Employers Face Difficult Decision About Deferring Payroll Tax

On August 8, 2020, President Trump signed an executive order in the form of a memorandum directing the Secretary of the Treasury to allow employers to defer the withholding, deposit and payment of a certain portion of social security taxes in light of the ongoing COVID-19 pandemic. Notice 2020-26 permits employers to implement the president's order. Notably, the IRS guidance still leaves employers responsible for collecting the tax from employees and for interest and penalties if the employers are unable to collect the tax after the deferral period. In a time of economic and political uncertainty, employers should carefully weigh the risks and benefits of participating in this tax deferral program.

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Guidance to Implement President Trump's Order for Deferral

The president's order and IRS guidance permit employers to defer withholding the 6.2 percent employee portion of social security tax on wages paid between September 1, 2020 and December 31, 2020. Employers may defer this tax for employees whose income is less than $4,000 per bi-weekly pay period, or the equivalent based on a different period. While the order also directs the Treasury to "explore avenues" to forgive the tax; ultimately, only an act of Congress can do so. Key IRS directives which implement the deferral and repayment of the taxes are as follows:

- Employers are identified as the "Applicable Taxpayers" affected by the COVID-19 emergency for purposes of the relief described in the president's order.
- The wage threshold is calculated on a pay period-by-pay period basis without regard to any other period.
- Employers must ratably repay the deferred taxes by withholding from wages and compensation paid between January 1, 2021 and April 30, 2021.
- If employers are unable to repay the tax through wage withholding, employers may "make arrangements" to collect the taxes from the employee.
- Employers are subject to interest, penalties and additions to tax for any deferred tax unpaid by April 30, 2021.

Employer Considerations

Employers Who Opt-in are Subject to Penalties for Failure to Pay. The IRS defines employers rather than employees, as the "Applicable Taxpayer" entitled to relief provided by the order. Employees are not entitled to deferral of the tax, and participation in the program is optional for employers. This distinction is also important because the IRS charges Applicable Taxpayers with collection of the deferred tax and imposes interest and penalties on Applicable Taxpayers if not repaid by April 30, 2021.

Employers Cannot Continue to Withhold and Refrain from Depositing Tax Without Penalty. The IRS does not allow an employer to withhold the tax and delay depositing these funds with the IRS. The IRS imposes failure-to-deposit and failure-to-pay penalties if employment taxes are not deposited and paid in a timely fashion. The new guidance forecloses the possibility of employers retaining the deferred tax without penalty to "wait and see" if Congress will forgive the taxes or if the IRS releases further guidance.

Double-Withholding is Required for January 1, 2021 to April 30, 2021. Employees for whom tax is deferred are subject to double-withholding beginning in January 2021. The additional amount could be up to $248 per paycheck, totaling more than $2,232 in taxes owed. If an employee leaves employment at any time between September 1, 2020 and April 30, 2021, it is unclear what "arrangements" employers can make to collect the tax. Similarly, if an employee's wages or compensation in 2021 are not enough to ratably repay the tax, employers will have to ask employees for other forms of payment or face paying the tax themselves to avoid interest and penalty.

Payroll Providers and Human Resource Departments May Struggle with the Logistics of Implementing the Deferral. Aside from the fact that the IRS issued guidance a mere four days before employers are allowed to defer, technology constraints will also impede swift implementation of the tax deferral. One such instance is in the case of variable income. The guidance precludes an employee who receives a bi-weekly paycheck greater than $4,000 from deferral; an employee is not eligible for deferral "up to" the threshold amount. Thus, employees' eligibility for deferral may vary from paycheck to paycheck making any blanket deferral difficult to execute. Employers should work closely with payroll providers to develop a plan for implementation.

Employees May Still be Eligible for a Refund if and when the Tax is Forgiven. Rather than deal with the complexities of implementing the deferral, employers who choose not to defer may still be able to refund the tax to employees if it is forgiven. If the tax is forgiven in 2020 however, the law allows employees to request a refund of any overpayment directly from employers. If the tax is forgiven in 2021, employees will have to wait until they file their income tax returns to request a refund of the overpaid tax.

Communications with Employees Should be Clear. Employers who defer should ensure employees are aware of the obligations to repay the tax through paycheck withholding beginning January 1, 2021. Additionally, employers may want to make arrangements on the front-end with employees for repayment upon separation or other circumstance that hinders collection come January. On the flip side, employers should consider communicating reasons to employees for not participating in the deferral.

Employers with questions regarding the payroll tax deferral program should contact Heidi Gabriel, Michael Goller or another member of Reinhart's Tax Practice.