Employer Taxes, with a Focus on Payroll Taxes

Senate Finance Committee

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Outline of talk

Part 1: What taxes do employers pay?

Part 2: How does the payroll tax work?

Part 3: Payroll tax considerations

Part 1: What taxes do employers pay?

Employer taxes

- The taxes that employers generally must pay every pay period include
  - Federal income tax
  - State and local income tax
  - Federal and state unemployment insurance, workers compensation
  - Social Security and Medicare taxes [commonly known as “payroll taxes”]
- Employers are responsible for
  - deducting the correct amount of taxes from their employees’ wages
  - calculating their own share of taxes
  - depositing the payments
  - filing returns with government agencies on time

Federal income taxes

- For 2022 and 2023, seven federal tax brackets apply depending on taxable income and filing status
- For taxes due in April 2023 ➔
- Progressive tax structure:
  - Tax rate increases with taxable income

Married, filing jointly

Tax rate	Taxable income bracket	Taxes owed
10%	$0 to $20,550.	10% of taxable income.
12%	$20,551 to $83,550.	$2,055 plus 12% of the amount over $20,550.
22%	$83,551 to $178,150.	$9,615 plus 22% of the amount over $83,550.
24%	$178,151 to $340,100.	$30,427 plus 24% of the amount over $178,150.
32%	$340,101 to $431,900.	$69,295 plus 32% of the amount over $340,100.
35%	$431,901 to $647,850.	$98,671 plus 35% of the amount over $431,900.
37%	$647,851 or more.	$174,253.50 plus 37% of the amount over $647,850.

Vermont income taxes

- For 2022 and 2023, four Vermont tax brackets apply, depending on Vermont taxable income and filing status
- For taxes due in April 2023 ➔
- Progressive tax structure: Tax rate increases with taxable income

Married Filing Jointly, Schedule Y-1
Use if your filing status is:
Married Filing Jointly; Qualifying Widow(er); or Civil Union Filing Jointly

If VT Taxable Income is Over	But Not Over	VT Base Tax is	Plus	of the amount over
0	68,400	0.00	3.35%	0
68,400	75,000	2,291.00	6.60%	68,400
TAXABLE INCOME UNDER $75,000 USE THE TAX TABLES				
75,000	165,350	2,727.00	6.60%	75,000
165,350	251,950	8,690.00	7.60%	165,350
251,950	-	15,272.00	8.75%	251,950

Federal unemployment taxes

- Federal unemployment taxes (FUTA) range from 0.6% to 6.0% on the first $7,000 of wages per worker
  - Submitted to IRS to pay for the cost of administration of state programs, the federal cost of extended unemployment benefits, and loans to states when state unemployment trust funds experience shortfalls and must borrow to pay benefits
  - Vermont's current federal UI tax rate is 0.6%
  - It was higher when the State had borrowed to support its UI Trust Fund, most recently in April 2011 when it borrowed $77.7 million

State unemployment insurance (UI) taxes

- State law determines Vermont UI taxes; they depend on the funding in the UI Trust Fund and on an employer's UI experience
  - The Vermont Dept. of Labor administers the UI program
  - Vermont established five statewide Tax Rate Schedules
    - The middle tax schedule, Schedule 3, is designed to provide a sustainable level of funding across the business cycle. Schedules 1 and 2 have lower rates. During the current fiscal year (FY 2023), Vermont is using Schedule 1.
  - Vermont has 21 Tax Rate Classes for businesses, depending on each employer's "experience rating" based on the past three years (but not 2020)
- For more details, see the new JFO Issue Brief:
  - "How Unemployment Insurance Tax Rates Are Determined"
  - https://ljfo.vermont.gov/assets/Subjects/General/26204f4e26/GENERAL-364034-v3-How_UI_Tax_Rates_Are_Determined-v3.pdf

Vermont UI tax rates depend on Tax Rate Schedule and Tax Rate Class

Table 1. Vermont UI Tax Rate Classes and Tax Rate Schedules

Tax Rate Class	Tax Rate Schedule 1	2	3	4	5
0	0.4	0.6	0.8	1.1	1.3
1	0.5	0.7	0.9	1.2	1.5
2	0.6	0.8	1.1	1.4	1.8
3	0.7	1.0	1.4	1.7	2.1
4	0.8	1.2	1.7	2.0	2.4
5	0.9	1.4	2.0	2.3	2.7
6	1.1	1.7	2.3	2.6	3.0
7	1.4	2.0	2.6	2.9	3.3
8	1.7	2.3	2.9	3.2	3.6
9	2.0	2.6	3.2	3.5	4.0
10	2.3	2.9	3.5	3.8	4.4
11	2.6	3.2	3.8	4.1	4.8
12	2.9	3.5	4.1	4.5	5.2
13	3.2	3.8	4.4	4.9	5.6
14	3.5	4.1	4.7	5.3	6.0
15	3.8	4.4	5.0	5.7	6.4
16	4.1	4.7	5.3	6.1	6.8
17	4.4	5.0	5.6	6.5	7.2
18	4.7	5.3	5.9	6.9	7.6
19	5.0	5.6	6.2	7.3	8.0
20	5.4	5.9	6.5	7.7	8.4

