

Potential Payroll Tax Deferral Is Available - Employers Must Understand the Program and Use Extreme Caution Before Blindly Jumping Into the Deferral Pool

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On August 8, 2020, President Trump issued an [executive order](#), directing the U.S. Treasury to grant employers the ability to defer the withholding, deposit and payment of certain payroll taxes as further COVID-19 tax relief. The deferral applies only to the employee portion of Social Security taxes and Railroad Retirement taxes (i.e., 6.2 percent of wages) required to be withheld and paid under Internal Revenue Code ("Code") Sections 3101(a) and 3201(a) from September 1, 2020 to December 31, 2020.

PRACTICE ALERT: The deferral does **not** apply to required employee Medicare tax withholdings under Code Section 3101(b) (either the standard 1.45 percent on all wages or the additional 0.9 percent tax on wages in excess of \$200,000). Further, the deferral is not available for the employer's share of Social Security (6.2 percent) or Medicare (1.45 percent) taxes.

IRS NOTICE 2020-65

On August 28, 2020, the IRS issued [Notice 2020-65](#), providing guidance relative to the president's executive order. It provides answers to several important questions.

Notice 2020-65 defines employers required to withhold and pay Social Security and Railroad Retirement taxes as "Affected Taxpayers." It goes on to provide that the due date for withholding and payment of the employee portion of Social Security taxes and Railroad Retirement taxes for the period September 1, 2020 to December 31, 2020 is postponed until the period commencing January 1, 2021 through April 30, 2021.

CLARIFICATION

Notice 2020-65 also clarifies that:

- The wages subject to the deferral ("Applicable Wages") are wages paid during the September 1, 2020 through December 31, 2020 period, but only if the amount paid for a bi-weekly payroll period is less than \$4,000 (\$104,000 annually) or the equivalent threshold for other payroll periods.
- The Applicable Wage amount is to be determined each pay period, and if the amount of wages for an employee is less than the applicable dollar threshold, then that amount is considered "Applicable Wages" for the pay period, irrespective of wages paid to the employee in other pay periods.
- The Affected Taxpayer (i.e., the employer) must withhold and pay the deferred taxes ("Applicable Taxes") ratably from wages and compensation paid between January 1, 2021 and April 30, 2021.
- If the taxes are not paid as prescribed in the executive order, interest and penalties will begin to accrue on May 1, 2021.
- If necessary, employers may "make arrangements to otherwise collect the total Applicable Taxes from the employee."

PITFALLS

Although it appears seemingly simple, employers must proceed with caution. They need to understand the framework and the implications of the payroll tax deferral before determining whether to participate. Deferral may not be appropriate for all employers. Several potential pitfalls exist.

First, the deferral is permissive. Employers are not required to defer the withholding and payment of the Applicable Taxes.

Second, deferred taxes must ultimately be paid by April 30, 2021 unless Congress acts to further defer the obligation or eliminate the obligation altogether through some form of tax forgiveness program. Unpaid taxes will be subject to penalties and interest after that date.

Third, employers should understand that the deferred taxes are both the *employee's* and *the employer's* tax obligation, with potential adverse implications if unpaid.

Impact on the Employee

The deferred taxes are the employee's obligation because, absent Congressional action to forgive the taxes, the taxes must be withheld from the employee's pay during the four-month period from January 1, 2021 and April 30, 2021. This means, for the average employee, their pay will effectively be subject to double-withholding during that time—the regular 7.45 percent combined Social Security and Medicare taxes, plus the deferred 6.2 percent of deferred Social Security taxes. The extra tax burden during the four-month repayment period could be a shock to employees who don't realize that the taxes must ultimately be paid and whose take-home pay substantially drops in January.

PRACTICE ALERT: What happens if the employee is no longer employed? The tax obligation does not go away.

