PAYROLL **CURRENTLY**

The Compliance Publication of the American Payroll Association

November 6, 2020 **Volume 28** **Issue 11**

Inside this issue...

IRS Announces 2021 Retirement Plan Contribution, Benefit Limits

The IRS has announced the changes to the dollar limits on benefits and contributions under qualified retirement plans, as well as other items, for tax year 2021 [Notice 2020-79, 10-26-20].

IRC §415, which provides for dollar limits on benefits and contributions under qualified retirement plans, requires that the IRS annually adjust these limits for cost-of-living changes. The IRC also requires various other amounts to be adjusted at the same time and in the same manner as these dollar limits.

- The limitation on the exclusion for elective deferrals under §402(g)(1) (e.g., §401(k) and §403(b) plans) remains unchanged at $19,500.
- The limit on annual additions to defined contribution plans under §415(c)(1)(A) increases to $58,000 (from $57,000).
- The limit on the annual benefit under a defined benefit plan contained in §415(b)(1)(A) remains unchanged at $230,000.
- The annual compensation limit under §401(a)(17), §404(l), §408(k)(3)(C), and §408(k)(6)(D)(ii) increases to $290,000 (from $285,000).
- The compensation amount under §408(p)(2)(E) regarding elective deferrals to SIMPLE retirement accounts remains unchanged at $13,500.
- The limitation under §457(e)(15) concerning elective deferrals to deferred compensation plans of state and local governments and tax-exempt organizations (§457(b) plans) remains unchanged at $19,500.
- The limitation under §416(i)(1)(A)(i) concerning the definition of "key employee" in a top-heavy plan remains unchanged at $185,000.
- The limitation under §414(v)(2)(B)(i) for catch-up contributions to §§401(k), 403(b), and 457(b) plans for individuals age 50 or over remains unchanged at $6,500; the limitation under §414(v)(2)(B)(ii) for catch-up contributions to an employer's SIMPLE plan for individuals age 50 or over remains unchanged at $3,000.
- The limitation used in the definition of "highly compensated employee" under §414(q)(1)(B) remains

unchanged at $130,000.

• The annual compensation limit under §401(a)(17) for eligible participants in certain government plans that, under the plan as in effect on July 1, 1993, allowed cost-of-living adjustments to the compensation limit under the plan under §401(a)(17) to be taken into account, increases to $430,000 (from $425,000).

• The compensation amount under §408(k)(2)(C) regarding simplified employee pensions (SEPs) increases to $650 (from $600).

• The compensation amount under Treas. Reg. §1.61-21(f)(5)(i), concerning the definition of "control employee" for fringe benefit valuation purposes, remains unchanged at $115,000. The compensation amount under §1.61-21(f)(5)(iii) increases to $235,000 (from $230,000).

• The limit on annual contributions to an Individual Retirement Arrangement, remains unchanged at $6,000. The additional catch-up contribution limit for individuals aged 50 and over is not subject to an annual cost-of-living adjustment and remains $1,000. ■

IRS Announces 2021 COLAs for Transportation Fringes, FSA Deferrals, Foreign Earned Income Exclusion, and More

The IRS released inflation-adjusted tables for 2021 reflecting any increases in the flexible spending arrangements (FSA) deferral limit, foreign earned income exclusion, and excludable transportation fringes, among other changes [Rev. Proc. 2020-45, 10-26-20].

Qualified transportation fringes

The amounts that may be excluded from gross income for employer-provided qualified transportation fringe benefits (transportation in a commuter highway vehicle and any transit pass) and qualified parking for 2021 both remain at $270.

Health FSAs

For plan years beginning in 2021, the dollar limitation under IRC §125(i) on voluntary employee salary reductions for contributions to health FSAs remains at $2,750. For cafeteria plans that permit the carryover of unused amounts, the maximum carryover amount is $550.

Standard deduction

The standard deduction amounts for 2021 increase to $25,100 for married couples filing jointly or surviving spouses ($24,800 in 2020), $12,550 for single taxpayers and married taxpayers filing separately ($12,400 in 2020), and $18,800 for heads of household ($18,650 in 2020).

