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## Payroll Tax Deferral Under Notice 2020-65, FFCRA, and The CARES Act

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### INTRODUCTION

On August 8, 2020, President Trump issued an executive order (the “Presidential Memorandum”)<sup>1</sup> directing the U.S. Secretary of the Treasury (Treasury) to authorize, by use of a presidential declared disaster, deferral by employers, generally deemed affected by Covid-19<sup>2</sup> (Affected Taxpayers), of withholding, deposit, and payment of certain federal payroll taxes (Applicable Taxes) on wages or compensation (Applicable Wages) until January 1, 2021.

On August 28, 2020, Treasury and the IRS issued Notice 2020-65 (the “Notice”) implementing the Presidential Memorandum and setting forth procedures and requirements for employers in connection with deferral of the employee portion of Social Security tax under FICA<sup>3</sup> or the RRTA<sup>4</sup> equivalent.

This article discusses the payroll tax deferral requirements in the Notice and alerts employers to re-

quired actions or considerations in deferring withholding, deposit,<sup>5</sup> and payment of the employee portion of withholding taxes, and interaction with other Covid-19 payroll tax relief.<sup>6</sup>

### DEFERRAL DATES

The period, for which the Applicable Taxes may be deferred begins September 1, 2020, and ends December 31, 2020 (for purposes of this article, the “Deferral Period”).<sup>7</sup> The period, during which the Deferred Applicable Taxes must be paid to the IRS begins on January 1, 2021, and ends April 30, 2021 (for purposes of this article, the “Payment Period”).<sup>8</sup> Thus, employers must deposit all of the Applicable Taxes within four months of end of the Deferral Period.<sup>9</sup> The Notice clarifies that the beginning date of the Deferral Period is based on the payroll date, not the first day of the payroll period.<sup>10</sup>

### LIMITATION ON APPLICABLE WAGES

The Applicable Wages limitation is determined based on each payroll period.<sup>11</sup> Thus, the wages or compensation are not aggregated or annualized for purposes of determining eligibility for deferral of Ap-

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<sup>1</sup> 85 Fed. Reg. 49,857 (Aug. 13, 2020), available at <https://www.whitehouse.gov/presidential-actions/memorandum-deferring-payroll-tax-obligations-light-ongoing-covid-19-disaster/>.

<sup>2</sup> Stafford Act §501(b), Pub. L. No. 93-288, 42 U.S.C. §5121 *et seq.*

<sup>3</sup> Federal Insurance Contribution Act, §3101 *et seq.* All section references herein are to the Internal Revenue Code of 1986, as amended (the “Code”), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

<sup>4</sup> Railroad Retirement Tax Act, §3201 *et seq.*

<sup>5</sup> See generally §6302(g) (employment and withheld income tax deposit requirements).

<sup>6</sup> Families First Coronavirus Response Act, Pub. L. No. 116-127 (FFCRA); Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136 (CARES Act), amended by Enhancement Act, Pub. L. No. 116-139; Flexibility Act, Pub. L. No. 116-142; S. 4116, Pub. L. No. 116-147. See Vishnepolskaya, *Financing Payroll with Covid-19 Loans, Grants, and Tax Credits*, 48 Comp. Plan. J. No. 7 (July 2, 2020) (payroll tax relief); Vishnepolskaya, *Paid Leave Credit for Private Sector and Nonprofit Employers Within the Families First Coronavirus Response Act*, 48 Comp. Plan. J. No. 4 (Apr. 3, 2020) (refundable tax credits).

<sup>7</sup> Notice 2020-65.

<sup>8</sup> Notice 2020-65.

<sup>9</sup> Notice 2020-65.

<sup>10</sup> Notice 2020-65.

<sup>11</sup> Notice 2020-65.

plicable Taxes.<sup>12</sup> As the accompanying news release clarifies, the limitation is an amount that is below \$4,000 per bi-weekly payroll period.<sup>13</sup> The limitation of \$104,000 of Applicable Wages, if annualized, is somewhat below the wage base for aggregate 12.4% Social Security tax or RRTA equivalent payable by the employer and employee.<sup>14</sup> The wage base for the Social Security tax is \$137,700 for earnings in calendar year 2020.<sup>15</sup>

In the event an employer pays wages weekly or more frequently, the Presidential Memorandum provides that the limitation amount is prorated with respect to other pay periods.<sup>16</sup> Thus, in the event of a weekly payroll schedule, the limitation on wages per payroll period would be \$2,000. The Notice does not clarify whether an employer may reduce wages subject to applicable federal, state and local tax, labor and employment laws, including without limitation ERISA,<sup>17</sup> to meet the Applicable Wages threshold.<sup>18</sup>

