



PAYROLL CURRENTLY

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Many Obama Administration Fiscal 2011 Budget Proposals Would Impact Payroll

President Obama's proposed budget for fiscal 2011, released on February 1, includes many items that would impact payroll operations. Keep in mind that the following are merely proposals and have not yet been introduced or enacted into law.

Extend the Making Work Pay (MWP) credit

The MWP credit is a temporary provision of the American Recovery and Reinvestment Act of 2009 (ARRA; Pub. L. No. 111-5). In 2010, individual taxpayers are eligible for a refundable income tax credit equal to 6.2% of earned income up to a maximum credit of \$400 (\$800 for married taxpayers filing a joint return). The credit is phased out for taxpayers with a modified adjusted gross income (AGI) in excess of \$75,000 (\$150,000 for married taxpayers filing jointly), and is completely lost at \$95,000 (\$190,000 for married taxpayers filing jointly). The IRS withholding tables have been modified to reflect the MWP credit. Overwithholding and underwithholding are reconciled on annual income tax returns. The MWP credit expires at the end of 2010. The administration's fiscal 2011 budget proposes to extend the MWP credit for one year – through December 31, 2011 [www.treas.gov/offices/tax-policy/library/greenbk10.pdf].

Extend COBRA health insurance premium assistance

ARRA in certain circumstances limits the employee's cost of purchasing health care continuation coverage to 35% of the COBRA premium charged by the group health plan. Employers (or other entities providing the coverage) are allowed a credit against payroll taxes for the remaining 65% of the premium. Under ARRA, as amended by the Department of Defense Appropriations Act, 2010 (Pub. L. No. 111-118; see [PAYROLL CURRENTLY, Issue No. 1, Vol. 18](#)), the premium assistance is available for a maximum of 15 months. The premium assistance is limited to individuals who qualify for COBRA coverage as a result of an involuntary termination of employment between September 1, 2008, and February 28, 2010.

The budget proposes to extend the COBRA premium assistance eligibility period by allowing individuals who qualify for COBRA coverage as the result of an involuntary termination of employment prior to January 1, 2011, to qualify for the assistance. The duration of the COBRA premium assistance that results from an involuntary termination of employment from March 1 - December 31, 2010, would be 12 months.

Remove cell phones from listed property

The administration's budget proposes that cell phones (and other similar telecommunications equipment) would no longer be classified as listed property (see [PAYROLL CURRENTLY, Issue No. 13, Vol. 17](#)), effectively removing the requirement of strict substantiation of business use, effective for taxable years ending after the date of enactment. Also, the fair market value of personal use of a cell phone (or other similar telecommunications equipment) provided primarily for business purposes would be excluded from gross income.

Automatic enrollment in individual retirement accounts (IRAs)

Under the budget proposal, employers in business for at least two years that have more than 10 employees would be required to offer an automatic IRA option to



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employees, with regular contributions being made through payroll deductions. If the employer sponsored a qualified retirement plan, SEP, or SIMPLE for its employees, it would not be required to provide an automatic IRA option for them. However, if the qualified plan excluded from eligibility a portion of the employer's work force or a class of employees such as all employees of a subsidiary or division, the employer would be required to offer the automatic IRA option to those excluded employees.

The employer offering automatic IRAs would give employees a standard notice and election form informing them of the automatic IRA option and allowing them to elect to participate or opt out. Any employee who did not provide a written participation election would be enrolled at a default rate of 3% of the employee's compensation in an IRA. Employees could opt out or opt for a lower or higher contribution rate up to the IRA dollar limits. For most employees, the payroll deductions would be made by direct deposit.

Under the proposal, there would be no employer contributions, no employer compliance with qualified plan requirements, and no employer liability or responsibility for determining employee eligibility to make tax-favored IRA contributions or for opening IRAs for employees. In addition, employers could claim a temporary tax credit for making automatic payroll-deposit IRAs available to employees. The amount of the credit for a year would be \$25 per enrolled employee up to \$250, and the credit would be available for two years. The proposal would become effective January 1, 2012.