Federal tax levies

The Tax Cuts and Jobs Act altered the way the amount of wages, salary, or other income exempt from a federal tax levy is calculated. For taxable years beginning in 2021, the dollar amount used to calculate the amount determined under IRC §6334(d)(4)(B) remains unchanged at $4,300.

Foreign earned income exclusion

For 2021, the maximum foreign earned income exclusion amount under IRC §911(b)(2)(D)(i) is $108,700 (up from $107,600 in 2020). The maximum amount of the foreign housing cost exclusion is $15,218 (up from $15,064 in 2020).

Medical Savings Accounts

To be eligible to make contributions to a Medical Savings Account (or to have the employer make the contributions), an employee must be covered by a high deductible health plan. For 2021, a high deductible health plan is a plan with an annual deductible of $2,400-$3,600 for individual coverage (up from $2,350-$3,550 in 2020) and $4,800-$7,150 for family coverage (up from $4,750-$7,100 in 2020).

Maximum out-of-pocket expenses can be no more than $4,800 for individual coverage (up from $4,750 in 2020) and $8,750 for family coverage (up from $8,650 in 2020).

Long-term care insurance benefits

If a long-term care insurance contract makes per diem benefit payments, the amount of the payments that is excluded from income in 2021 is capped at $400 per day (up from $380 in 2020).

Adoption assistance

For 2021, the maximum amount that can be excluded from an employee's gross income for qualified adoption expenses under an employer's adoption assistance program is $14,440 (up from $14,300 in 2020). The maximum amount that can be excluded in connection with the adoption of a child with special needs is $14,440 (up from $14,300 in 2020).

The amount excludable from an employee's gross income begins to phase out for taxpayers with adjusted gross income of $216,660 (up from $214,520 in 2020) and is completely phased out for taxpayers with adjusted gross income of $256,660 (up from $254,520 in 2020).

Qualified small employer HRA

For 2021, a qualified small employer health reimbursement arrangement (QSEHRA) is an arrangement which, among other requirements, makes payments and reimbursements for qualifying medical care expenses of an eligible employee that do not exceed $5,300 (up from $5,250 for 2020), or $10,700 in the case of an arrangement that also provides for payments or reimbursements for family members of the employee (up from $10,600 for 2020).

Pipeline construction industry per diem option

For 2021, an eligible employer may pay certain welders and heavy equipment mechanics up to $18 per hour for rig-related expenses that will be deemed substantiated under an accountable plan (unchanged from 2020) and up to $11 per hour for fuel (unchanged from 2020), when paid in accordance with Rev. Proc. 2002-41 (2002-23 IRB 1098).

Penalties increased

For tax years beginning in 2021 (forms filed in 2022), the penalty amounts under IRC §6721, failure to file correct information returns, and the penalty amounts under IRC §6722, failure to furnish correct payee statements, are $280 under the general rule, $50 if corrected on or before 30 days after the required filing date, and $110 if corrected after the 30th day but on or before August 1 (unchanged from 2020). For businesses with annual gross receipts of $5 million or less, the maximum penalty increases to $1,142,000 (up from $1,130,500 in 2020) under the general rule, to $199,500 (up from $197,500 in 2020) if corrected on or before 30 days after the required filing date, and to $571,000 (up from $565,000 in 2020) if corrected after the 30th day but on or before August 1. For businesses with annual gross receipts of more than $5 million, the maximum penalty increases to $3,426,000 (up from $3,392,000 in 2020) under the general rule, to $571,000 (up from $565,000 in 2020) if corrected on or before 30 days after the required filing date, and to $1,713,000 (up from $1,696,000 in 2020) if corrected after the 30th day but on or before August 1.

For intentional disregard of the obligations under either of these provisions, the penalty increases to $570 per return for 2021 (up from $560 for 2020), and there is no calendar year limit. ■

Social Security Wage Base Increases to $142,800 for 2021

The Social Security Administration (SSA) announced that the 2021 social security wage base will be $142,800, an increase of $5,100 from $137,700 in 2020.

Maximum social security tax. The maximum social security tax employees and employers will each pay in 2021 is $8,853.60, an increase of $316.20 from $8,537.40 in 2020.

