



# PAYROLL CURRENTLY

The Biweekly Payroll Compliance Publication of the American Payroll Association

Volume 17

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## **New Stimulus Law Means New Withholding Tables and COBRA Payments Funded by Payroll Taxes**

On February 17, 2009, President Barack Obama signed the “American Recovery and Reinvestment Act of 2009” (ARRA; Pub. L. No. 111-5) into law. The centerpiece of this legislation, which is aimed at jump-starting the American economy, is a \$400 individual “Making Work Pay” income tax credit (\$800 for joint filers) for 2009 and 2010 that will be distributed through reduced withholding from workers’ paychecks. This and other provisions of interest to payroll professionals are itemized below.

### **Making Work Pay income tax credit**

ARRA provides eligible individuals a refundable income tax credit for 2009 and 2010. The credit is the lesser of (1) 6.2% of an individual’s earned income or (2) \$400 (\$800 for married individuals filing jointly) for each year.

The credit is phased out at a rate of 2% of the eligible individual’s modified adjusted gross income (AGI) above \$75,000 (\$150,000 for joint filers). Therefore, individuals with modified AGI over \$95,000 (\$190,000 for joint filers) are ineligible for the credit. To be eligible for the credit, an individual must provide a valid social security number issued by the SSA, not a taxpayer identification number (TIN or ITIN) issued by the IRS. Nonresident aliens and those who can be claimed as a dependent by another taxpayer are not eligible for the credit.

☛ **NEW TABLES WITH EXTRA REDUCED WITHHOLDING** — According to the Conference Agreement accompanying the bill, the tax credit will be implemented through revised income tax withholding tables designed to reduce withholding so that the full amount of the credit will be implemented during the remainder of 2009. This means that 12 months of reduced withholding for 2009 will be accomplished in a compressed time frame beginning with the effective date of the tables.

**Definitions.** The definition of *earned income* is the same as for the earned income tax credit with two modifications:

- Earned income for these purposes does not include net earnings from self-employment that are not taken into account in computing taxable income;
- Earned income for these purposes includes combat pay excluded from gross income under IRC §112.

*Modified adjusted gross income* is an eligible individual’s adjusted gross income increased by any amount excluded from gross income because of the foreign earned income or housing cost exclusion or because of the exclusions for amounts earned in certain U.S. possessions and Puerto Rico.

### **COBRA premium subsidies to come from payroll taxes**

ARRA provides that, for up to nine months, if an assistance eligible individual pays 35% of the COBRA continuation premium, the group health plan must treat the individual as having paid the full premium required for COBRA continuation coverage,



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and the individual would be entitled to a subsidy of 65% of the premium. *Note:* If a person other than the individual's employer (e.g., a parent or guardian) pays on the individual's behalf, then the individual is treated as paying 35% of the premium and is entitled to the premium subsidy.

**Assistance eligible individual.** An assistance eligible individual is any qualified beneficiary who elects COBRA continuation coverage and satisfies two additional requirements. First, the qualifying event must be a loss of group health plan coverage on account of an involuntary termination of the covered employee's employment (other than an involuntary termination for gross misconduct). Second, the qualifying event must occur during the period beginning September 1, 2008, and ending December 31, 2009, and the qualified beneficiary would have to be eligible for COBRA continuation coverage during that period and elect such coverage.

**Termination of eligibility for reduced premiums.** The assistance eligible individual's eligibility for the subsidy ends with the first month beginning on or after the earlier of:

- the date that is nine months after the first day of the first month for which the subsidy applies,
- the end of the maximum required period of continuation coverage for the qualified beneficiary under the IRC or other state or federal law or regulation, or
- the date the assistance eligible individual becomes eligible for Medicare benefits or health coverage under another group health plan.

Note that eligibility for coverage under another group health plan would not terminate eligibility for the subsidy if the other group health plan provides only dental, vision, counseling, or referral services, is a health flexible spending account or health reimbursement arrangement, or is coverage for treatment that is furnished in an on-site medical facility maintained by the employer that consists primarily of first-aid services, prevention and wellness care, or similar care.

**Income includability.** Any premium subsidy provided is excluded from the gross income of the covered employee and any assistance eligible individuals under new IRC §139C.

**High earners must give back premium subsidy.** ARRA contains an income threshold as an additional condition on an individual's entitlement to the premium subsidy during any taxable year. The income threshold is based on the modified AGI of an individual for the taxable year in which the subsidy is received (i.e., either 2009 or 2010) with respect to which the assistance eligible individual is the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer. Modified AGI for this purpose has the same meaning as it does for the "Making Work Pay" tax credit discussed above.

If the premium subsidy is provided and the taxpayer's modified AGI exceeds \$145,000 (or \$290,000 for joint filers), then the amount of the premium subsidy for all months during the taxable year must be repaid. The mechanism for repayment is an



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increase in the taxpayer's income tax liability for the year equal to such amount. For taxpayers with modified AGI between \$125,000 and \$145,000 (or \$250,000 and \$290,000 for joint filers), the amount of the premium subsidy for the taxable year that must be repaid is reduced proportionately. The income threshold is applied separately to each taxable year.

An individual may make a permanent election to waive the right to the premium subsidy for all periods of coverage if the individual feels they will not be eligible for the subsidy because their modified AGI will exceed the threshold. This waiver applies to all periods of coverage (regardless of the tax year of the coverage) for which the individual might be entitled to the subsidy. The premium subsidy for any period of coverage cannot later be claimed as a tax credit or otherwise be recovered, even if the individual later determines that the income threshold was not exceeded for a relevant tax year. This waiver is made separately by each qualified beneficiary (who could be an assistance eligible individual) with respect to a covered employee.

