

Recent Guidance on Employee Payroll Tax Deferral: Implementation Steps and Employer Discretion

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The Internal Revenue Service (IRS) recently issued Notice 2020-65 (Notice), which provides guidance regarding the employee payroll tax deferral that was announced by the White House on the August 8, 2020 (Executive Order). The Executive Order addressed the deferral of payroll tax obligations in light of the ongoing COVID-19 pandemic and directed the Treasury Department to use its authority under Code Section 7508A to defer the withholding, deposit and payment of the employee portion of Social Security tax on wages paid during September through December 2020, subject to certain wage limits. The Executive Order also directed the Treasury Department to explore avenues, including legislation, to eliminate the obligation to pay the tax that was deferred.

The Notice provides details on the implementation of the Executive Order and, in an indirect way, addresses if employers have discretion to determine whether to implement the deferral. The key aspects of the Notice are summarized below.

Employer Discretion

Neither the Executive Order nor the Notice specifically address the issue of whether employers are required to implement the deferral. This absence of clarity has raised questions from many employers regarding their obligation to defer the employment tax. However, the IRS has indirectly addressed the discretion issue through information provided on their Notice 2020-65 Hotline, which is referenced at the end of the Notice. The Hotline states that the deferral is optional for employers, leaving employers with the ability to choose whether to participate in the deferral.

Covered Tax

The deferral only applies with respect to the employee portion of the Social Security tax (and the railroad retirement equivalent). As a result, income tax withholding, the employer portion of Social Security and Medicare tax must still be withheld and deposited. The relief provided in the Notice is solely a deferral of the timing of the payment of the employee portion of the Social Security tax. While the Executive Order mentions the possibility of converting the deferral into tax forgiveness, the Notice only addresses the deferral of the tax payment and does not mention tax forgiveness.

Applicable Wages

The employee portion of Social Security tax relates to wages paid on a pay date during the period from September 1, 2020 through December 31, 2020, but only if the wages are less than \$4,000 calculated on a bi-weekly basis for the applicable pay period. The \$4,000 corresponds to \$104,000 of annual income and \$36,000 of income for the period from September through December 2020. Based on a 6.2% Social Security tax rate, the maximum tax subject to deferral is \$2,322 per employee (6.2% tax rate times \$36,000).

The \$4,000 threshold is to be recomputed for other pay periods, such as weekly or monthly, to create an equivalence. The \$4,000 seems to be a hard cap, so if the amount of wages is equal to or greater than \$4,000 (or the recomputed pay period equivalent), then none of the wages qualify. The \$4,000 threshold is computed for each applicable pay period, so it is possible for wages to qualify for

one pay period and not qualify for another pay period.

Deferral Mechanics

The deferral is accomplished by shifting the payment of the taxes otherwise payable from September through December 2020 to the period from January 1, 2021 through April 30, 2021. The deferral mechanics are creating most of the questions and concerns from employers. For example, if employee X has wages for the period from September 1, 2020 through December 31, 2020 and the deferred Social Security tax for this period was \$900, the \$900 of deferred tax is then withheld ratably based on employee X's wages that are paid from January 1, 2021 through April 30, 2021. If employee X is paid the same amount for each pay period from January 1, 2021 through April 30, 2021 (assume this is nine pay periods), one-ninth of the \$900 is to be withheld and paid during each pay period from January 1, 2021 through April 30, 2021. This withholding is in addition to the otherwise required withholding for the wages from January 1, 2021 through April 30, 2021.

The deferral mechanics work if an employee is employed from September 1, 2020 through April 30, 2021 since the employer can then withhold the deferred tax from the January 1, 2021 through April 30, 2021 wages. In any other scenario, such as an employee quitting or being fired before April 30, 2021, the intended mechanics do not work well. Employers are then required to develop an alternative tax collection mechanism and determine if the alternative mechanism is consistent with federal, state and local employment tax laws as well as applicable employment contracts.

Observations

From a pure economic perspective, the present value of a four month employee tax deferral is likely to be less than \$200 per employee. Employers will need to balance the uncertainties associated with dealing with employee withholding in January through April 2021 and the additional compliance cost with what seems to be a limited economic benefit to employees. This calculus would change, however, if the IRS (or Congress) provides guidance regarding the forgiveness of the tax.

To discuss how the Executive Order and Notice applies to your business, please contact James Anelli (anellij@whiteandwilliams.com; 201.368.7224).

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