CLIENT ALERTS & INSIGHTS

Payroll Tax Deferral: (Some) Questions Answered

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On August 8, 2020, President Trump issued a Presidential Memoranda allowing for the deferral of employees' payroll tax obligations. Notably, this Presidential Memoranda does not change any obligation to pay these taxes; it allows only for a change in timing.

On August 28, 2020, the IRS issued guidance (Notice 2020-65) explaining how employers are to implement the deferral. The guidance, issued 2 business days prior to the September 1, 2020 effective date of the deferral, provided some detail on the executive action while leaving other questions unanswered:

Are employers required to participate in the deferral? No. Nothing in the Presidential Memorandum or the IRS guidance states that employers must facilitate the deferral. And the guidance is directed to the "Affected Taxpayer," i.e., the employer and not the employee.

What tax can be deferred? The deferral applies to the 6.2% social security payroll tax imposed under 26 U.S.C. § 3101(a). While the CARES Act already allows employers to defer the payment of the employer's share of the social security tax, this executive action goes one step further by allowing for the deferral of the *employee's* share of the social security tax.

When can taxes be deferred? The deferral may be implemented on wages with a pay date between and including September 1, 2020 through December 31, 2020.

Who is eligible for the deferral? Employees can have their share of social security tax deferred if their bi-weekly pay is less than $4,000, or an equivalent amount with respect to other pay periods (i.e., less than $2,000 is paid on a weekly basis). Eligibility for deferral is determined on a pay period-by-pay period basis.

How are the deferred taxes to be recouped? If employers elect to participate in the deferral, they must ratably withhold from the wages of participating employees between January 1, 2021 and April 30, 2021 and pay the tax due. Interest, penalties, and additions to tax will begin to accrue on unpaid taxes on May 1, 2021 and be assessed to the employer.

What if employees who had taxes deferred no longer work for the employer? The IRS has yet to provide specific guidance on this point, other than to say that employers (referred to in the IRS guidance as "Affected Taxpayers") "may make arrangements to otherwise collect the total Applicable Taxes from the employee."

Key takeaways: Employers should approach the payroll tax deferral with caution. Employers will ultimately be responsible for paying the tax due if, for whatever reason, they are unable to collect the tax from employees. If employers elect to implement the deferral, affected employees will see relatively higher paychecks in the last four months of 2020 and then relatively lower paychecks in 2021. Participating employers should clearly communicate to their employees that this is a tax *deferral*, and that employees will ultimately be responsible for paying the tax in 2021. Notwithstanding, employers appear to be at risk for payment of the tax for employees that no longer work for them during the January - April 2021 repayment period.

Given the administrative challenges with implementing the deferral and the risk of not being able to recoup unpaid taxes, many employers are, per media reports, deciding not to participate. Employers who decide not to implement the deferral should be prepared for questions from employees who have heard about the deferral in the media. Employers should explain that the deferral was optional and remind employees that this was not a tax holiday - employees would have seen additional withholding in 2021 to make up for taxes not paid in 2020.

For more information, please contact a member of the firm's Labor & Employment Practice Group.

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