American Payroll Association

Government Relations • Washington, DC

February 14, 2012

Representative Dave Camp
Chairman, Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington D.C. 20515

Representative Sander Levin
Ranking Member, Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington D.C. 20515

Senator Orrin G. Hatch
Ranking Member, Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510-6200

Senator Max Baucus
Chairman, Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510-6200

RE: Public Law 112-78 – Temporary Payroll Tax Cut Continuation Act of 2011

Dear Chairman Camp, Ranking Member Levin, Chairman Baucus, and Ranking Member Hatch:

We are writing to express our concerns regarding the expiration of Section 101 of Public Law 112-78, the Temporary Payroll Tax Cut Continuation Act of 2011 (TPTCCA). The TPTCCA continues the reduced 4.2% Social Security tax withholding rate on employees for wages paid through February 29, 2012.

The American Payroll Association (APA) is a nonprofit association of over 20,000 payroll professionals, most of whom are responsible for the payroll of approximately 17,000 employers throughout the 50 states, the District of Columbia, and U.S. territories. Our membership also includes representatives of large, medium, and small payroll service providers, who in turn process payroll for an additional 1.5 million employers, representing an aggregate total of one-third of the private-sector workforce. The employers for whom APA members process payrolls are diverse in size and industry.

The APA is strictly neutral on policy matters, and does not take a position on whether a reduced social security withholding rate is needed or desired. Our organization and government relations staff serve largely to advise policymakers concerning the administrative and practical implications of proposals affecting payroll and payroll tax administration.

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The difficulty is the unprecedented establishment of a new Social Security tax rate of 6.2% on wages paid to employees during March 2012, which is the third month of the first quarter, and then for the remainder of 2012. Policymakers need to be aware that, while payroll professionals will do whatever they can to pay their employees correctly and on time, as they always do, there is inadequate lead time available for payroll departments, software companies, and service providers to timely design, program, test, and implement a change to the withholding rate before the end of February without reallocating limited technical resources that are currently assigned to different projects. This is markedly different than the changes enacted by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, which only required changing predefined tables in most payroll systems.

The programming change required by the expiration of the temporary payroll tax cut would have to be made even if subsequent legislation extends the 4.2% rate for the full year. Requiring payroll departments and software companies to implement such a difficult change on such short notice will create substantial problems, as well as widespread confusion and increased costs for thousands of employers. If payroll software developers, service providers, and employers are unable to modify payroll software in time for March payrolls, this would lead to confusion later in the year as employers try to make sure what should have been collected in March is correct, and they may also have to amend first quarter employment tax returns. Moreover, employers need time to test and run software updates provided by developers, such as an update changing the 4.2% rate to a 6.2% rate. This lead time can be as much as one month for some employers under normal operating procedures.

Furthermore, the majority of payroll systems are designed to self-adjust for social security tax withholding. This means that if an employer logs into the payroll system to change the current rate of 4.2% to 6.2% beginning March 1, the system will go back and tax all wages paid in 2012 at 6.2%, including wages paid in January and February, which were initially subject to the lower 4.2% rate. This will lead to overwithholding and tax reconciliation problems. To avoid such an occurrence, software developers will need to design updates to override this self-adjust feature and provide these updates to employers. This entire process can take several weeks to complete.

While the best resolution of this issue would be a full calendar year extension of the payroll tax cut, if the payroll tax cut is extended only for an additional short-term period, instead of the full calendar year, it is less burdensome on employers to implement a rate change that begins at the start of a calendar quarter for bookkeeping and tax filing purposes. That is because federal payroll tax reporting is accomplished on a quarterly basis by completing and filing Form 941, *Employer's Quarterly Federal Tax Return*. Quarter ending dates are March 31, June 30, September 30, and December 31.

The IRS will have to work quickly to produce guidance necessary to enable appropriate design of compliant systems, plus possible penalty relief for employers who find it impossible to make the changes in the short time frame. The IRS also would need to change Forms 941, 941-X, W-2, W-2c, W-3, and W-3c to require separate reporting of the wages subject to different social security tax rates. Using a 4.2% rate for January and February and a 6.2% rate for March would require the IRS to quickly re-design Form 941 for the first quarter of 2012 to allow separate reporting of social security wages and tips paid in January and February and those paid in March. This is bound to create reconciliation and adjustment problems for both the IRS and employers.

Thank you for taking the time to allow us to explain our concerns. Please do not hesitate to contact us if you have any questions or if we can be of further assistance.

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Sincerely,

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