Reinstate the 39.6% and 36% income tax rates

39.6% rate. Prior to the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; Pub. L. No. 107-16), the highest individual income tax rate was 39.6%. EGTRRA phased in a temporary reduction in the 39.6% rate to 35%. The 35% tax rate sunsets after 2010. The budget proposal would permit the EGTRRA reduction in the highest income tax rate to sunset as scheduled. Thus, beginning in 2011, the highest income tax rate would be 39.6%.

36% rate. EGTRRA also phased in a temporary reduction in the second highest individual income rate from 36% to 33%. The budget proposal would permit the EGTRRA reduction in the second highest income tax rate to sunset as scheduled after 2010. Thus, beginning in 2011, the second highest tax rate would be 36%. *Note:* The 28% tax rate bracket would be expanded so that taxpayers earning less than the amounts subject to the 33% tax rate would not see their taxes rise as a result of the increased tax rate brackets.

Make FUTA surtax permanent

The Federal Unemployment Tax Act (FUTA) tax rate currently has two components: a permanent tax rate (6.0%) and a "temporary" surtax rate (0.2%) that has been in effect for more than 30 years. The surtax has been extended many times, most recently through June 30, 2011 (see [PAYROLL CURRENTLY, Issue No. 22, Vol. 17](#)). The budget proposal would make the 0.2% surtax permanent.

Restructure federal wage reporting process

The budget proposes to restructure the federal wage reporting process "by reverting to quarterly wage reporting. Currently, wages are reported to the federal



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government once a year. Increasing the timeliness of wage reporting would enhance tax administration, improve program integrity for a range of programs, and facilitate implementation of automatic workplace pensions. The administration will work with the states so that the overall reporting burden on employers is not increased” [www.whitehouse.gov/omb/budget/fy2011/assets/socsec.pdf].

Other information reporting changes

Require information reporting on payments to corporations. Under the budget proposal, a business would be required to file an information return (e.g., on Form 1099-MISC, *Miscellaneous Income*) for payments for services or for determinable gains aggregating to \$600 or more in a calendar year to a corporation (except a tax-exempt corporation). This would end a longstanding regulatory exception from information reporting for payments to corporations. The proposal would be effective for payments made to corporations after December 31, 2010.

Require a certified taxpayer identification number (TIN) from contractors. Under the budget proposal, a contractor receiving payments of \$600 or more in a calendar year from a particular business would be required to furnish to the business (on Form W-9, *Request for Taxpayer Identification Number and Certification*) the contractor’s certified TIN. A business would be required to verify the contractor’s TIN with the IRS, which would be authorized to disclose, solely for this purpose, whether the certified TIN-name combination matches IRS records.

If a contractor failed to furnish an accurate certified TIN, the business would be required to withhold a flat-rate percentage of gross payments for federal income tax and pay the withheld amounts to the U.S. Treasury. Contractors receiving payments of \$600 or more in a calendar year from a particular business could require the business to withhold a flat-rate percentage of their gross payments – with the flat-rate percentage of 15%, 25%, 30%, or 35% being selected by the contractor. The proposal would be effective for payments made to contractors after December 31, 2010.

Increase information reporting for government payments for property and services. Under the budget proposal, the IRS would be authorized to issue regulations requiring information reporting on all non-wage payments by federal, state, and local governments to procure property or services. Certain categories of payments would be excluded from the new information reporting requirements (e.g., payments of interest, payments for real property, payments to tax-exempt entities or foreign governments, intergovernmental payments, and payments made pursuant to a classified or confidential contract). The proposal would be effective for payments made after December 31, 2010.

Information return penalties

Under a proposal included in the budget, the first-tier penalty (correct information return filed within 30 days after the prescribed filing date) would be increased from \$15 to \$30, and the calendar year maximum would be increased from \$75,000 to \$250,000. The second-tier penalty (correct information return filed more than 30 days after the prescribed filing date but on or before August 1) would be increased from \$30 to \$60, and the calendar year maximum would be increased from \$150,000 to \$500,000. The



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third-tier penalty (correct information return not filed on or before August 1) would be increased from \$50 to \$100, and the calendar year maximum would be increased from \$250,000 to \$1,500,000.