## SCOPE OF APPLICABLE WAGES

### In General

Applicable Taxes on wages or compensation, which may be deferred under the Notice, apply to amounts deemed wages under §3121(a)<sup>19</sup> for purposes of FICA<sup>20</sup> or compensation under §3231(e) for purposes of RRTA.<sup>21</sup> Thus, Applicable Wages exclude parsonage, or amounts paid to certain clergy workers for housing and related expenses under §107, which are not withheld on by an employer or reported as wages on IRS Form W-2.<sup>22</sup> Applicable Wages generally also exclude qualified plan contributions.<sup>23</sup> Likewise, Ap-

plicable Wages exclude certain fringe benefits,<sup>24</sup> and employer contributions to certain accident, and health or medical expense reimbursement plans<sup>25</sup> not subject to employment taxes or withholding and excludible from employee gross income under the I.R.C.

## Interaction with FFCRA and CARES Act Payroll Credits, Covid-19 PTO Programs

In addition, Applicable Wages exclude amounts of qualified sick leave or family leave wages under FFCRA,<sup>26</sup> allocable qualified health plan expenses,<sup>27</sup> and creditable employer portion of FICA Medicare tax on such wages.<sup>28</sup> Furthermore, Applicable Wages exclude the creditable portion of allocable health plan expenses included within qualified wages, which are subject to an employee retention credit available under the CARES Act.<sup>29</sup>

Also, Applicable Wages exclude surrendered or deposited leave from wages of donor employees pursuant to a qualified employer-sponsored medical leave-sharing plan,<sup>30</sup> a bona fide employer-sponsored major disaster leave-sharing plan,<sup>31</sup> or a Covid-19 leave-based donation program.<sup>32</sup>

## SCOPE OF APPLICABLE TAXES

### In General

Applicable Taxes include only the employee portion of the FICA Social Security tax or the RRTA

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and wage withholding requirements).

<sup>24</sup> See §119 (meals and lodging), §127 (educational assistance programs), §129 (dependent care assistance programs), §132 (certain other fringe benefits), §3121(a)(18), §3121(a)(19), §3121(a)(20) (corresponding exclusions from wages). See §3401(a)(18), §3401(a)(19) (exclusion from withholding requirements for above benefits, other than meals and lodging subject to §119); Reg. §31.3401(a)-1(b)(9) (value of meals and lodging excluded from withholding if excludible from gross income of employee).

<sup>25</sup> §104(a)(3), §105(a), §106(a), §3121(a)(2).

<sup>26</sup> FFCRA §7001(c), §7003(c), §7005(a).

<sup>27</sup> FFCRA §7001(d), §7003(d); §106(a).

<sup>28</sup> FFCRA §7005(b)(1).

<sup>29</sup> CARES Act §2301(a), §2301(c)(3)(C); §106(a). *But see* CARES Act §2301(c)(3)(A), §2301(c)(5) (qualified wages other than allocable qualified health plan expenses treated as wages for FICA purposes or compensation for RRTA purposes).

<sup>30</sup> See §61(a)(1); Rev. Rul. 90-29.

<sup>31</sup> Notice 2006-59; IRS FAQ, *Leave Sharing Plans Frequently Asked Questions*, Q&A 1 (Aug. 3, 2020).

<sup>32</sup> Notice 2020-46, Notice 2001-69 (safe harbor for victims of September 11, 2001 terrorist attacks).

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<sup>12</sup> Notice 2020-65.

<sup>13</sup> IR-2020-195 (Aug. 28, 2020).

<sup>14</sup> See §3101(a), §3111(a), §3201(a), §3221(a); Notice 2020-65.

<sup>15</sup> Soc. Sec. Admin., *OASDI and SSI Program Rates & Limits, 2020* (Oct. 2019), [https://www.ssa.gov/policy/docs/quickfacts/prog\\_highlights/RatesLimits2020.pdf](https://www.ssa.gov/policy/docs/quickfacts/prog_highlights/RatesLimits2020.pdf).

<sup>16</sup> 85 Fed. Reg. 49,857 (Aug. 13, 2020).

<sup>17</sup> Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974).

<sup>18</sup> See Notice 2020-65.

<sup>19</sup> §3121(a).

<sup>20</sup> Federal Insurance Contributions Act, §3101 *et seq.*

<sup>21</sup> Railroad Retirement Tax Act, §3201 *et seq.* See Notice 2020-65.

