



Payroll Insights

Employment tax news to guide you now and for the future

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John Montgomery's *fresh take*: Federal, state, and local payroll tax audits to increase

With pandemic-related tax credits and temporary nexus provisions having mostly expired, we anticipate an increase in federal, state, and local government payroll tax audits for both income withholding and unemployment insurance taxes. Over the past 2 years, with little and often unclear guidance, employers have scrambled to remain in compliance while navigating all other non-payroll tax aspects of the COVID-19 pandemic. Simultaneously, employers had to calculate and apply for new payroll tax credits.

For federal purposes, there may be extra scrutiny under audit for qualifying for and calculating:

- Employee Retention tax credit
- Emergency Paid Sick Leave tax credit
- Emergency FMLA Expansion tax credit
- COBRA tax credit
- Deferred employer Social Security contributions
- Deferred employee Social Security contributions
- Interaction of Payroll Protection Program loan forgiveness and tax credits

Employers may also see the IRS take more time reviewing compliance in connection with nonresident aliens performing services in the U.S. who may have unexpectedly extended their stay due to travel restrictions.

For state and local purposes, there may be extra scrutiny around employees who became telecommuters as a result of office closures or changes in company policy. States and local jurisdictions were not consistent in their treatment of new telecommuters, including:

- Not changing existing law;
- Not requiring withholding if an employee is temporarily providing services within the jurisdiction due to COVID-19;
- Temporarily taxing telecommuters who were previously performing services within the jurisdiction.

Further, state departments of labor may take different positions as to whether employees became subject to state unemployment insurance tax in the new work state.

We recommend documenting all positions in writing and keeping record of any support used to calculate credits. Also, be on the watch for letters and emails notifying of an audit or penalties and address them promptly!





IRS requests input on worker classification

As states seek to clarify worker classification of employees versus independent contractors, the federal Department of Labor (“DOL”) is also trying to make worker classification determinations easier on companies for purposes of the Fair Labor Standards Act (“FLSA”). The DOL requested comments [via public forum](#) for both employers (June 24, 2022) and workers (June 29, 2022) on legislation intended to simplify the worker classification decision process.

While properly classifying workers has been a hot topic from both labor and tax law perspectives for many years, the current emphasis relates to a rule issued by the Wage and Hour Division of the Labor Department (DOL rule) at the end of the Trump Administration that was delayed and dismissed by the current administration. However, on March 14, 2022, a district court determined that the delay and dismissal were not valid, and the original DOL rule is effective as of March 4, 2021.

The rule, Independent Contractor Status Under the Fair Labor Standards Act ([86 Fed. Reg. 1168](#)) is intended to simplify worker classification from the current decentralized multi-factor test to a more defined 5-factor test to be used in analyzing the “economic dependence” of a worker:

1. The nature and degree of the individual’s control over the work
2. Opportunity for profit or loss
3. Skill required
4. Permanence of the working relationship
5. Integrated unit

The fifth factor, “integrated unit” is intended to replace the commonly used “integral part” factor. Where an “integral part” of a business refers to “the importance of the services rendered to the company’s business,” the “integrated unit” factor refers to the level that the services are a segregable piece of the company’s production process.

The DOL rule delves further into the first and second factors as “core factors” and states that if both core factors are aligned, the resulting worker classification does not require any further analysis.

The DOL rule includes a qualifier that additional, unlisted factors may apply depending on the facts and circumstances of the situation, but unlisted factors should not carry the same weight as the listed factors.

The DOL rule discusses how the new rule will not narrow the standard for employment (i.e., make it easier to be classified as an independent contractor). However, “gig economy” companies, such as ride share companies, led the lobbying efforts to issue this rule, which they feel will more definitively classify “gig economy” workers as independent contractors.

As part of the federal labor laws, the FLSA governs minimum wage and overtime law. Workers who are classified as independent contractors under the FLSA generally are not subject to these rules. Workers classified as employees may be entitled to additional pay and benefits under the FLSA. For payroll tax purposes, the employer is liable for the employer’s share of Social Security, Medicare, and unemployment taxes, in addition to withholding, reporting, and remitting taxes from employee wages.

Worker classification determined for FLSA purposes does not automatically translate to the same classification for tax law purposes (e.g., federal income tax withholding, social tax contributions). While many of the factors considered when evaluating independent contractor versus employee classification are similar, the DOL rule does not directly apply to tax law. However, as indicated above, determinations made for FLSA purposes can drive payroll tax requirements. KPMG generally recommends that companies review their workforce and policies for compliance with both the FLSA and tax law.