For some perspective on this, take the example of an employee making \$52,000 per year, and receiving a bi-weekly paycheck of \$2,000. The deferred tax liability would be about \$248 per month (\$124 per paycheck). Although the employee's take-home pay would be \$124 higher per paycheck during the last few months of the year, come January, the employee's take-home pay, assuming he or she remains employed, would drop by \$248 per check (\$496) per month for the next four months as the deferred payroll taxes are repaid. This could come as quite a shock after the expensive holiday season that most American households face. Why would the take-home pay appear to drop by double the amount of the increase? Simple math. During the January 2021 through April 2021 period, the employer is still required to withhold the normal \$124 of Social Security taxes, but it will now be obligated to withhold an additional \$124 to make up for the deferred taxes. As a result, when the employee looks at difference in take-home pay between the last paycheck in December and the first paycheck in January, the difference would be \$248-double the amount of the deferral. For employees who have gotten used to spending the extra take-home pay during the deferral period, this may make for a not-so-happy new year.

The deferral is really an interest-free loan. Employees who don't understand the financial impact of the deferral and who live paycheck to paycheck may face additional financial stresses when it's time to repay the government. Employers electing to defer the taxes should *clearly* communicate this message to employees. Adverse employee morale could easily result from poor communication surrounding the deferral. Likewise, employers will want to alert employees that the obligation will not go away if they are no longer employed.

Impact on the Employer

Employers should also remember that the deferred tax obligation is also *their* tax obligation as well. Under the federal payroll tax withholding framework, employers who fail to withhold and pay over the employee's share of Social Security and Medicare taxes are generally liable to pay the taxes that should have been withheld. As a result, employers choosing to participate in the deferral program are taking on some risk regarding the non-payment of the deferred tax liability. Although the notice provides that employers must withhold and remit the deferred taxes during the January 2021 through April 2021 timeframe, there is still some risk to employers.

For example, if an employee voluntarily quits work or is otherwise terminated by the employer before April 2021, the employer could be on the hook for unpaid taxes. Although Notice 2020-65 provides that employers may "make arrangements" to separately collect the deferred taxes from the employee,

employees who are no longer working may not have the funds to pay the taxes, whether out of their final paycheck or otherwise. In such cases, the employer, in the absence of action by Congress to forgive the taxes, would remain liable for the unpaid taxes, and pursuing the terminated employee for the remaining taxes due may be more trouble than it's worth from both a cost and time standpoint.

PRACTICE ALERT: Employers with high turnover in their workforces should be cautious before electing to participate in the deferral program.

PRACTICE ALERT: Employers should be careful to comply with the mechanics of the deferral program. It only applies to employees who, in any bi-weekly paycheck, receive wages of less than \$4,000 (or the equivalent amount for other pay periods). For an employee earning more than the \$4,000 threshold, no deferral is allowed—even on amounts below the \$4,000 limit. Thus, an employee earning \$3,999 on a bi-weekly basis is eligible for deferral, while an employee earning \$4,001 on a bi-weekly basis is not eligible to have any taxes deferred. If employers are not careful, they could end up facing under-withholding and non-payment penalties and interest.

PRACTICE ALERT: Employers, even if the deferral is elected, still must timely withhold and remit Medicare taxes from employees' pay. Employers that erroneously fail to withhold and remit Medicare taxes will, as is always the case, still be responsible to pay the taxes and will be subject to penalties and interest.

Unanswered Questions

IRS Notice 2020-65 leaves some questions unanswered, including:

- In order for an employer to participate in the deferral opportunity, does the employer have to defer with respect to all eligible payroll? In other words, is it an all-or-nothing game?
- If an employee does not want to participate in the deferral, can the employer exclude that employee?

CONCLUSION

Employers need to fully understand the impact of President Trump's payroll tax deferral order before deciding to participate. Absent an act of Congress to forgive the tax liability, the employer is ultimately on the hook for the deferred taxes. Without clear communications to employees about the implications on their personal finances and future paychecks, employee morale could take a hit come January. Caution is advised!

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