New IRS Guidance for Implementing Payroll Tax Deferral

Date: September 3, 2020

On Friday, August 28, 2020, the IRS issued Notice 2020-65 in an attempt to provide employers with guidance on how to implement President Trump's payroll tax deferral Memorandum issued earlier in the month. The Memorandum is intended to provide temporary tax relief to employees related to the impact of COVID-19. Some questions still remain regarding the deferral program, but here is what we know now.

Context

The employer and the employees each share in paying Social Security payroll taxes. The CARES Act permitted the employer to defer its share of payroll taxes. President Trump's Executive Order replicates this same type of deferral for the employees. President Trump has stated his intent to seek total forgiveness for deferred payroll taxes, but Congress will need to pass legislation that provides for this forgiveness, and it has not yet done so.

Overview

The guidance indicates that employers may permit employees to defer the withholding and payment of the employee's Social Security taxes for the period September 1, 2020 to December 31, 2020. The deferral applies to employees who are paid less than $4,000 in biweekly pre-tax income which limits the deferral to employees who earn less than approximately $104,000 a year. According to the Notice, each pay period is considered separately. Employees that have fluctuating wages above and below $4,000 will not be entitled to the deferral for any pay period in which the wages exceed the $4,000 cap. Employees paid overtime or a bonus in any pay period that bumps them above the cap will not be entitled to the deferral for that specific pay period.

As written, the Executive Order places the decision-making power in the hands of the employers. It is unclear whether an employee has any choice regarding if his/her employer opts into the deferral program or not. Further, it is also unclear whether an individual employee can opt out of the program individually, if his/her employer chooses to opt in.

Paying Back the Taxes

The guidance provides that employers must later withhold and then pay the deferred taxes during the period of January 1, 2021, through April 30, 2021. As the guidance is written today, this means that impacted employees will owe more in Social Security taxes during this period in early 2021 – i.e., the taxes deferred in fall of 2020 plus the current tax liability for the first several months of 2021. Employers are provided some latitude to make alternative arrangements when collecting the 2020 deferred taxes if necessary, like in the case when employees are working few hours or not working at all.

Unaddressed Questions

There still remains several unanswered questions. The Notice is silent on whether this is a mandatory or optional deferral. Most guidance indicates it is not mandatory. Regarding departing employees, it is unclear whether an employee could be legally required to sign an agreement allowing the employer to recover unpaid deferred amounts from the employee if the employee leaves or is terminated before the final payback date of April 30, 2021.

The IRS's Notice also does not address whether Form W-2 reporting of deferrals will be required and how this tax deferral will impact employers' COVID-19 payroll tax credits.

The DOL has not indicated whether it would issue further guidance to clarify these issues, however, it has provided information about penalties for non-compliance – i.e., employers that do not deposit all deferrals on time may be liable for interest, penalties and additions to tax accruing as of May 1, 2021.

HBI will provide updates when additional information becomes available.