<sup>22</sup> §107; Notice 2020-65; see IRS Form W-2, *Wage and Tax Statement* (2020).

<sup>23</sup> See §125, §401(a), §403(b), §408(p), §457(b), §3121(a)(5) (exclusion of qualified plan contributions generally from the definition of wages for purposes of FICA); see also §3231(e)(1)(iv), §3306(b)(5), §3401(a)(12) (conforming definitions for purposes of RRTA, Federal Unemployment Tax Act, §3301 *et seq.* (FUTA)

equivalent.<sup>33</sup> Thus, employer portion of FICA Social Security tax, the FICA Medicare tax, FUTA tax, and state or local taxes on employee compensation, including state unemployment insurance (SUI) or state disability insurance (SDI) paid by employers are excluded from deferral relief in the Notice.<sup>34</sup>

## Interaction with Tax Deferrals Under FFCRA, Cares Act

Further, Applicable Taxes are distinguished in scope from withheld employment taxes, which an employer may retain in anticipation of a payroll credit under FFCRA or the CARES Act, and for which an employer did not file an advance credit payment request on IRS Form 7200.<sup>35</sup> The payroll credits are effective for payroll periods beginning April 1, 2020, and ending not later than December 31, 2020, under FFCRA and for wages paid March 13, 2020, to December 31, 2020, under the CARES Act.<sup>36</sup> Employers generally may reduce deposit, but not withholding, of the employer and employee portion of FICA taxes or of RRTA tax amounts attributable to the applicable FICA Social Security tax rate in anticipation of receiving refundable employment tax credits due to Covid-19 circumstances.<sup>37</sup>

The excess amount of the credit not applied to employer Social Security tax liability for a calendar quarter is refundable to the employer by filing IRS Form 7200.<sup>38</sup> There is also a waiver of the failure to deposit penalty under §6656 applied to retained payroll taxes that did not exceed the actual amount of allowed payroll credit for the calendar quarter.<sup>39</sup> Similar relief with respect to the refundable tax credits under FFCRA was available to self-employed individuals subject to the SECA<sup>40</sup> tax, including certain religious workers within the scope of §3401(a)(9), with respect to estimated tax payments for a calendar quarter.<sup>41</sup>

Under FFCRA, qualified sick leave or family leave wages paid to employees were creditable only against

the employer portion of FICA Social Security tax or the RRTA equivalent.<sup>42</sup> Thus, the employer portion of the Medicare tax on qualified sick leave or family wages was creditable together with the qualified sick leave or family leave wages, and allocable qualified health plan expenses.<sup>43</sup> Conversely, qualified sick leave or family leave wages, allocable qualified health plan expenses, or creditable Medicare tax liability were not creditable against employer portion of Medicare tax.<sup>44</sup> Therefore, an employer may reduce deposit of the Medicare tax in anticipation of payroll credits for a calendar quarter.<sup>45</sup> However, the withheld Medicare tax amounts generally would be deposited on the next regular deposit date, absent anticipation of additional applicable payroll credits.<sup>46</sup>

In addition, CARES Act §2302 permits employers to defer payment or deposit of the employer portion of FICA Social Security tax or the RRTA tax amount attributable to the tax rate set forth in §3111(a) beginning March 27, 2020, and until January 1, 2021.<sup>47</sup> CARES Act §2302(d)(3) requires 50% of the deferred amount to be deposited by December 31, 2021, and the remaining amount to be deposited by December 31, 2022. Self-employed individuals may obtain similar relief with respect to 50% of tax liability under SECA, which is equivalent to the combined employer and employee portions of FICA, social security, and Medicare taxes.<sup>48</sup>

Section 4 of the Flexibility Act extended deferral under CARES Act §2302 to employers receiving forgiveness of all or a portion of Paycheck Protection Program (PPP) loan amounts under CARES Act §1106.<sup>49</sup> PPP is administered by the Small Business Administration (SBA).<sup>50</sup> Section 4 of the Flexibility Act also applied to recipients of forgiveness of loans

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claimed on the income tax return for the calendar year without express reference to §6654 penalties); cf. IRS FAQ, *Deferral of Employment Tax Deposits and Payments Through December 31, 2020*, Q&A 12 (July 30, 2020) (CARES Act §2302 relief is in addition to Notice 2020-22 relief from failure to deposit penalties), Q&A 22 (expressly excluding deferred SECA taxes under CARES Act §2302 from calculating installments of estimated tax under §6654).

<sup>42</sup> FFCRA §7001(b)(2), §7003(b)(2).