Social Security Trust Fund balance update

While there has been a focus on the depleting unemployment fund balances due to layoffs resulting from the effect of the COVID-19 pandemic on the economy, the Social Security (a.k.a. Old-Age and Survivors Disability Insurance) trust fund balance has also taken a hit from the economic downturn. The 2021 report of the balances issued by the Social Security Board of Trustees anticipated an annual deficit of 3.54% of taxable payroll over the next 75 years. The 2021 report also projected a depletion date of 2034.

Due to a stronger-than-expected recovery from the recession and miscellaneous other factors, the anticipated annual deficit over the next 75 years, as detailed in [The 2022 OASDI Trustees Report \(ssa.gov\)](#), has decreased to 3.42% of taxable payroll. Further, the 2022 report projects a fund depletion date of 2035, an extra year from previously estimated.



2023 social security wage base projection

In the same report, the Social Security Board of Trustees projects the 2023 Social Security wage base to increase to \$155,100, up from \$147,000 in 2022. Adjustments to the annual Social Security wage base are indexed to the average wage index. The projected 2023 wage base may be revised if economic developments fluctuate unexpectedly later this year.



IRS increases mileage rate

In an unusual move to help taxpayers with rising fuel costs, the IRS [announced](#) the mileage reimbursement rate will increase to 62.5 cents per mile for July 1, 2022 – December 31, 2022. Reimbursements of up to 62.5 cents per mile paid to an employee for business mileage may be exempt from payroll taxes during this period. The previously stated rate of 58.5 cents per mile will remain in effect for the period January 1, 2022 – June 30, 2022.



IRS foreign per diem rate updates

The IRS published current [per diem rates](#) for foreign locations as of June 1, 2022, reflecting updates to more than 80 jurisdictions.



Local payroll tax updates

- Jersey City, NJ - Beginning in 2019, Jersey City, New Jersey imposed a 1% tax on most wages that are subject to federal income tax withholding paid for services either rendered within Jersey City or rendered by an individual outside the city, if direction and control over the services is performed within the city (i.e. telecommuting). The tax is not imposed on wages paid to city residents and is employer-funded. The employer may not deduct the tax from the employees' wages.

At the time the tax was implemented, certain Jersey City employers sued the city arguing the tax is not legal under the federal Commerce Clause since wages paid to city residents are exempt. In March 2019, the Superior Court of New Jersey upheld the constitutionality of the tax and dismissed the complaint. The Appellate Court upheld the trial court's dismissal with respect to the tax imposed on nonresidents performing services within the city. Citing insufficient evidence, the Appellate Court remanded the matter of telecommuter wages.

On May 31, 2022, in a 5-1 [ruling](#), the New Jersey High Court affirmed the Appellate Court's decisions. Therefore, barring a reversal from the U.S. Supreme Court, the Jersey City payroll tax shall continue to be imposed on wages paid to nonresidents performing services in the city, but not to residents of the city. It is uncertain if the telecommuter section of the law will

be revisited. However, employers in Jersey City supervising the activities of employees performing services outside the city should continue to report and remit payroll tax on those wages.

- **Cincinnati, OH** – The Ohio Supreme Court will review a lower court decision to dismiss a suit against the City of Cincinnati arguing that the city cannot impose local income taxes on employees performing services outside Cincinnati for a Cincinnati employer for the COVID-19 pandemic period. The High Court had denied a request to hear a similar suit against the City of Columbus, OH that was dismissed by the lower court 2 months earlier.
- **City of Hazelton, PA** – A 0.26% tax on employer’s City of Hazelton payroll (called a Payroll Preparation tax) took effect January 1, 2022. The tax is employer-funded and may not be withheld from employees’ wages. The return and tax will be due the 2nd month following the end of each quarter (May 31, August 31, November 30, February 28).
- **Scranton, PA** – A 0.2787% tax on employer’s Scranton payroll (called a Payroll Preparation tax) took effect January 1, 2022. The tax is employer-funded. The return and tax will be due the 2nd month following the end of each quarter (May 31, August 31, November 30, February 28). However, the first deadline was extended to June 30, from May 31, to allow employers additional time to process the new tax.



Meet one of our Employment Tax professionals: Monica Wajsman

Monica Wajsman, a senior manager, has been with the KPMG Employment Tax practice in Atlanta for over 10 years and has assisted clients in a variety of industries and market sizes with restructurings, tax refund claims, notice resolution, and more. On fall weekends, you can find her cheering on the University of Georgia Bulldogs!

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