



Payroll Insights

Employment tax news to guide you
now and for the future

March 2025



John's fresh take: Payroll compliance and efficiency for the 2025 tax year

As we are into a new tax year, it's imperative to confirm, if you haven't already, that your payroll systems and processes are updated to reflect the latest changes in 2025 tax law and inflation adjustments, such as tax wage limits and rates with respect to Social Security, federal unemployment insurance, state unemployment insurance, and Internal Revenue Code §401(k) contribution thresholds. By now, all states should have provided employers with updated state unemployment insurance tax rate notices for 2025. If you engage a third-party payroll provider or unemployment claims company, then you should have provided these rate notices to them and confirmed that the 2025 rates are in place before the April 30 filing and payment deadlines. Some states impose significant penalties for underpayment and might impose a penalty tax rate for a subsequent year.

Now is also a good time to reflect on and review year-end processes from 2024. With the close of the 2024 Form W-2 filing season, employers should take the opportunity to review their year-end processes for efficiencies, areas of improvement, and potential updates for 2025. Any changes to the process should be considered now to help ensure that they are implemented and appropriately tested before the 2025 year-end process begins.

Federal updates

Employee Retention Credit lawsuits

The Internal Revenue Service (IRS) is currently facing multiple lawsuits related to their processing of Employee Retention Credit (ERC) claims and the time it has taken to review all requests. At the end of 2024, Daniel Warfel, the former IRS Commissioner, announced a goal to cut into the backlog of claims (1.2 million in October 2024) by about half. However, there were no details regarding the process the IRS would employ to reach that goal and recent developments with changes to commissioners and staffing levels will likely impact the go-forward approach.

In late 2024, Stenson Tamaddon LLC (Stenson) and ERC Today LLC (ERC Today) brought a case against the IRS in federal district court in Arizona to stop the use of the automated software. Stenson and ERC Today claim that the software unduly disallowed claims that were legitimate. The injunction cites the Tax Advocate Service (TAS) as having confirmed the "most recent batch of ERC disallowances and the process the IRS will use to review taxpayers' responses to these



denials deviates significantly from normal IRS procedures.” If the filed injunction is successful, then it would mean even longer processing times for claims given the IRS would have to manually review each one (*ERC Today LLC et al. v. McInnelly et al.*).

Similarly, North Sunflower Medical Center (NSMC) has also brought suit against the IRS—this time for a disallowed claim. The case, which was filed in the US District Court for the Northern District of Mississippi on February 13, 2025, argues against the IRS’s denial of the hospital’s claim for \$8.6 million despite “hundreds of pages” of documentation. The hospital claims that the IRS “ignored tremendous disruptions to NSMC brought on by COVID related governmental orders”—specifically OSHA mandates, CDC rules, and state orders.

In addition to the \$8.6 million credit, the plaintiff has also requested the court grant damages to cover attorneys’ fees and “other relief as this Court deems necessary (*North Sunflower Medical Center v. United States of America*).

President Trump formally nominates William Long as IRS Commissioner

Daniel Werfel resigned as the IRS Commissioner effective January 20, 2025. In addition, Acting Commissioner Douglas O’Donnell retired effective February 27, 2025. Melanie Krause is now the Acting Commissioner.

President Trump announced his [nomination of William Long](#) to serve as the next IRS Commissioner for the remainder of Werfel’s term, expiring November 2027.

US Court of Appeals for the Fifth Circuit grants delay in independent contractor rule case

The US Court of Appeals for the Fifth Circuit passed a motion filed by the US Department of Justice (DOJ) to delay oral arguments in a legal challenge brought by trucking companies, challenging the 2024 updates to worker classification. The 2024 independent contractor rules being challenged were enacted under the Biden administration and reinstated the “Economic Realities Test,” replacing the guidelines set during the previous Trump administration.

The DOJ requested 60 days to give the incoming leadership under the Trump administration at the US Department of Labor (DOL) sufficient time to review the case and determine next steps. The oral arguments were originally scheduled for February 5, 2025. A decision regarding the oral arguments will now be made after the Court receives a status report from the DOL, due by March 25, 2025.

The new rules and subsequent appeals are creating confusion among some employers who are trying to maintain compliance with worker classification while balancing business considerations (*Frisard’s Transp., LLC v. United States DOL*).

IRS released draft Form 941-X

The IRS released a draft revision of [Form 941-X, Adjusted Employer’s Quarterly Federal Tax Return or Claim for Refund](#), removing the remaining lines related to the COVID-19-era ERC. The draft revision of Form 941-X marks lines 18a, 26a, and 30–32 as reserved for future use. In the prior versions of Form 941-X, these lines are all related to the ERC.

The draft revision has an April 2025 revision date that, if finalized, would replace the April 2024 version of Form 941-X. Until the draft revision is finalized, employers should continue to use the April 2024 version of Form 941-X to file their amended quarterly returns.

IRS released Form W-4 in Haitian Creole

The IRS released its first Form W-4 in Haitian Creole. The [2025 Form W-4](#) is now translated into seven languages: Spanish, simplified Chinese, traditional Chinese, Korean, Russian, Vietnamese, and Haitian Creole.

