



**THE REVENUE PROVISION CONTAINED IN THE “TEMPORARY PAYROLL TAX
CUT CONTINUATION ACT OF 2011”**

Present Law

Federal Insurance Contributions Act (“FICA”) tax

The FICA tax applies to employers based on the amount of covered wages paid to an employee during the year.¹ Generally, covered wages means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash.² Certain exceptions from covered wages are also provided. The tax imposed is composed of two parts: (1) the old age, survivors, and disability insurance (“OASDI”) tax equal to 6.2 percent of covered wages up to the taxable wage base (\$106,800 for 2011 and \$110,100 for 2012); and (2) 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 generally subject to FICA taxes equal to the amount of tax imposed on the employer (the “employee portion”).³ The employee portion of FICA taxes generally must be withheld and remitted to the Federal government by the employer.

Self-Employment Contributions Act (“SECA”) tax

As a parallel to FICA taxes, the SECA tax applies to the self-employment income of self-employed individuals.⁴ The rate of the OASDI portion of SECA taxes is generally 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. 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

¹ Sec. 3111.

² Sec. 3121(a).

³ Sec. 3101. For taxable years beginning after 2012, an additional HI tax applies to certain employees.

⁴ Sec. 1401.

FICA tax, and there is no cap on the amount of self-employment income to which the rate applies.⁵

An individual may deduct, in determining net earnings from self-employment under the SECA tax, the amount of the net earnings from self-employment (determined without regard to this deduction) for the taxable year multiplied by one half of the combined OASDI and HI rates.⁶

Additionally, a deduction, for purposes of computing the income tax of an individual, is allowed for one-half of the amount of the SECA tax imposed on the individual's self-employment income for the taxable year.⁷

Railroad retirement tax

Instead of FICA taxes, railroad employers and employees are subject, under the Railroad Retirement Tax Act (“RRTA”), to taxes equivalent to the OASDI and HI taxes under FICA.⁸ The employee portion of RRTA taxes generally must be withheld and remitted to the Federal government by the employer.

Reduced OASDI rates for 2011

For 2011, the OASDI rate for the employee portion of the FICA tax, and the equivalent employee portion of the RRTA tax, is reduced by two percentage points to 4.2 percent. Similarly, for taxable years beginning in 2011, the OASDI rate for a self-employed individual is reduced by two percentage points to 10.4 percent.

Special rules coordinate the SECA tax rate reduction with a self-employed individual’s deduction in determining net earnings from self-employment under the SECA tax and the income tax deduction for one-half of the SECA tax. The rate reduction is not taken into account in determining the SECA tax deduction allowed for determining the amount of the net earnings from self-employment for the taxable year. The income tax deduction allowed for SECA tax for taxable years beginning in 2011 is computed at the rate of 59.6 percent of the OASDI tax paid, plus one half of the HI tax paid.⁹

⁵ For taxable years beginning after 2012, an additional HI tax applies to certain self-employed individuals.

⁶ Sec. 1402(a)(12).

⁷ Sec. 164(f).

⁸ Secs. 3201(a) and 3211(a).

⁹ This percentage replaces the rate of one half (50 percent) allowed under present law for this portion of the deduction. The new percentage is necessary to allow the self-employed individual to deduct the full amount of the employer portion of SECA taxes. The employer OASDI tax rate remains at 6.2 percent, while the employee portion falls to 4.2 percent. Thus, the employer share of total OASDI taxes is 6.2 divided by 10.4, or 59.6 percent of the OASDI portion of SECA taxes.

The Federal Old-Age and Survivors Trust Fund, the Federal Disability Insurance Trust Fund and the Social Security Equivalent Benefit Account established under the Railroad Retirement Act of 1974¹⁰ receive transfers from the General Fund of the United States Treasury equal to any reduction in payroll taxes attributable to the rate reduction for 2011. The amounts are transferred from the General Fund at such times and in such a manner as to replicate to the extent possible the transfers which would have occurred to the Trust Funds or Benefit Account had the provision not been enacted.

For purposes of applying any provision of Federal law other than the provisions of the Internal Revenue Code of 1986, the employee rate of OASDI tax is determined without regard to the reduced rate for 2011.

Explanation of Provision

Under the provision, the reduced employee OASDI tax rate of 4.2 percent under the FICA tax, and the equivalent employee portion of the RRTA tax, is extended to apply to covered wages paid in the first two months of 2012. The provision also provides for a recapture of any benefit a taxpayer may have received from the reduction in the OASDI tax rate, and the equivalent employee portion of the RRTA tax, for remuneration received during the first two months of 2012 in excess of \$18,350.¹¹ The recapture is accomplished by a tax equal to two percent of the amount of wages (and railroad compensation) received during the first two months of 2012 that exceed \$18,350. The provision directs the Secretary of the Treasury (or the Secretary's delegate) to prescribe regulations or other guidance that are necessary and appropriate to carry out this provision.

In addition, for taxable years beginning in 2012, the OASDI rate for a self-employed individual is reduced to 10.4 percent, for self-employment income of up to \$18,350 (reduced by wages subject to the lower OASDI rate for 2012). Related rules for 2011 concerning coordination of a self-employed individual's deductions in determining net earnings from self-employment and income tax also apply for 2012, except that the income tax deduction allowed for the OASDI portion of SECA tax paid for taxable years beginning in 2012 is computed at the rate of 59.6 percent¹² of the OASDI tax paid on self-employment income of up to \$18,350. For self-employment income in excess of this amount, the deduction is equal to half of the OASDI portion of the SECA tax paid.

¹⁰ 45 U.S.C. 231n-1(a).

¹¹ \$18,350 is 1/6 of the 2012 taxable wage base of \$110,100.

¹² This percentage used with respect to the first \$18,350 of self-employment income is necessary to continue to allow the self-employed taxpayer to deduct the full amount of the employer portion of SECA taxes. The employer OASDI tax rate remains at 6.2 percent, while the employee portion falls to a 4.2 percent rate for the first \$18,350 of self-employment income. Thus, the employer share of total OASDI taxes is 6.2 divided by 10.4, or 59.6 percent of the OASDI portion of SECA taxes, for the first \$18,350 of self-employment income.

Rules related to the OASDI rate reduction for 2011 concerning (1) transfers to the Federal Old-Age and Survivors Trust Fund, the Federal Disability Insurance Trust Fund and the Social Security Equivalent Benefit Account established under the Railroad Retirement Act of 1974, and (2) determining the employee rate of OASDI tax in applying provisions of Federal law other than the Code also apply for 2012.

Effective Date

The provision is effective for remuneration received during the months of January and February in 2012 and for self-employment income for taxable years beginning in 2012.