

THIS MONTH:

- ◆ **SPECIAL: New Medicare Tax on Wage and Self Employment Income!**

New Medicare Tax on Wage and Self Employment Income

Starting in 2013, some high wage earners will pay an extra 0.9% Medicare Tax on a portion of their wage income, in addition to the 1.45% Medicare Tax that all wage earners pay. The 0.9% tax applies to wages in excess of \$250,000 for joint filers, \$125,000 for a married individual filing separately and \$200,000 for all others. The 0.9% tax applies only to employees, so there is not an employer match. All wages that are currently subject to Medicare Tax are also subject to the additional Medicare Tax. Taxpayers filing as nonresident aliens or U.S. citizens living abroad will also be subject to this tax. The extra 0.9% Medicare Tax also applies to self-employment income (in excess of the stated thresholds stated above) and is in addition to the regular 2.9% Medicare Tax on all self-employment income. This edition of the Small Biz Builder will address how this new tax affects the employer-employee relationship, as well as, the self employed individual.



How Does This Affect Employers and Employees?

The statute requires an employer to withhold Additional Medicare Tax on wages it pays to an employee in excess of \$200,000 in a calendar year. An employer need not notify an employee when it begins withholding the Additional Medicare Tax. An employer begins withholding the tax in the pay period in which it pays wages to the employee exceeding the \$200,000 threshold and not earlier, even if the employee's annual wages are expected to exceed the threshold. If an employer has two employees, who are married to each other, and their combined wages exceed the \$250,000 threshold, the employer should not combine the wages it pays to the two employees to determine whether to withhold Additional Medicare Tax. Below are some examples to illustrate how this new tax is applied.

Example 1: John and Jane file their income tax return as married filing jointly. John has wages of \$220,000 and Jane has wages of \$20,000. John's employer is required to withhold the Additional Medicare Tax on \$20,000, (the excess of John's wages over \$200,000), even though the couple will not be subject to the additional tax when they file their individual income tax return. The couple will receive a refund for this amount when they file their personal income tax return.

Example 2: If instead, in the above example, John has wages of \$150,000 and Jane has wages of \$175,000. The couple's employers are not required to withhold the Additional Medicare Tax even though John and Jane will have \$75,000 subject to the additional tax (\$325,000 total wages less the \$250,000 threshold for MFJ.) The couple will be responsible for the Additional Medicare Tax when they file their personal income tax return.



How Does This Affect Self-Employed Taxpayers?

The 0.9% Medicare Tax applies to self-employment income (in excess of the stated thresholds) and is in addition to the regular 2.9% Medicare Tax on all self-employment income. Self-employed individuals calculate and report the Additional Medicare Tax on their individual income tax returns. When determining your total estimated tax liability, self-employed taxpayers should consider all compensation and self-employment income in excess of the applicable threshold. Estimated tax payments will apply to any and all tax liabilities on the individual income tax return, including any Additional Medicare Tax liability. It is also important to note, the additional 0.9 percent is not a reduction of adjusted gross income as a deductible part of self-employment tax. Self-employed individuals who have both wages and self-employment income calculate the additional tax as follows:

1. Calculate Additional Medicare Tax on any wages in excess of the applicable threshold, then
2. Reduce the applicable threshold by the total amount of Medicare wages received, and
3. Calculate Additional Medicare Tax on any self-employment income in excess of the reduced threshold.

For example, Mike is a single filer with \$130,000 in wages and \$145,000 in self-employment income.

1. Mike's wages are not in excess of the \$200,000 threshold for single filers, so he is not liable for Additional Medicare Tax on these wages.
2. Before calculating the Additional Medicare Tax on self-employment income, the \$200,000 threshold for single filers is reduced by his \$130,000 in wages, resulting in a reduced self-employment income threshold of \$70,000.
3. Mike is liable to pay Additional Medicare Tax on \$75,000 of self-employment income (\$145,000 in self-employment income minus the reduced threshold of \$70,000).

For additional guidance on how this may affect your business, please contact your local Padgett office.

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