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PAYROLL TAX HOLIDAY

Congress has passed H.R. 3630, the Middle Class Tax Relief and Job Creation Act of 2012 (MCTRJCA). It extends the temporary two percentage point payroll tax "holiday" for employees (and to the same extent, to the self-employed) through the end of 2012.

Under existing law, the Federal Insurance Contributions Act (FICA), employers pay a tax based on the amount of wages paid to an employee during the year. The tax imposed is composed of two parts: the old age, survivors, and disability insurance ((OASDI) and sometimes referred to as the "Social Security tax") tax equal to 6.2 percent of covered wages up to the taxable wage base ($110,100 for 2012); and the Medicare hospital insurance (HI) tax amount equal to 1.45 percent of covered wages. In addition to the tax on employers, each employee is subject to FICA taxes equal to the amount of tax imposed on the employer (the "employee portion"). The employee portion of FICA taxes is withheld and remitted to the Federal government by the employer.

The Self-Employment Contributions Act (SECA) tax applies to the self-employment income of self-employed individuals. The rate of the OASDI portion of SECA taxes is 12.4 percent, which is equal to the combined employee and employer OASDI FICA tax rates, and applies to self-employment income up to the FICA taxable wage base (thus $110,000 in 2012). Similarly, the rate of the HI portion of SECA tax is 2.9 percent, the same as the combined employer and employee HI rates under the FICA tax, and there is no cap on the amount of self-employment income to which the rate applies.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 gave us the first temporary reduction (for 2011) in the OASDI rate for the employee portion of the FICA tax. It was reduced by two percentage points to 4.2 percent. Similarly, for taxable years beginning in 2011, the OASDI rate for a self-employed individual was reduced by two percentage points to 10.4 percent.

The Temporary Payroll Tax Cut Continuation Act of 2011 extended that two percentage point reduction through the end of February 2012.

The bill passed by Congress extends the reduction through December 31, 2012.

SELF EMPLOYMENT ASSISTANCE

I do not know how many folks realize it but under existing federal unemployment benefit law there is a program to encourage the unemployed to become "self-employed." The Self-Employment Assistance (SEA) program permits states to pay a self-employed allowance, instead of regular unemployment insurance benefits, to help unemployed workers while they are establishing businesses and becoming self-employed.

While it has been on the books since the mid 1990's, it is a voluntary program for states and, only Delaware, Maine, New Jersey, New York, Oregon, Pennsylvania and Washington have active Self-Employment Assistance programs.

The payroll tax holiday extension bill passed by Congress includes some "tweaks" to the program. It might get more states to look at the SEA program. The bill permits the federal financed "extended benefits" to be used for the self-employment assistance. Before that, only the state's "regular" benefits could be used. The bill also requires the federal government through the Department of Labor and the Small

Business Administration to provide technical assistance to the states on how to set up such programs.

Now here's the part that I think might motivate states. The new bill also provides a mechanism for the federal government to provide grants to the states to administer such programs. Under the existing program the states had to use their own money. The bill says: "There are appropriated, out of moneys in the Treasury not otherwise appropriated, $35,000,000 for the period of fiscal year 2012 through fiscal year 2013 for purposes of carrying out the grant program under this section." (Caveat: I am always leery there is a trick question lurking when it comes to legislation that does not originate in the appropriations process that appears to be actually appropriating money. Sometimes it actually is not doing so, but in this case, it sure looks like it is.)

WORK SHARE

The MCTRJCA also encourages states to implement "work share" programs that some states are already have in place. Basically, instead of laying off an employee, the employee's hours are reduced and the unemployment compensation fills some of the gap.

The participation of an employer is voluntary and the employer reduces the number of hours worked by employees in lieu of layoffs. The employees whose workweeks have been reduced by at least 10 percent, and by not more than the percentage, if any, that is determined by the state to be appropriate (but in no case more than 60 percent) would be eligible for unemployment compensation. If the employer provides health benefits, retirement contributions or other fringe benefits such as vacation leave, those have to be continued.

