KPMG
cutting through complexity™

December 4, 2012
2012-218

flash International Executive Alert

A Publication for Global Mobility and Tax Professionals by KPMG's International Executive Services Practice

United States – IRS Releases Proposed Regulations on Additional Medicare Tax

by KPMG LLP's Washington National Tax practice, Washington, D.C. (KPMG LLP in the United States is a KPMG International member firm)

On November 30, 2012, the U.S. Internal Revenue Service (IRS) released Proposed Regulations[1] on the Additional Hospital Insurance Tax, more commonly known as the Additional Medicare Tax, which will apply to wages received in any tax year beginning after December 31, 2012. The Additional Medicare Tax was introduced as part of President Obama's 2010 health care legislation embodied in the Patient Protection and Affordable Care Act, signed into law on March 23, 2010, and the Health Care and Education Reconciliation Act, signed into law on March 30, 2010. For prior coverage, see the following issues of *Flash International Executive Alert*: 2012-123, (June 28, 2012) and 2010-077 (April 1, 2010).[2]

The IRS intends to finalize these Proposed Regulations in 2013. The Proposed Regulations are not binding until such time as they are published as final regulations in the Federal Register. However, taxpayers may rely on them before that date.

KPMG Note

The Additional Medicare Tax will take effect as from January 1, 2013; this effective date is not dependent on the outcome of the current "fiscal cliff" negotiations concerning the federal income tax rates and thresholds that will come into effect after 2012. The Additional Medicare Tax will have a significant impact on both employers, as regards their liability to withhold on wages and other compensation, and on individual taxpayers, as regards their ultimate liability for the tax. The new tax is also likely to have an impact on tax equalization calculations for employees on international assignment.

Background

The health care legislation referred to above increased the employee portion of Medicare tax by an additional 0.9 percent of wages in excess of certain thresholds for wages received in any tax year beginning after December 31, 2012.[3] The threshold is based on the filing status of the individual taxpayer, as follows:

- $250,000 for married taxpayers filing jointly;
- $125,000 for married taxpayers filing separately;
- $200,000 for all other taxpayers.

KPMG Note

It appears (although the IRS has not confirmed this position) that the Additional Medicare Tax is covered by social security totalization agreements. Thus, where a U.S. citizen or resident is working overseas, or where a foreign national is working in the United States, in situations such that these individuals are not subject to U.S. social security tax by

KPMG Note (cont'd)

reason of a totalization agreement, then they would not be subject to the Additional Medicare Tax.

There is no employer portion of the Additional Medicare Tax. Employers are obliged to withhold the employee portion of Additional Medicare Tax only to the extent that wages an employee receives exceed $200,000 in a calendar year. In applying this threshold, the employer should disregard wages received by the employee's spouse.[4]

To the extent the Additional Medicare Tax is not withheld by the employer, the employee must pay the tax.[5] However, in such situations, the employer would remain subject to applicable penalties and additions to tax for failure to withhold.[6]

Additional Medicare Tax is also payable on self-employment income to the extent it exceeds certain thresholds, also determined according the taxpayer's filing status.[7] The thresholds are the same as for wage income, set out above. If an individual receives both self-employment income and wages as an employee in the same year, the thresholds for self-employment income purposes are reduced (but not below zero) by the amount of wages taken into account in determining Additional Medicare Tax.

Proposed Regulations

The Proposed Regulations provide rules for:

- the withholding, computation, reporting, and payment of Additional Medicare Tax on employee wages, self-employment income, and Railroad Retirement Tax Act compensation;
- when and how employers may make interest-free adjustments to correct over-payments or under-payments of Additional Medicare Tax; and
- how employers and employees can claim refunds for over-payments of the tax.

Rates and Computation

The Proposed Regulations update the applicable rates for social security and Medicare tax on employees, including the Additional Medicare Tax. The Proposed Regulations specify that an employer must withhold Additional Medicare Tax from an employee's wages only to the extent such wages exceed $200,000 per calendar year. In applying this threshold, the employer does not take into account the employee's filing status, or other compensation that may affect the employee's liability to the tax (including wages paid to the employee by another employer and wages of the employee's spouse).

An employee may not request the employer to deduct and withhold Additional Medicare Tax on wages of $200,000 or less. However, an employee who anticipates liability for the tax may request the employer to withhold additional amounts of regular federal income tax on Form W-4. This additional withholding can be applied against taxes due on the employee's federal income tax return, including Additional Medicare Tax.

Example

A is married and files a joint return with her spouse, B. A earns $190,000 of wages in 2013 and B earns $150,000. They file a joint return. They are liable for Additional Medicare Tax on $90,000 ($340,000 of combined wages less the $250,000 threshold). However, their respective employers are not required to withhold Additional Medicare Tax because neither spouse's wages exceed $200,000. It may be in the interest of A and/or B to request their respective employers to withhold additional federal income tax to offset their liability for Additional Medicare Tax.

Employees' Obligations to Report and Pay Additional Medicare Tax

The Proposed Regulations provide that an employee is liable for Additional Medicare Tax on wages to the extent that the tax is not withheld by the employer. The liability for the tax must be reported on the employee's individual income tax return. Thus, if A and B in the example above had not requested their employers to withhold additional federal income tax, their liability for Additional Medicare Tax would be payable when they file their joint income tax return on Form 1040.

Self-Employed Individuals

The Proposed Regulations provide for the payment of Additional Medicare Tax by self-employed individuals. Specifically, the Proposed Regulations describe how the applicable threshold amounts are reduced (but not below zero) by the amount of employee wages taken into account in determining liability to the tax.

Interest-Free Adjustments

The Proposed Regulations provide that adjustments of under-payments of Additional Medicare Tax may be made only if the error is discovered in the same year the wages were paid unless (1) the under-payment is attributable to an administrative error, (2) in certain situations where the employer failed to treat the individual as an employee, or (3) the adjustment is as the result of an IRS examination.

Claims for Refund

The Proposed Regulations provide a process whereby employers and employees can claim refunds of overpaid Additional Medicare Tax. Employers can claim refunds only if they paid the tax without having deducted or withheld it from the employee's wages.

For employees seeking refunds, the Proposed Regulations eliminate the requirement that they first seek a refund from the employer and provide a statement that such action has been taken. Instead, employees are directed to claim the refund or credit of overpaid Additional Medicare Tax by taking the over-payment into account in claiming a credit against, or refund of, tax on their individual income tax return for the year in which the over-payment was made, or on an amended return. Employees may only claim such a refund if they have not received repayment from their employer in connection with an interest-free adjustment.

Footnotes:

1 REG-130074-11. The IRS has also issued FAQs on the Additional Medicare Tax: http://www.irs.gov/Businesses/Small-Businesses-%26-Self-Employed/Questions-and-Answers-for-the-Additional-Medicare-Tax .

2 For a KPMG LLP Webcast that was broadcast in September on "Impact of the Affordable Care Act on International Assignment Programs", see: http://www.kpmginstitutes.com/taxwatch/events/health-care-act-impact-on-assignment-programs.aspx .

3 Section 3101(b)(2). All section references are to the U.S. Internal Revenue Code.

4 Section 3102(f)(1).

5 Section 3102(f)(2).

6 Section 3102(f)(3).

7 Section 1401(b)(2).

* * * *

The information contained in this newsletter was submitted by KPMG LLP's Washington National Tax practice. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Flash International Executive Alert is an IES publication of KPMG LLP's Washington National Tax practice. To view this publication or recent prior issues online, please click **here**. To learn more about our IES practice, please visit us on the Internet: click **here** or go to http://www.kpmg.com .

ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY KPMG TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.