<sup>43</sup> FFCRA §7005(b).

<sup>44</sup> See FFCRA §7001(b)(2), §7003(b)(2).

<sup>45</sup> Notice 2020-22.

<sup>46</sup> See Notice 2020-22.

<sup>47</sup> CARES Act §2302(a), §2302(d); §3111(a), §3211(a), §3221(a), §6302(g) (timing of deposit of certain withholding taxes). IRS FAQ, *Deferral of Employment Tax Deposits and Payments Through December 31, 2020*, Q&A 4 (July 30, 2020).

<sup>48</sup> CARES Act §2302(b)(2); §1401(a), §6654.

<sup>49</sup> Paycheck Protection Program Flexibility Act of 2020 §4(a), Pub. L. No. 116-142; CARES Act §1106, §2302.

<sup>50</sup> Small Business Act §7(a)(36), Pub. L. No. 85-536; CARES Act §1106(a) (enacting new paragraph 7(a)(36) of the Small Busi-

<sup>33</sup> §3101(a), §3201(a); Notice 2020-65.

<sup>34</sup> See §3111(a), §3101(b), §3111(b), §3301(a); Notice 2020-65.

<sup>35</sup> See FFCRA §7001-§7004; CARES Act §2301; IRS Form 7200, *Advance Payment of Employer Credits Due to COVID-19* (Mar. 2020), <https://www.irs.gov/pub/irs-pdf/f7200.pdf>.

<sup>36</sup> FFCRA §7001(g), §7003(g); CARES Act §2301(m).

<sup>37</sup> See FFCRA §7001(f)(3), §7003(f)(3); CARES Act §2301(k). *But see* Reg. §31.3111-6T, §31.3221-5T (FICA and RRTA tax credit recapture provisions).

<sup>38</sup> See CARES Act §2301(l)(1), §3606; §6656; Notice 2020-22.

<sup>39</sup> See FFCRA §7001(f)(3), §7003(f)(3); CARES Act §2301(k).

<sup>40</sup> Self-Employment Contributions Act, §1401 *et seq.*

<sup>41</sup> See FFCRA §7002(a), §7004(a); §1401, §3401(a)(9), §6654(a); IRS FAQ, *COVID-19-Related Tax Credits: Special Issues for Employees and Additional Questions FAQs*, Q&A 66 (Apr. 28, 2020) (permitting reduction in estimated tax payments to fund the refundable employment tax credits under FFCRA

issued by certain non-SBA lenders pursuant to CARES Act §1109.<sup>51</sup> Thus, the tax authorities may overlap with respect to an amount of reduced withholding or deposit of employer or employee payroll taxes.<sup>52</sup> Therefore, employers or third-party administrators<sup>53</sup> must ensure any reduction in withholding or deposit of payroll taxes does not exceed the limitations for each applicable form of payroll tax deferral.

## REPORTING AND PAYMENT OF DEFERRED APPLICABLE TAXES AND PENALTIES

Failure to withhold and pay the Deferred Applicable Taxes timely would result in penalties, interest, and additions to tax accruing to the Affected Taxpayer beginning May 1, 2021.<sup>54</sup> As is required generally, an employer reports annually the employee portion of withheld Social Security taxes in box 4 of IRS Form W-2 for the calendar year during which the remuneration was paid. The employer files the information return on Form W-2 and an accompanying transmittal IRS Form W-3 with the Social Security Administration, and furnishes a copy of Form W-2 to the employee.<sup>55</sup> Absent clarifying guidance from Treasury and the IRS, an employer would exclude the amount of Deferred Applicable Taxes from box 4 of Form W-2 for calendar year 2020, which includes the Deferral Period. Likewise, absent further guidance, an employer may include the amounts of Deferred Applicable Taxes on Form W-2 filed and furnished for calendar year 2021, which would include the Payment Period.

In addition, an employer generally is required to file a tax return on IRS Form 941 on a quarterly basis for withholding and deposit of employee federal income tax and employee and employer FICA taxes with respect to certain wages paid and received.<sup>56</sup> Form 941, revised in April 2020, contains new line 13b for reporting of deferred employer share of Social

Security tax under CARES Act §2302.<sup>57</sup> Current Form 941 does not contain similar disclosure for the deferred employee share of Social Security tax pursuant to the Notice. Further amendment of Form 941 may clarify appropriate disclosure for deferrals under the Notice.

