Budget reconciliation & payroll — what should you expect?

The budget reconciliation bill Congress is currently considering is a key piece of legislation and will affect your payroll and benefits administration, as well as your corporate tax rate and your appetite for tax risk. The bill beefs up IRS enforcement efforts, to the tune of almost $79 billion over 10 years. Stricter tax enforcement is one of the ways those who drafted the legislation hope to pay for its costly provisions.

The House Ways and Means Committee is in the process of marking up the budget reconciliation bill. While this is only the first step toward enactment, Congress wants this bill and the infrastructure bill wrapped up by the end of the month. Perhaps those deadlines will slip a bit, but the message is clear: Time is of the essence.

While there's a lot to unpack here, we're going to focus on some of the payroll-related provisions for now.

Bye, bye corporate FMLA leave tax credit

The corporate tax credit for providing paid FMLA leave to certain employees—IRC § 45S—would expire for tax years beginning after Dec. 31, 2023, instead of Dec. 31, 2025. Not coincidentally, employees would become eligible for paid FMLA leave in 2023.

Tax rate increases

The flat 21% corporate tax rate would once again be graduated and would equal 18% on the first $400,000 of income, 21% on income up to $5 million, and 26.5% thereafter.

The maximum personal income tax rate would increase to 39.6%, from 37%, for marrieds filing jointly with taxable income exceeding $450,000, heads of household with taxable income exceeding $425,000, and single taxpayers with income exceeding $400,000.

This will affect withholding on supplemental wages in excess of $1 million.

High earners would also be subject to a 3% surcharge. The surcharge would apply to modified adjusted gross income in excess of $5 million for marrieds filing jointly and, presumably $2.5 million for single taxpayers.

High earners could adjust their withholding to account for the surcharge.

The increase in the personal income tax rate is proposed to become effective beginning Jan. 1, 2022.

The kids are all right

The maximum pretax amount employees can salt away in their dependent care assistance plans has been stuck at $5,000 since, well, forever. The American Rescue Plan increased the maximum to $10,500 but for 2021 only.

The budget reconciliation bill would make permanent the increase to $10,500 and for the first time would inflation-adjust the amount, beginning Jan. 1, 2022. Three things immediately leap to mind:

- A permanent increase would negate the IRS' rather complicated rules regarding taxing excess amounts next year.
- Retroactive plan amendments would be allowed, providing the amendment is adopted no later than the last day of the plan year in which it's effective and the plan is operated consistently with the amendment terms beginning on the effective date of the amendment and ending on the date the amendment is adopted.
- If you want to avoid having to make amendments every year, your amendment should reference the inflation-adjusted amount, without a dollar figure. Take a look at your 401(k) plan for a template.

The advance child tax credit, which most families began receiving in July, would be extended. The credit would remain 50% of employees' employment-related expenses, up to $8,000 in the case of one qualifying child and $16,000 for two or more qualifying children. The credit would still be subject to a two-part phase-out.

Eligible child-care employers would be entitled to a tax credit against their 1.45% share of Medicare taxes and a proportionate amount of employees' health care expenses.

Those provisions would become effective beginning Jan. 1, 2022.

Enhanced Work Opportunity Tax Credit (WOTC)

You're eligible for the WOTC if you hire members of certain targeted groups. Right now, the basic credit is 40% of the first $6,000 paid to eligible employees.

The basic credit would increase to 50% of the first $10,000 through Dec. 31, 2023. The provision wouldn't apply to qualified summer youth employees.

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