PAYROLL AND PENALTY PROVISIONS IN THE LATE - 2007 TAX LEGISLATION

Contained in the flurry of legislation passed by Congress at the end of 2007 - including the Mortgage Forgiveness Debt Relief Act of 2007, the Tax Technical Corrections Act of 2007, the Energy Independence and Security Act of 2007 and the Virginia Tech Victim's Relief Act - were measures that included new or revised payroll and tax penalty provisions. Here is a quick overview of the payroll and penalty provisions in the new law.

- ***Partnership failure to file penalty increased.***

  Under pre-Mortgage Relief Act law, any partnership required to file a return for any year, which failed to file on time (including extensions) or whose return failed to show the information required, was liable for a monthly penalty equal to $50 times the number of persons who were partners during any part of the tax year, for each month or fraction of a month for which the failure continued. However, the total penalty could not be imposed for more than five months. The Mortgage Relief Act extends the period for calculating the monthly failure-to-file-penalty for partnership returns from 5 to 12 months and increases the per-partner penalty amount from $50 to $85 per partner, effective for returns required to be filed after December 20, 2007. Note, also, under the Virginia Tech Victim's Relief Act, for tax years beginning in 2008 only, the dollar amount per partner is increased by $1. Thus, for tax years beginning in 2008, the per-partner penalty for failure to file a partnership return is $86.

- ***New failure to file penalty for S corporation returns.***

  Under pre-Mortgage Relief Act law, there was no penalty for failure to file an S corporation return. The Mortgage Relief Act imposes a monthly penalty for any failure to timely file an S corporation return or any failure to provide the information required to be shown on such a return, effective for returns required to be filed after December 20, 2007. The penalty, assessed against the S corporation, is $85 times the number of shareholders in the S corporation during any part of the tax year for which the return was required, for each month (or a fraction of a month) during which the failure continues, up to a maximum of 12 months.

- ***Penalty for substantial and gross valuation misstatements attributable to incorrect appraisals.***

  In the 2006 Pension Protection Act, a penalty was added for substantial and gross valuation misstatements attributable to incorrect appraisals. That legislation omitted to apply the penalty with respect to substantial valuation understatements for estate and gift tax purposes. The Tax Technical Corrections Act of 2007 clarifies that the penalty applies for such purposes. The 2006 Pension Protection Act made another omission in the cross references for the penalty where the language relating to the time period for assessment of the penalty was not properly described. The new legislation corrects that error by providing that the penalty for valuation misstatements attributable to incorrect appraisals is subject to a 3-year limitation period.

- ***FUTA surtax extended through 2008.***

  The Federal Unemployment Tax Act (FUTA) imposes a 6.2% gross tax rate on the first $7,000 paid annually by covered employers to each employee, consisting of a permanent tax rate of 6%, and a temporary surtax rate of 0.2%. Under pre-Energy Act law, the temporary surtax only applied through the end of 2007. Under the Energy Act, the temporary surtax rate (which amounts to $14 per worker) is extended through December 31, 2008. Thus, the FUTA rate remains at 6.2% through the end of 2008.

- ***Designated Roth contributions are subject to FICA.***

  Beginning in 2006, plan sponsors have been able to offer their employees the ability to make after-tax 401(k) contributions where earnings are not usually taxed on distribution. These contributions are called "Roth contributions." The Tax Technical Corrections Act of 2007 clarifies that Roth contributions are subject to FICA taxes (i.e., Social Security and Medicare) at the time they are made.