The Notice provides that an employer must withhold and pay over the Deferred Applicable Taxes ratably during the Payment Period.<sup>58</sup> The Notice does not clarify how the “ratable” withholding and deposit requirements apply.<sup>59</sup> Without clarification, an employer might allocate the Deferred Applicable Taxes equally among the payroll dates between January 1, 2021, and April 30, 2021. Thus, the employer generally would have to deposit the Deferred Applicable Taxes accordingly based on the required deposit schedule and report such Deferred Applicable Taxes on appropriate Form 941 for the applicable calendar quarters.<sup>60</sup>

Therefore, an employer may have Deferred Applicable Taxes only for the fourth quarter of calendar year 2020. A reasonable interpretation of the ratable withholding and deposit rule may require an employer to apportion the total amount of Deferred Applicable Taxes equally among the payroll periods beginning on or after January 1, 2021, the payroll dates for which are included within the Payment Period. Alternatively, the Notice allows an Affected Taxpayer to make other arrangements with the employee, if necessary, to collect the total Deferred Applicable Taxes.<sup>61</sup>

## EMPLOYER CONSIDERATIONS AND ACTION ITEMS FOR DEFERRAL

Notice 2020-65 permits only deferral, and not forgiveness of the employee portion of Social Security tax or equivalent railroad tax for the period from September 1, 2020, to December 31, 2020. The deferred tax liability must be paid within four months, from January 1, 2021, to April 30, 2021, to avoid accrual of interest, penalties or additions to tax under the I.R.C. for failure by the employer to withhold or deposit the employee portion of payroll taxes.<sup>62</sup> The relief is optional and employers may have alternate methods for collecting deferred payroll tax amounts from employees to meet the payment requirements.

However, employers should consider in general whether additional economic hardship to employees

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ness Act).

<sup>51</sup> Flexibility Act §4; CARES Act §1109.

<sup>52</sup> See, e.g., IRS FAQ, *Deferral of Employment Tax Deposits and Payments Through December 31, 2020*, Q&A 13 (July 30, 2020) (permitting an employer to defer the deposit and payment of employer share of employment taxes under CARES Act §2302 before determining eligibility for FFCRA or CARES Act refundable employment tax credits or amount of employment tax deposits that may be retained in anticipation of such credits).

<sup>53</sup> See CARES Act §2302(c)(2) (employer liability for taxes deferred by third party payor).

<sup>54</sup> See §6651, §6656; Notice 2020-65.

<sup>55</sup> See §6041(a), §6051(a).

<sup>56</sup> §6071(a); Reg. §31.6071(a)-1.

<sup>57</sup> See Notice 2020-54.

<sup>58</sup> Notice 2020-65.

<sup>59</sup> See Notice 2020-65.

<sup>60</sup> Reg. §31.6071(a)-1(a), §601.401(c)(1)(i).

<sup>61</sup> See Notice 2020-65.

<sup>62</sup> See §6656(a), §6672(a).

may result from the deferral due to subsequent unavailability of funds. Another factor to consider is the risk of incurring penalties or interest for failure to comply timely with the Notice requirements, including collection from employees and payment of tax.<sup>63</sup> Employers also should take into account additional operating costs associated with implementing deferred withholding, deposit, and reporting of Applicable taxes, whether internally or through third-party administrators.

Many employers have claimed refundable payroll credits under FFCRA or the CARES Act or deferred the employer portion of FICA Social Security tax or RRTA equivalent under the CARES Act. Such taxpayers must comply with both the deadlines for deferring deposit of employer or employee portions of withholding taxes, and the due dates for withholding and payment of Applicable Taxes under CARES Act §2302 or Notice 2020-65. Employers also must continue to report, withhold, and pay, as applicable, any required state income tax withholding, SUI tax or SDI

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<sup>63</sup> See §6672(a).

tax on wages. Moreover, employers participating in a payroll tax deferral program remain subject to any FUTA tax deposit and IRS Form 940 filing requirements.<sup>64</sup>

## CONCLUSION

The elective payroll tax deferral regime allows employers to reduce deposits in anticipation of FFCRA or CARES Act payroll credits, defer employer Social Security tax under CARES Act §2302, as amended, or defer employee payroll tax under the Notice. However, current tax relief is temporary and partial. Therefore, employers must coordinate the respective federal payroll tax relief provisions with necessary remaining federal and state tax withholding, payment, and reporting rules. Accordingly, in considering payroll tax deferral options, affected taxpayers should consult with tax counsel to ensure compliance with applicable tax withholding, deposit, payment, or filing requirements with respect to wages or compensation earned through December 31, 2020.

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<sup>64</sup> §6071(a); Reg. §31.6071(a)-1(c).