For small filers (whose average annual gross receipts do not exceed \$5,000,000), the calendar year maximum would be increased from \$25,000 to \$75,000 for the first-tier penalty, from \$50,000 to \$200,000 for the second-tier penalty, and from \$100,000 to \$500,000 for the third-tier penalty.

The minimum penalty for each failure due to intentional disregard would be increased from \$100 to \$250. The proposal would be effective for information returns required to be filed after December 31, 2011.

Employee leasing companies' liability for clients' federal employment taxes

The budget includes a proposal to set forth standards for holding employee leasing companies jointly and severally liable with their clients for federal employment taxes. The proposal would also provide standards for holding employee leasing companies solely liable for such taxes if they meet specified requirements. The provision would be effective for employment tax returns required to be filed with respect to wages paid after December 31, 2010.

Earned Income Tax Credit (EITC)

Expand the EITC. ARRA increased the EITC percentage for families with three or more qualifying children to 45% of a certain base amount for 2009 and 2010. ARRA also increased the threshold phase-out amounts for married couples filing joint returns to \$5,000 above the threshold phase-out for singles, surviving spouses, and heads of household for 2009 and 2010. The budget proposal would make permanent the increased EITC for workers with three or more qualifying children. Specifically, the phase-in rate of the EITC for workers with three or more qualifying children under ARRA would be maintained at 45%, resulting in a higher maximum credit amount and longer phase-out range.

Eliminate the advance EITC. Since 1978, most EITC-eligible individuals have had the option of requesting advance payments of the EITC from their employers throughout the year. Employers offset the costs of the advance payments by reducing their payments of withheld income and employment taxes. The budget proposal would repeal the advance payment option of the EITC. Workers would no longer be able to receive an advance payment of their expected EITC through their employer. This proposal would be effective for taxable years beginning after December 31, 2010.

National Directory of New Hires (NDNH)

The budget includes a proposal to require employers to report a "start work date" to the NDNH for all new hires, in addition to their name, address, and social security number.

The budget also includes a proposal to expand IRS access to the NDNH data for general tax administration purposes, including data matching, verification of taxpayer claims during return processing, preparation of substitute returns for noncompliant taxpayers, and identification of levy sources. Data obtained would be protected by existing taxpayer privacy law. These proposals would be effective upon enactment.



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E-Verify program

The budget would provide more than \$103 million to continue expansion of E-Verify, the electronic employment eligibility verification program run by U.S. Citizenship and Immigration Services

[www.dhs.gov/xlibrary/assets/budget_bib_fy2011.pdf].

Unemployment insurance 'integrity'

The budget proposes to: allow states to redirect up to 5% of unemployment benefit overpayment recoveries to additional enforcement activity; require states to impose a penalty of at least 15% on recipients of fraudulent overpayments and use penalty revenue exclusively for additional enforcement activity; expand the ability to collect benefit overpayments due to a state from income tax refunds owed to a benefit recipient; and allow states to deposit up to 5% of the money recovered in the course of an unemployment insurance tax investigation into a special fund dedicated to implementing the State Unemployment Tax Act (SUTA) Dumping Prevention Act of 2004 (Pub. L. No. 108-295) or enforcing state laws on employer fraud or tax evasion.

Saver's Credit

The budget proposes to expand the Saver's Credit by providing a 50% match for the first \$1,000 of retirement savings for families that earn less than \$65,000. The credit would be fully refundable. *Note:* The credit is equal to a specified percentage of certain employee contributions to an employer-sponsored retirement plan or an IRA.

Small Business Jobs and Wages Tax Credit

Included in the budget is a proposal for a new Small Business Jobs and Wages Tax Credit. Under the proposal, employers would receive a tax credit of up to \$5,000 against their payroll taxes for every net new employee they hire in 2010 (start-ups would be eligible for half the credit). The credit would be administered off an employer's unemployment insurance wage base (equal to 72% of the unemployment insurance wage base increase, or \$5,000 credit for each additional worker who earns at least \$7,000).