However, the IRS’s Tax Withholding Estimator, which is mentioned on all versions of Form W-4, remains available in English and Spanish only.

Potential 2025 FUTA credit cuts

The [Federal Unemployment Tax Act \(FUTA\)](#) provides for a tax of 6 percent of wages up to an annual wage base of \$7,000. A credit against FUTA tax of up to 5.4 percent may be available to employers for payments to state unemployment insurance, resulting in a net FUTA tax rate of 0.6 percent.

Employers are subject to a reduction in the FUTA credit if they have employees performing services in states that have an outstanding balance of advances from the federal government on the first day of the year for two or more consecutive years and that balance is not repaid before November 10 of the taxable year, pursuant to sections 3302(c)(2) and 3302(d)(3) of the FUTA. This credit reduction effectively increases the FUTA tax rate for employers.

The DOL announced potential FUTA tax credit reductions for 2025 for California, Connecticut, New York, and the US Virgin Islands.

The potential 2025 FUTA credit reduction for California, Connecticut, and New York is 1.2 percent. If the credit reduction is imposed, employers in these states could pay an effective FUTA tax rate of 1.8 percent or up to \$126 per employee. The potential 2025 FUTA credit reduction for the US Virgin Islands is 4.5 percent, which would equal a 5.1 percent effective FUTA tax rate or up to \$357 per employee.

These credit reduction rates do not include any benefit-cost rate (BCR) add-on, which can be assessed on states that have an outstanding federal advance for five consecutive years. If the DOL assesses the BCR add-on, the total estimated 2025 potential credit reduction would be 4.9 percent for California, 2 percent for Connecticut, and 2.3 percent for New York.

If your company utilizes a third-party payroll provider, then you may find that they impose a surcharge in anticipation of credit reductions and then refund the overcollection if the applicable state is not ultimately assessed a FUTA tax credit reduction.

Foreign per diem rates

The US Department of State updated its foreign [per diem rates](#), effective February 1, 2025, for more than 185 locations. Foreign per diem rates are updated monthly by the Office of Allowances as maximum US dollar rates for US government employees travelling on official business in foreign areas. The IRS also allows nongovernment employers use these rates for the purposes of determining nontaxable business expense reimbursements.

Employers should continuously monitor the foreign per diem rates to ensure that they are not underreporting taxable wages and consequently underpaying employment taxes.

Secretary United States Department of Labor v. Nursing Home Care Management Inc.

The US Court of Appeals for the Third Circuit upheld the ruling in which the [DOL](#) required Prestige Home Care Agency to pay their employees for time spent travelling between their office and client sites. According to Judge David J. Porter, the Fair Labor Standards Act was interpreted correctly by the lower court when it determined that the law and “accompanying regulations requires compensation for work-related travel during the workday.” The ruling is considered precedential, and the penalty payment includes back pay owed to the affected employees and liquidated damages.

Arizona passes bill to exempt service tips from state income tax

Ending state income tax on tipped income is listed as a priority on the Arizona's House of Representatives [2025 agenda](#). House Bill 2081, which exempts tipped income from state income tax, has now been passed. The bill will move to Senate for consideration.

If the bill is enacted, then the exemption of tipped income from state income tax would be effective for taxable years beginning after December 31, 2024.

Arkansas bill proposes withholding exemption for employers for certain remote and mobile employees

Arkansas House Bill 1116 proposes an exemption for employers from withholding taxes for qualifying mobile employees who work in the state for 15 or fewer days during the tax year. If an employee exceeds the 15-day threshold, then the withholding and filing requirements apply for every day including the first 15 days.

The bill also proposes an income tax exemption for remote and mobile employees working in the state. However, the threshold for exemption from income tax is not days based but dollar based. An employee with total income earned for employment duties performed in the state of \$2,500 or less will be exempt from income tax.

If enacted, the bill would be effective for taxable years beginning on or after January 1, 2026.

Illinois: *Mercado v. S&C Electric Co.*, 2025 IL 129526

The Illinois Supreme Court overturned a previous decision made by the lower courts to dismiss a case brought by two former employees of S&C Electric Co. who claimed the company underpaid their overtime wages by incorrectly excluding performance bonuses from their regular rate of pay used to calculate overtime pay.

S&C Electric Co. argued that performance bonuses were statutorily excluded from the regular rate of pay because the department's definition of regular rate of pay excludes gifts that are not measured by or dependent on hours worked. However, the plaintiffs argued that the performance bonuses were not gifts but compensation for their services performed at the company.

The court agreed with the plaintiffs, stating that the exclusion of gifts from the definition of regular rate of pay should be read as a description of payments similar to gifts, which are given freely and not in exchange for labor. The performance bonuses were deemed not gifts by the court and consequently should have been included in the regular rate of pay for calculating overtime wages.

Minnesota proposes income tax exemption for qualifying nonresident employees

A Minnesota bill ([Minnesota Bill S.F. 46](#)), introduced on January 16, 2025, proposes an exclusion from income tax for qualifying nonresident employees who temporarily relocate to Minnesota for their jobs, provided they work in the state for fewer than 30 days in a taxable year.