Medicare tax. As in prior years, there is no limit to the wages subject to the Medicare tax; therefore, all covered wages are still subject to the 1.45% tax. As in 2020, wages paid in excess of $200,000 in 2021 will be subject to an extra 0.9% Medicare tax that will only be withheld from employees' wages. Employers will not pay the extra tax. Note that the $200,000 threshold for the Additional Medicare tax is not subject to adjustments for inflation.

FICA (combined) tax. The FICA tax rate, which is the combined social security tax rate of 6.2% and the Medicare tax rate of 1.45%, will be 7.65% for 2021 up to the social security wage base.

Self-employed. The social security wage base for self-employed individuals in 2021 will also be $142,800. There is no limit on covered self-employment income that will be subject to the Medicare tax. The self-employment tax rate will be 15.3% (combined social security tax rate of 12.4% and Medicare tax rate of 2.9%) up to the social security wage base. In 2021, the maximum social security tax for a self-employed individual will be $17,707.20.

TRUSTEES' ESTIMATE WAS LOW – In its annual report for 2020, the Board of Trustees of the Social Security Trust Fund projected that the 2021 social security wage base would be $141,900, which is $900 less than the actual amount (see PAYROLL CURRENTLY, Issue 5, Vol. 28). Those employers that budgeted for their 2021 FICA tax expense based on the trustees' projection will need to go back and recalculate that number.

Quarters of coverage; retirement earnings test

The SSA has also announced that the amount of earnings needed to qualify for a quarter of coverage to receive full social security benefits will be $1,470 in 2021, up from $1,410 in 2020.

Retirees who will not reach full retirement age in 2021 can earn up to $18,960 a year ($1,580 a month) without losing any benefits (up from $18,240 a year/$1,520 a month in 2020); for these retirees, $1 in benefits will be withheld for every $2 in earnings above the applicable limit.

Retirees who reach full retirement age in 2021 will lose $1 in benefits for every $3 earned above $50,520 (up from $48,600 in 2020), but only counting earnings before the month they reach full retirement age. Starting with the month retirees reach full retirement age, they will receive full benefits with no limit on earnings.

FICA coverage threshold for domestic, election workers

The threshold for coverage under social security and Medicare for domestic employees (i.e., the "nanny tax") will increase to $2,300 in 2021 (up from $2,200 in 2020); the coverage threshold for election workers will increase to $2,000 in 2021 (up from $1,900 in 2020).

REMINDER – For retirees born between 1943 and 1954, "full retirement age" is 66. Note, however, that full retirement age gradually increases for retirees born thereafter – from 66 and 2 months (for retirees born in 1955) to 67 (for those born in 1960 and later). Individuals born in 1955 will reach full retirement age (66 and two months) in 2021. To find your full retirement age, go to https://www.ssa.gov/planners/retire/agereduction.html. ■

IRS Clarifies Form W-2 Reporting of Employee Social Security Tax Deferrals

The IRS has clarified how employers should complete Forms W-2 if they deferred the employee share of social security tax in 2020 [IRS, *Form W-2 Reporting of Employee Social Security Tax Deferred Under Notice 2020-65*, 10-29-20].

Background

On August 28, the IRS issued guidance that allows employers to defer the withholding and payment of the employee share of social security tax on applicable wages paid between September 1, 2020, and December 31, 2020 (Notice 2020-65, 8-28-20; see PAYROLL CURRENTLY, Issue 9, Vol. 28). The guidance was in response to the president's memorandum directing the Secretary of the Treasury "to defer the withholding, deposit, and payment" of the employee share of social security tax on wages paid between the dates listed previously. The deferral is limited to employees whose wages or compensation during any biweekly pay period generally is less than $4,000, calculated on a pretax basis, or the equivalent amount with respect to other pay periods.

In 2021, employers that chose to defer will then withhold the deferred amount from employees' wages and compensation paid between January 1, 2021, and April 30, 2021, and make appropriate tax payments based on the withholding date. If the deferred amounts are not paid by April 30, 2021, the IRS will assess interest and penalties.