Businesses would receive an additional 6.2% tax credit (wage bonus) on aggregate wages in excess of inflation – reimbursing employers for the social security payroll taxes they pay on those payroll increases. This wage bonus would be calculated off the social security payroll tax base, so firms would not get credit for increasing wages for employees making more than the current taxable maximum of \$106,800.

The maximum credit would be limited to \$500,000 per business, and employers would have the option of receiving it on a quarterly estimated basis.

Anti-abuse provisions would include making businesses that reduce employment or payrolls in 2010 ineligible for both the \$5,000 credit and the wage bonus, denying the credit to employers that replace full-time employees with part-time employees, limiting the maximum credit to 25% of the increase in an employer's social security payroll wage base, and preventing businesses from renaming themselves or merging in order to claim the credit [www.whitehouse.gov/sites/default/files/FACT_SHEET_Small_Business%20_jobs_and_Wages_Tax_Cut.pdf].



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'Misclassification Initiative'

The fiscal year 2011 budget includes a joint Labor-Treasury initiative to identify and deter misclassification of employees as independent contractors.

IRS initiative. The IRS would be permitted to require prospective reclassification of workers who are currently misclassified. Reduced penalties for misclassification under current law would apply only if the employer voluntarily reclassified its workers before being contacted by the IRS or other enforcement agency and had filed all required information returns (Forms 1099) reporting the payments to the independent contractors. For a small employer with a small number of misclassified workers, even reduced penalties would be waived if the employer had consistently filed Forms 1099 reporting all payments to all misclassified workers and agreed to prospective reclassification of misclassified workers.

The IRS would also be permitted to issue guidance on the proper classification of workers under common law standards, as well as guidance providing safe harbors and/or rebuttable presumptions. Employers would be required to notify independent contractors, when they first begin performing services, explaining how they will be classified and the consequences of the classification (e.g., tax, workers' compensation, and wage and hour implications). The IRS would be permitted to disclose to the U.S. Department of Labor information about employers whose workers are reclassified.

The proposal would be effective upon enactment, but prospective reclassification of those covered by §530 of the Revenue Act of 1978 would not be effective until the first calendar year beginning at least one year after the date of enactment. The transition period could be up to two years for independent contractors with existing written contracts establishing their status.

WHD initiative. For fiscal 2011, the Department of Labor has budgeted funds to hire 90 full-time Wage and Hour Division (WHD) employees and support an additional 4,700 investigations that will target industries with "misclassification characteristics," such as construction, child care, home health care, grocery stores, janitorial, business services, poultry and meat processing, and landscaping.

In addition, with funds appropriated by ARRA, WHD has hired 100 investigators in an effort to ensure that contractors on stimulus projects are in compliance with applicable laws. The fiscal year 2011 budget includes funding to maintain these staffing increases.

Child support matching funds for states

The budget would extend federal matching of state spending on child support incentive payments for one year, through September 30, 2011

[www.acf.hhs.gov/programs/olab/budget/2011/2011_all.pdf]. Note: ARRA resumed from October 1, 2008, through September 30, 2010, the federal matching of incentive funding that state child support enforcement agencies reinvest back into their enforcement programs, which was cut by the Deficit Reduction Act of 2005 (Pub. L. No. 109-171). The APA has lobbied on behalf of restoration of this funding, which provides much needed revenue to the state agencies, including funds to hire employees who help



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answer employers' questions (see "Inside Washington," for **March** and **November** 2007).

Labor certification fees

The budget proposes legislation to authorize an application fee for employers filing new applications in three major labor certification programs. The fees – which would be collected from employers for processing applications in connection with the Permanent Labor Certification Program, the H-2A Temporary Agricultural Program (replacing the current fee, which reverts to the Treasury), and the H-2B Temporary Non-Agricultural Program – would permit the Department of Labor to recover the costs of administering these programs [www.dol.gov/dol/budget/2011/PDF/bib.pdf].