The amount of unemployment compensation payable to any such employee is a pro rata portion of the unemployment compensation which would otherwise be payable to the employee if such employee were unemployed.

WHERE DO WE GO FROM HERE

For a while, there was buzz that Congress might include some other tax "extenders" in the payroll tax holiday renewal bill. The extenders refer generally to perennial short-term tax relief that has already expired again. The Research and Development Credit is one business example. There was even some talk about extending some items less commonly referred to as extenders, such as restoring the temporary 100 percent depreciation bonus, which has dropped down to a temporary 50 percent at the beginning of the year. None of them were included.

So it begs the question, "what happens now?" There is one school of thought that the Republican House leadership was prepping their rank and file for the possibility that a really BIG "revenue offset blink" may be needed down the road. The Republicans gave up on their insistence on a revenue offset (or as we would prefer to think of it and which we would prefer, a spending reduction offset) to pay for the payroll tax holiday extension. This blink was modest in size, and only time will tell whether a blink once leads to a blink later. (Mind you, I am not passing judgment on the blink or the nature of it. I think everybody knows where I stand; that it is sad we have gotten to the point in Washington that it is about "whether one sides blink." I like consensus and the win-wins.)

History would say that September in a congressional election year is time for a little bipartisan, "let's get us all re-elected and pass a bunch of good things" activity. But history is no longer our guide when it comes to Congress and it is tough to imagine this Congress doing it.

There is already a lot of hallway talk about a lame duck session after the elections. Right now I would call it probable that they will have a session but I am not sure that cobbling together a tax package will be high on the lame ducks' list of things to do. If we get to that point, the most likely candidates would be expired items, basically those most often referred to as the extenders. The single biggest one for me is the Alternative Minimum Tax (AMT) "patch" – the temporary increases in the income levels to which the tax is applied. They have expired but the impact is not felt until most of us file our tax returns for this year after the first of the year in 2013. And, you may recall from past last minute AMT relief decisions, the IRS will be sounding the warning bells about the need to know the answer about the extension before it allows the filing of returns.

While those may be the leading candidates, the tax issue that will be one of the principal issues feeding the lame duck anxiety will be the looming expiring phenomenon - almost every tax relief provision known to humankind will expire on December 31, 2012. If this were the stock market, we would be calling it the triple witching hour.

The payroll tax relief which was just renewed will lead the list. Anybody paying FICA or SECA taxes has now assumed it is a given part of life on the planet. How do you take it away? Of course, that was the theory of some when the 2001 and 2003 tax relief provisions were passed – when the bell tolls no one is going to want to hear it.

The 4.6 percent increase in the top marginal rate and the return to pre 2001 estate tax rates and exemptions lead the list for us, but there is a lot more on the scorecard.

If I were the party that will be the lead dog in 2013, I sure would want the lame duck session to do the work for me. Why?

If the tax relief expires, the revenue increases become baked into the baseline of the budget; the increased revenue becomes part and parcel of the budget. To restore the expired relief would be undoing that which exists as opposed to stopping an assumption from occurring (how's that for a Zen-like statement). AND automatic sequestration will be occurring. Hello, can you say "defense." (BTW, the looming sequestration would be THE big topic, if there is a lame duck session.)

The bottom line is that it is going to either take an extraordinarily fast economic recovery (everybody is making more, and paying more in tax payments) or a really, really big BLINK (or through the magic of tax reform a sleight of hand is performed and we will feel better, but the higher effective rate of taxation die is under the middle cup) to get us around the double whammy of the expired tax relief and sequestration. Regardless of who is minding the store.

Of course, I could be entirely wrong, and this Congress might have a kumbaya moment sometime this year and all of our worries will disappear. Hey, it could happen. And I wouldn't mind being wrong.

NO WEEKLY

No Weekly next Monday. Congress is off this week. I don't expect to have anything to say.