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**PAYROLL TAX CUT
EXTENSION SIGNED INTO LAW
BY U.S. PRESIDENT**

by KPMG LLP's Washington
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On February 22, 2012, U.S. President Barack Obama signed into law the *Middle Class Tax Relief and Job Creation Act of 2012* (H.R. 3630),¹ which extends through the end of 2012 the 2-percent cut in employee payroll and self-employment taxes that was otherwise due to expire at the end of February 2012.

Background

U.S. Social Security tax is imposed on both the employer and employee. The tax is composed of two parts: (i) the old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the taxable wage base (\$110,100 for 2012), and (ii) the Medicare hospital insurance tax amount equal to 1.45 percent of covered wages. Self-employed individuals are subject to OASDI tax of 12.4 percent and Medicare tax of 2.9 percent on their self-employment income.

For 2011, the employee portion of the OASDI tax was reduced from 6.2 percent to 4.2 percent, while the employer portion remained at 6.2 percent.² The OASDI rate for self-employed individuals was reduced from 12.4 percent to 10.4 percent, and coordinating provisions were enacted relating to deductions for self-employment tax. In December 2011, these reduced rates for employees and self-employed individuals were extended through February 29, 2012.³

H.R. 3630 and the 2012 Payroll Tax Cut Extension

H.R. 3630 passed its final legislative hurdle with approval coming in the House of Representatives on February 17, 2012, by a vote of 293 to 132, followed the same day with passage in the Senate by a vote of 60 to 36.

The *Middle Class Tax Relief and Job Creation Act of 2012* extends the so-called "payroll tax holiday" through the end of 2012 (thus, the 2-percent reduction in OASDI tax for both employees and self-employed individuals will not expire at the end of February).

The aim of the payroll tax holiday is to boost disposable incomes and consumers' purchasing power, thereby generating economic growth. According to the non-partisan Congressional Research Service, "The temporary reduction in the payroll tax for employees and the self-employed in 2011 was intended to provide an economic stimulus by increasing workers' take-home pay. For example, the annual Social Security withholding for a worker earning the average wage in 2011 (an estimated \$44,687) was lower by about \$894. The annual Social Security withholding for a worker earning the maximum taxable wage (\$106,800 in 2011) was lower by \$2,136."⁴

Lawmakers agreed to not require that the payroll tax holiday – estimated to cost \$93.2 billion – be offset by revenue-raising measures.

KPMG Note

Prior to the extension of the payroll tax holiday, higher-income individuals would have been subject to an income cap of \$18,350 for cumulative compensation received during January and February 2012. Compensation in excess of this amount would have been subject to a special “recapture” rule whereby the excess would have been subject to an additional income tax of 2 percent.

This rule will not now be effective. In addition, employers were given until January 31, 2012, to implement the 4.2-percent withholding rate. Those that withheld at a higher rate must return the excess to the employee via an adjustment to withholding by March 31, 2012. This rule remains in place.

Footnotes:

1 See the White House Web site for news of the president signing the bill: <http://www.whitehouse.gov/blog/2012/02/22/president-obama-signs-payroll-tax-cut>. *Middle Class Tax Relief and Job Creation Act of 2012* (H.R. 3630). For the text of the legislation and other related documents, see the Library of Congress’s Thomas Web site at: <http://thomas.loc.gov/>. For the JCT report (JCX-17-12, February 16, 2012) “Estimated Revenue Effects Of The Revenue Provisions Contained In The Conference Agreement For H.R. 3630, The ‘Middle Class Tax Relief And Job Creation Act Of 2012’,” see: <http://www.jct.gov/publications.html?func=startdown&id=4399>.

2 *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010* (P.L. 111-312). For the text of the Act, see the Library of Congress’s Thomas Web site at: <http://thomas.loc.gov/>. For prior coverage, see [Flash International Executive Alert 2010-208](#), December 17, 2010.

3 *Temporary Payroll Tax Cut Continuation Act of 2011* (P.L. 112-78). For the text of the Act, see the Library of Congress’s Thomas Web site at: <http://thomas.loc.gov/>. For prior coverage, see [Flash International Executive Alert 2012-006](#), January 5, 2012.

4 Dawn Nuschler, “Social Security: Temporary Payroll Tax Reduction,” Congressional Research Service No. R41648 (February 17, 2012).

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