The bill would also exempt employers from the withholding requirements and related filing requirements for qualifying nonresidents who work in the state for fewer than 30 days. If an employee exceeds the 30-day threshold, then the withholding and filing requirements apply for every day including the first 30 days.

To qualify as an exempt nonresident employee, an individual must meet the following criteria:

- (1) Their residence, place of abode, and customary return location for at least once a month is in another state
- (2) They receive wages for employment duties, excluding those as an entertainer, in Minnesota for 30 or fewer days within the taxable year
- (3) They perform employment duties in more than one state during the calendar year
- (4) Their state of residence offers a similar tax exclusion, does not impose an individual income tax, or their income is exempt from Minnesota taxation under the United States Constitution or the Internal Revenue Code.

The proposed bill also outlines the use of a time and attendance system by employers to precisely track the work locations of employees for tax purposes. This system is intended to ensure compliance and safeguard employers from penalties related to nonwithholding, provided they rely on accurate data or reasonable assessments made by employees regarding their time spent working in Minnesota.

If enacted, the bill would be effective for taxable years beginning after December 31, 2025.

Mississippi House of Representatives passes bill to phase out income tax

The Mississippi House of Representatives passed [House Bill 1](#) to phase out income tax over the next 10 years.

If enacted, the income tax rate would be reduced to 3 percent in 2027, and would be further reduced by 0.3 percent each year until the income tax is fully phased out in 2037.

New York State Department of Taxation and Finance is streamlining the process to report wages and withhold tax

The [New York State Department of Taxation and Finance](#) announced that it is streamlining the process for businesses to report wages and withholding taxes, effective March 2025. The key changes include:

- Employers will now be able to e-file all withholding returns, including amended returns, and the improved online applications will automatically perform all calculations to reduce errors.
- When using the online system to amend returns, if the original return was e-filed, all information will prepopulate on an amended return to make the amended return easier and faster for employers.
- On Form NYS-45, *Quarterly Combined Withholding, Wage Reporting, and Unemployment Insurance Return*, all parts must be filed together as a single return. This includes Part A – *Unemployment insurance (UI) information*, Part B – *Withholding tax (WT) information*, and Part C – *Quarterly employee/payee wage reporting and withholding information*.
- If amending Form NYS-45 or Form NYS-1, *Return of Tax Withheld*, a complete, new filing (including **all** return parts and **all** employee records, not just the changes) must be submitted to avoid processing delays and penalties. If amending Form NYS-1, the payroll date previously reported must be included.
- There will be some new, updated or discontinued withholding tax and wage reporting forms and publications.

Seattle ballot for additional payroll expense tax approved by voters

On February 11, 2025, Seattle voters voted on two alternative propositions, Proposition 1A and Proposition 1B, concerning a new payroll expense tax that is separate from the existing [Seattle payroll expense tax](#). Proposition 1A would levy a 5 percent payroll expense tax on employers doing business in Seattle and paying an annual compensation over \$1 million to any employee in Seattle. The proceeds from the proposed tax would help fund the Social Housing Developer, a public development authority to develop and maintain social housing in Seattle. Proposition 1B was proposed by the Seattle City Council and mayor as an alternative to Proposition 1A. Proposition 1B proposed to allocate \$10 million a year for the next five years from the existing payroll expense tax to fund the Social Housing Developer.

Voters were first asked if one of the propositions should be enacted, and then regardless of their answer to question one, whether Proposition 1A or Proposition 1B should be enacted. Voters voted that Proposition 1A should be enacted. When enacted, Seattle employers will be required to pay two separate payroll expenses taxes at the same time, due quarterly. The new tax would be applied retroactively to January 1, 2025.

Minimum wage updates:

[Los Angeles, California](#) – The minimum wage in the City of Los Angeles will increase from \$17.28 to \$17.87 per hour effective July 1, 2025.

[Los Angeles County, California](#) – The minimum wage in Los Angeles County will increase from \$17.27 to \$17.81 per hour effective July 1, 2025.

[Washington, D.C.](#) – The minimum wage in the District of Columbia will increase from \$17.50 to \$18 per hour effective July 1, 2025.

[Bernalillo County, New Mexico](#) – The minimum wage in Bernalillo County, New Mexico, increased from \$10.30 to \$10.60 per hour effective January 1, 2025. However, the state's minimum wage of \$12 per hour supersedes the County's minimum wage.

[Santa Fe County, New Mexico](#) – The living wage in Santa Fe County, New Mexico, will increase to \$15 per hour effective March 1, 2025.

[Burien, Washington](#) – The City of Burien, Washington, adopted a minimum wage ordinance to take effect on January 1, 2025. According to the ordinance, the minimum wage in the city is \$19.66 per hour for Level 1 employers and \$18.66 per hour for Level 2 employers. The rate is determined based on adding \$3 and \$2 to the state's minimum wage for Level 1 and Level 2 employers, respectively. Level 1 employers are defined as employers who employ more than 500 full-time employees in King County. Level 2 employers are defined as employers who employ between 21 and 499 full-time employees in King County. Level 3 employers (employers who employ 20 or less full-time employees) are exempt from the ordinance.

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