Form W-2 reporting

For the deferrals, employers should report total social security wages paid to an employee on Form W-2, *Wage and Tax Statement,* including any wages for which the employer deferred withholding and payment of employee social security tax, in Box 3 and/or Box 7. Employers should not include in Box 4 any amount of deferred employee social security tax that was not withheld.

Employee social security tax deferred in 2020 withheld in 2021 and not reported on the 2020 Form W-2 should be reported in Box 4 on Form W-2c, *Corrected Wage and Tax Statement*. On Form W-2c, employers should enter tax year 2020 in Box c and adjust the amount previously reported in Box 4 of the Form W-2 to include the deferred amounts withheld in 2021.

Employers should file all Forms W-2c with the Social Security Administration, along with Form W-3c, *Transmittal of Corrected Wage and Tax Statements*, as soon as possible after they have finished withholding the deferred amounts. The IRS plans to include more information in the 2021 *General Instructions for Forms W-2 and W-3*, which will be published in January 2021.

Employers should furnish Forms W-2c to affected employees and may direct employees to the Instructions for Employees, for instructions specific to this correction. Employees with only one employer are not required to take further action. Employees with two or more employers in 2020 should determine whether they had excess social security tax on wages paid in 2020 by checking to see if total wages exceed the maximum amount ($8,537.40) of taxes owed. ■

State Unemployment Insurance Taxable Wage Bases for 2021

Many states have released their state unemployment insurance (SUI) taxable wage bases for 2021. Employers should be aware that due to UI trust fund balances that are lower than anticipated and economic concerns regarding employer taxes, some states may make changes to their taxable wage bases later this year or early next year. For a list of the state wage bases, check APA's website.

Following the Federal Unemployment Tax Act (FUTA) scheme, state unemployment contributions (taxes) are determined by applying a certain percentage to the taxable wages paid by the employer (see *The Payroll Source®*, §7.2-2). FUTA requires that each state's taxable wage base must at least equal the FUTA taxable wage base of $7,000 per employee, and most states have wage bases that exceed the required amount. The states use various formulas for determining the taxable wage base, with a few tying theirs by law to the FUTA wage base and others using a percentage of the state's average annual wage.

The types of payments included as taxable wages by the states are generally those considered taxable wages for FUTA purposes (wages, salary, bonuses, commissions, and noncash payments). But several states differ from the FUTA approach when it comes to sick or disability pay, cafeteria plan benefits, tips, and other payments. Employers must check the state laws and rules in the states where they have employees to determine whether the payments made to them are taxable wages.

For more information on SUI wage bases and tax rates, see *APA's Guide to State Payroll Laws,* Table 8.2. ■

IRS Issues Final Rules for Federal Income Tax Withholding

The IRS issued final regulations to update the federal income tax withholding rules and reflect changes made by the Tax Cuts and Jobs Act (TCJA) and other legislation enacted since the rules were last revised [85 F.R. 63019, 10-6-20; 2020-44 IRB 943]. The IRS issued proposed regulations in February (85 F.R. 8344, 2-13-20; see PAYROLL CURRENTLY, Issue 3, Vol. 28). The final regulations adopted the proposed regulations with a few changes.

The final regulations amend the Employment Tax Regulations (26 C.F.R. part 31) under IRC §§3401 and 3402. The IRS issued the regulations to implement the TCJA's tax law changes and to reflect the redesigned 2020 Form W-4, *Employee's Withholding Certificate.*

Background: Changes to the 2020 Form W-4

The Form W-4 no longer uses an employee's marital status and withholding allowances (as defined before the TCJA), which were tied to personal exemptions, to calculate income tax withholding (see PAYROLL CURRENTLY, Issue 1, Vol. 28). Employees can no longer claim personal exemptions because the TCJA reduced the value of the exemption to zero. Instead, tax withholding using the Form W-4 is based on the employee's standard deduction corresponding to the employee's anticipated filing status on their personal tax return.

Employees not required to furnish a new form

The final regulations and related guidance confirm that employees are not required to furnish a new Form W-4 solely because of the form's redesign. Employees who have a Form W-4 on file with their employer from years prior to 2020 generally will continue to have their withholding determined based on that form.