 2013 limit.

Other Provisions of Interest to Employers

- The ATRA retroactively extends the employer wage credit for differential wage payments to employees who are active military reservists, from January 1, 2012 through December 31, 2013.
- The Work Opportunity Tax Credit is retroactively extended from January 1, 2012 through December 31, 2013.
- The Act extends through 2013 the Returning Heroes and Wounded Warriors Work Opportunity Tax Credits; a Work Opportunity Tax Credit for hiring qualified veterans.
- The exclusion for employer-provided adoption assistance is made permanent by the Act.
- The expanded exclusion for employer-provided undergraduate and graduate educational assistance is made permanent, permitting up to \$5,250 per year to be excluded from income and employment taxes.



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- The ATRA includes other provisions as well. Please revisit the site for ongoing updates and additional information.

State Tax Implications

Several states have income tax withholding calculations that are directly or indirectly tied to federal tax calculations. These calculations will automatically be updated based on withholding guidance released by the applicable authorities. As with federal withholding tax calculations, any changes will apply to payrolls processed after implementation.

Employers May Assist in Explaining Transition to 2013 Tax Rates

Under these circumstances, it might be helpful if employers were to provide a brief explanation to employees as they review their initial paychecks of 2013. ADP clients are invited to use the information contained in this alert for such purposes; however, please remind all employees that they should seek the advice of a qualified attorney or tax professional to assist them in determining the effect to their particular circumstances.

ADP Compliance Resources

ADP maintains a staff of dedicated professionals who carefully monitor all federal and state legislative and regulatory measures affecting human resource, payroll, tax and benefits administration, and ensure that ADP systems are updated as relevant laws evolve. For the latest on late-breaking federal tax law changes, visit the ADP "Eye on Washington" web page located at www.adp.com/regulatorynews.

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