**Reimbursement of group health plans.** The ARRA provides that the “person to whom premiums are payable” will be reimbursed for the 65% discount on the premium for COBRA continuation coverage that is not paid by an assistance eligible individual. The person to whom COBRA premiums are payable is either:

- the multiemployer group health plan,
- the employer maintaining the group health plan, or
- the insurer providing coverage under the group health plan.

The plan or employer is not eligible for subsidy reimbursement, however, until it has received the reduced premium payment from the assistance eligible individual.

To the extent that the person (i.e., entity) receiving COBRA premium payments has liability for income tax withholding from wages or FICA taxes with respect to its employees, the entity will be reimbursed by treating the amount that is reimbursable as a credit against its liability for these payroll taxes. To the extent that the reimbursable amount exceeds the amount of the entity's payroll tax liability, the Treasury Secretary will reimburse the entity for the excess directly.

Any entity entitled to a premium reimbursement must submit reports at the time and in the form required by the Secretary, including:

- an attestation of the involuntary termination of employment of each covered employee on the basis of whose termination entitlement to reimbursement of premiums is claimed,
- a report of the amount of payroll taxes offset for a reporting period and the estimated offsets of such taxes for the next reporting period, and
- a report containing the TINs of all covered employees, the amount of the subsidy reimbursed for each covered employee and qualified beneficiaries, and a designation for each covered employee as to whether the reimbursement is for coverage of one individual or more than one individual.



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The entity filing for reimbursement of the COBRA premium 65% discount is treated as having paid that amount in payroll taxes on the day the 35% premium payment is received from the assistance eligible individual. Therefore, any reimbursement for an amount in excess of the payroll taxes owed by the entity is treated in the same manner as an overpayment of payroll taxes and will be credited or refunded by the IRS.

On the other hand, any overstatement of such a reimbursement will be treated as an underpayment of payroll taxes, and the IRS can assess appropriate penalties for failing to truthfully account for the reimbursement. But the conference report notes that it is not intended that any portion of the reimbursement be taken into account when determining the amount of any penalty to be imposed against any person who is required to collect, truthfully account for, and pay over any tax under IRC §6672 (i.e., the “trust fund” or “100%” penalty).

**Effective date.** The COBRA premium discount provision applies to periods of coverage beginning after February 17, 2009.

## **Parity for mass transit fringe benefits**

ARRA equalizes the monthly exclusion from gross income for employer-provided parking and commuter transportation (transit pass and vanpool) benefits. The provision is effective from March 1, 2009, through December 31, 2010. This means that transit benefits will be reset at \$230 per month from March - December 2009 and indexed equally with parking benefits for 2010.

## **Child support matching funds for states**

ARRA resumes 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 (see [PAYROLL CURRENTLY, Issue No. 6, Vol. 14](#)). The resumption is temporary – from October 1, 2008, through September 30, 2010 (Fiscal Years 2009 and 2010). *Note:* 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 answer employers’ questions (see “Inside Washington,” for [March](#) and [November](#) 2007).

## **Earned Income Tax Credit**

ARRA increases the EITC percentage for families with three or more qualifying children to 45% for 2009 and 2010. For example, in 2009 taxpayers with three or more qualifying children can claim a credit of 45% of earnings up to \$12,570, resulting in a maximum credit of \$5,656.50.

ARRA also increases the threshold phase-out amounts for married couples filing joint returns to \$5,000 above the threshold phase-out amounts for singles, surviving spouses, and heads of households for 2009 and 2010. For example, in 2009 the maximum credit of \$3,043 for one qualifying child is available for those with earnings between \$8,950 and \$16,420 (\$21,420 if married filing jointly). The credit begins to



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phase out at a rate of 15.98% of earnings above \$16,420 (\$21,420 if married filing jointly). The credit phases out to \$0 at \$35,463 of earnings (\$40,463 if married filing jointly). The \$5,000 amount will be indexed for inflation in 2010.

**AEIC TABLES TO CHANGE** — The IRS will issue new tables for calculating the Advance Earned Income Credit for the remainder of 2009 because of the increase in the phase-out threshold for a married couple filing jointly to \$40,463 from \$38,583. However, the maximum amount of the AEIC for 2009 will remain at \$1,826.

### **Delay of withholding tax on government contractors**

IRC §3402(t) generally requires information reporting and withholding at the rate of 3% on payments to persons providing property or services to a state or local government entity with \$100 million or more of covered annual expenditures, effective for payments made after December 31, 2010. ARRA delays the effective date of §3402(t) for one year, to payments made after December 31, 2011.

### **Suspension of tax on UC**

ARRA provides that up to \$2,400 of unemployment compensation benefits received under federal or state law in 2009 are not subject to federal income tax.

### **Work Opportunity Tax Credit expansion**

ARRA creates a new targeted group – unemployed veterans and disconnected youth – who begin working for the employer in 2009 or 2010. An unemployed veteran is someone who is certified by the designated local agency as:

- having served on active duty (other than for training) in the Armed Forces for more than 180 days or having been discharged or released from active duty in the Armed Forces for a service-connected disability;
- having been discharged or released from active duty in the Armed Forces during the five-year period ending on the hiring date; and
- having received unemployment compensation under state or federal law for at least four weeks during the one-year period ending on the hiring date.

A disconnected youth is an individual certified by the designated local agency as someone who is:

- 16 - 24 years old on the hiring date;
  - not regularly attending any secondary, technical, or post-secondary school during the six-month period preceding the hiring date;
  - not regularly employed during the six-month period preceding the hiring date;
- and
- not readily employable by reason of lacking a sufficient number of skills.

*Note:* a low-level of formal education may satisfy the requirement that an individual is not readily employable by reason of lacking a sufficient number of skills.