



IRS Addresses the President's Executive Order on Employee Payroll Tax Deferral in Notice 2020-65

Summary

On August 28, 2020, the IRS issued [Notice 2020-65](#) that provides some needed guidance for employers wondering whether and how to comply with the employee payroll tax deferral described in the August 8, 2020 [Presidential memorandum](#) (often referred to as an “executive order.”) Even though the Notice leaves many questions unanswered, it addresses some key items.

Insight

Although the IRS Notice does not specifically state whether the employee payroll tax deferral is mandatory, the deferral appears to be voluntary, which lines up with Treasury Secretary Mnuchin's widely reported comments.

Internal Revenue Code Section 7508A (which is the basis for the memorandum and the Notice) allows the President to postpone certain tax deadlines due to a disaster, such as COVID-19. However, Section 7508A does not give the President authority to require taxpayers to use the extended deadline. In other words, even if a deadline is postponed, a taxpayer could continue to adhere to the normal deadlines. As a result, employers can continue to withhold employee Social Security tax or Railroad Retirement tax from September 1 to December 31, 2020 if they do not wish to avail themselves of the deadline extension.

The Notice clearly places responsibility on employers for withholding and depositing the deferred taxes and states that penalties generally would apply for any failure to comply (although the Notice states that employers can “make arrangements to otherwise collect the total Applicable Taxes from the employee”). Neither the memorandum nor the Notice eliminates the tax liability.

It appears that the employee payroll tax deferral does not apply to self-employed individuals, since it only applies to Social Security tax and Railroad Retirement tax and does not include Self-Employment Contributions Act (SECA) taxes.

Background

In an August 8, 2020 memorandum to the Secretary of the Treasury entitled, “Deferring Payroll Tax Obligations in Light of the Ongoing COVID-19 Disaster,” President Trump directed Treasury Secretary Mnuchin to use his authority to defer the withholding, deposit and payment of employee Social Security tax on wages (i.e., 6.2% of employee wages) or Railroad Retirement tax on compensation paid to certain employees during the period September 1 through December 31, 2020. The memorandum instructed the Treasury Department to issue guidance explaining how to implement the deferral and to explore avenues, including legislation, to eliminate the obligation to pay the deferred taxes. Secretary Mnuchin made comments in an August 10 interview that employers would not be required to offer the deferral.

Insight

Since the guidance was released so close to the first available deferral date (i.e., September 1), employers have very little time to modify payroll procedures and payroll system to allow employees the deferral on the first pay cycle in September. Under the current IRS rules, it is not possible to “recover” the tax that already was withheld and remitted, but was eligible for the deferral, without causing issues with the employer tax filings and the imposition of penalties. Retroactive changes generally are not allowed simply because a taxpayer failed to use an available extension. This is consistent with the IRS's position on employers that failed to timely defer the employer's share of Social Security taxes (6.2%) as permitted under the CARES Act.



IRS Guidance

The two-and-a-half-page IRS guidance leaves unanswered many concerns surrounding the employee payroll tax deferral, but it does clarify several important points as they pertain to an employer's payroll process. Below is a summary of the guidance.

- The employee payroll tax deferral applies to wages and compensation paid on a pay date during the period beginning on September 1, 2020 and ending on December 31, 2020.
- The employee payroll tax deferral applies only if wages or compensation paid to an employee for a biweekly pay period are less than \$4,000, or the equivalent amount with respect to other pay period frequencies. This threshold is determined on a pay period-by-period basis.

Insight

The very short-term deferral and repayment period results in a modest benefit.

An employee who earns the Federal minimum wage would have an increased biweekly paycheck of \$36 (or \$324 for nine pay periods, from September 1 to December 31, 2020).

For employees that earn the maximum \$3,999 every two weeks for nine pay periods, the benefit is \$2,231. ($\$3,999 \times 6.2\% \times 9$ pay periods).

Unless something happens to dramatically improve the employee's household income before January 1, 2021, the repayment of taxes ratably over the first four months of 2021 may create a greater hardship than their current cash flow shortage.

Employer Dilemma

HB 1080 conforms to the CARES Act Section 1106(i)'s exclusion from gross income any forgiven Paycheck Protection Program (PPP) loans that are used on payroll, rent, or utility payments during COVID-19. However, the IRS recently stated in Notice 2020-32 that covered expenses related to forgiven PPP loans cannot be deducted. HB 1080 takes the same position as the IRS and requires taxpayers to add back any expenses deducted for federal purposes that were paid for by a forgiven PPP loan.

Since the employee payroll tax deferral takes effect as early as September 1, 2020, employers that consider implementing the tax deferral likely will face a dilemma due to some of the unanswered questions unless the IRS issues additional guidance soon. For example:

- Can a participating employer apply the same deferral policy to all employees, or must the employees be allowed to choose?
- What are the consequences if an employee unexpectedly leaves the employer before paying the deferred tax?
- If the employer cannot collect the taxes from former employees, is the employer liable for the tax or failure to withhold penalties?
- What if the employee does not earn enough wages during the period between January and April of 2021 due to disability, leave of absence, etc., to pay for the deferred tax?
- Does the employer report the deferred payroll tax as tax withheld on the employer's quarterly tax returns (i.e., Form 941) and Forms W-2?
- What happens if the employer did not defer the payroll tax, but the government later decides to forgive the deferred taxes? Will the employer or the employees be able to recover the tax that would have been forgiven had the tax been deferred?
- Will the IRS provide a mechanism (e.g., revising the employer's Form 941) to allow employers to "recover" the tax that was already withheld and remitted, but was eligible for the deferral, without causing issues with the employer tax filings and incurring penalties?
- What if an employee receives a supplemental wage payment (e.g., bonus) outside of a normal pay period, how will that be treated for the purpose of the \$4,000 eligibility threshold?