Source: Vermont Department of Labor, Unemployment Tax Rates. https://labor.vermont.gov/unemployment-insurance/ui-employers/unemployment-tax-rates

Workers' compensation

- The workers' compensation insurance rate depends upon the employer's payroll, experience rating (safety record) and the type of work performed.
  - A work injury can affect an employer's safety record and experience rating for a 3-year period.
  - Large employers with a good safety record may be able to obtain coverage in the voluntary market and will likely obtain lower rates than through the state
  - https://labor.vermont.gov/sites/labor/files/doc_library/Fact_Sheet_For_Employers.pdf
- Program administration is split
  - The Department of Financial Regulation - Insurance Division regulates issues relating to insurers and the insurance market
  - The Department of Labor deals with program administration and issues relating to claims

Payroll taxes

- Payroll taxes are generally levied on wages, tips, and salaries and are collected to support specific programs
- Federal Insurance Contribution Act (FICA) taxes support the federal Social Security and Medicare programs
  - The total due every pay period is 15.3% of an individual's wages – half of which is paid by the employee and the other half by the employer.
  - Each party pays 6.2% for Social Security up to a wage base limit of $160,200 in 2023
    - That wage base is adjusted annually by the average growth in wages
  - Each party pays 1.45% for Medicare with no limit
  - Employees who earn more than the amounts below may be charged an additional 0.9% for Medicare; employers do not have to pay a match
    - $250,000 for married filing jointly;
    - $125,000 for married filing separately; and
    - $200,000 for all other taxpayers.

Payroll taxes for the self-employed

- The self-employed pay Self-Employed Contributions Act (SECA) taxes on net earnings.
  - SECA taxes also fund Social Security and Medicare
  - The self-employed pay both the employee and the employer share of SECA
    - 15.3% total for both Social Security (up to $160,200) and Medicare (no limit)
    - Additional 0.9% if net earnings exceed $250,000 married filing jointly, etc.
  - The law permits the self-employed to deduct half of the self-employment tax as a business expense

Part 2: How might a new payroll tax work in Vermont?

IF a new payroll tax were proposed for Vermont

- Tax base: Wages in Vermont in 2021
  - Total wages ~$16.8 billion
  - Number of taxpayers ~400,000
- Suppose cap Vermont wages at the Social Security taxable maximum
  - This approach was taken in past versions of Paid Family Leave proposals
  - As of 2021, the Social Security cap was $142,800
  - Capped wages would be about 92 percent of total wages (83% in the U.S.)
- Suppose cap Vermont wages at twice the Social Security maximum
  - This approach appears in the current H.66 Paid Family Leave bill
  - Twice the cap in 2021 was $285,600
  - Covered about 96 percent of total wages
- Suppose exempt individuals earning no more than $25,000 in wages
  - Number of remaining taxpayers about 234,000; about 166,000 exempt
  - Cover about 91 percent of total wages

Challenges of administering a new payroll tax

- It is likely that the Department of Taxes would administer a new payroll tax
  - One very big challenge would be imposing a new payroll tax on self-employed workers, if required or part of a voluntary program
    - The Department of Taxes is working on estimating the size of the self-employed tax base
  - If very low earning individuals were exempt, it would be important to add all W-2s for each individual to be sure of their exempt status
    - The current approach in H.66 would be to offer a refund when an individual files a tax return
    - Could create a liquidity or cash flow problem for some

Part 3: Considerations regarding a payroll tax

Payroll tax considerations

- Progressivity difficult to achieve with a payroll tax
  - Above a certain earnings level, higher wages lead to a smaller share of one's income going to payroll taxes
- Falls only on employees
  - Missing are retirees, people living on returns from wealth and other non-wage income, people not in the formal workforce
- However, generally does not allow deductions, exemptions, and credits that narrow the tax base
- Labor does not respond much to small changes in take-home wages (low elasticity), so payroll taxes lead to a relatively small amount of economic inefficiency
  - Difficult to evade payroll taxes

Thank you!