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INSIGHT: IRS Guidance Implements Payroll Tax Deferral Measure

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On Aug. 8, 2020, President Trump issued an executive order (presidential memorandum) directing the U.S. Secretary of the Treasury to authorize deferral by employers, generally deemed affected by Covid-19, a Presidentially declared disaster, of withholding, deposit, and payment of certain federal payroll taxes on wages until Jan. 1, 2021.

On Aug. 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 the Federal Insurance Contributions Act (FICA) or the Railroad Retirement Tax Act (RRTA) equivalent.

This article discusses the payroll tax deferral requirements in the notice and alerts employers to required actions or considerations in deferring withholding, deposit, and payment of the employee portion of withholding taxes, and interaction with other Covid-19 payroll tax relief.

DEFERRAL DATES

The period, for which the applicable taxes may be deferred begins Sept. 1, 2020, and ends Dec. 31, 2020 (deferral period). The period, during which the deferred applicable taxes must be paid to the IRS begins on Jan. 1, 2021, and ends April 30, 2021 (payment period). Thus, employers must deposit all of the applicable taxes within four months of end of the deferral period. 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.

LIMITATION ON APPLICABLE WAGES

The applicable wages limitation is determined based on each payroll period. Thus, the wages or compensation are not aggregated or annualized for purposes of determining eligibility for deferral of applicable taxes. As the accompanying news release clarifies, the limitation is an amount that is below \$4,000 per bi-weekly payroll period. 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 employer and employee. The wage base for the social security tax is \$137,700 for earnings in calendar year 2020.

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. 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 to meet the applicable wages threshold.

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 tax code [Section 3121\(a\)](#) for purposes of FICA or compensation under tax code [Section 3231\(e\)](#) for purposes of RRTA. Thus, applicable wages exclude parsonage, or amounts paid to certain clergy workers for housing and related expenses under [Section 107](#), which are not withheld on by an employer or reported as wages on IRS Form W-2. Applicable wages generally also exclude qualified plan contributions. Likewise, applicable wages exclude certain fringe benefits, and employer contributions to certain accident, health, or medical expense reimbursement plans not subject to employment taxes or withholding and excludable from employee gross income under the tax code.

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 the Families First Coronavirus Response Act (FFCRA), allocable qualified health plan expenses, and creditable employer portion of FICA Medicare tax on such wages. 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 Coronavirus Aid, Relief, and Economic Security Act (CARES Act).

Also, applicable wages exclude surrendered or deposited leave from wages of donor employees pursuant

to a qualified employer-sponsored medical leave-sharing plan, a bona fide employer-sponsored major disaster leave-sharing plan, or a Covid-19 leave-based donation program.

SCOPE OF APPLICABLE TAXES

In General

Applicable taxes include only the employee portion of the FICA social security tax or the RRTA equivalent. Thus, employer portion of FICA social security tax, the FICA Medicare tax, Federal Unemployment Tax Act (FUTA) tax, and state or local taxes on employee compensation, including state unemployment insurance paid by employers are excluded from deferral relief in the notice.

Interaction with Tax Deferrals Under FFCRA, CARES Act

Further, applicable taxes are distinguished in scope from withheld payroll 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. The payroll credits are effective for payroll periods beginning April 1, 2020, and ending not later than Dec. 31, 2020, under FFCRA and for wages paid March 13, 2020, to Dec. 31, 2020, under the CARES Act. 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.

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. Waiver of failure to deposit penalty under tax code [Section 6656](#) applied to retained payroll taxes that did not exceed the actual amount of allowed payroll credit for the calendar quarter. Similar relief with respect to the refundable tax credits under FFCRA was available to self-employed individuals subject to SECA tax, including certain religious workers within the scope of tax code [Section 3401\(a\)\(9\)](#), with respect to estimated tax payments for a calendar quarter.

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 RRTA equivalent. Thus, the employer portion of 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. 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. Therefore, an employer may reduce deposit of Medicare tax in anticipation of payroll credits for a calendar quarter. However, the withheld Medicare tax amounts generally would be deposited on the next regular deposit date, absent anticipation of additional applicable payroll credits.

In addition, CARES Act Section 2302 permits employers to defer the employer portion of FICA social security tax or the RRTA tax amount attributable to the tax rate set forth in tax code [Section 3111\(a\)](#) beginning March 27, 2020, and until Jan. 1, 2021. 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.

Section 4 of the Flexibility Act extended deferral under CARES Act Section 2302 to employers receiving forgiveness of all or a portion of Paycheck Protection Program (PPP) loan amounts under CARES Act Section 1106. PPP is administered by the Small Business Administration (SBA). Section 4 of the Flexibility Act also applied to recipients of forgiveness of loans issued by certain non-SBA lenders pursuant to CARES Act Section 1109. Thus, the tax authorities may overlap with respect to an amount of reduced withholding or deposit of employer or employee payroll taxes. Therefore, employers or third party administrators 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, 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. 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 Form W-3 with the Social Security Administration, and furnishes a copy of Form W-2 to the employee. 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. Form 941, revised in April 2020, contains new line 13b for reporting of deferred employer share of social security tax under CARES Act Section 2302. Current Form 941 does not contain similar disclosure for 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. The notice does not clarify how the "ratable" withholding and deposit requirements apply. Without clarification, an employer might allocate the deferred applicable taxes equally among the payroll

dates between Jan. 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.

Thus, 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 Jan. 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.

EMPLOYER CONSIDERATIONS AND ACTION ITEMS FOR DEFERRAL

Notice 2020-65 permits only deferral, and not forgiveness of employee portion of social security tax or equivalent railroad tax for the period from Sept. 1, 2020, to Dec. 31, 2020. The deferred tax liability must be paid within four months, from Jan. 1, 2021, to April 30, 2021, to avoid accrual of interest, penalties, or additions to tax under the tax code for failure by employer to withhold or deposit the employee portion of payroll taxes. 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 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 employee and payment of tax. 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 payroll 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 Notice 2020-65. Employers also must continue to report, withhold and pay, as applicable, any required State income tax, unemployment insurance (SUI) tax or disability insurance (SDI) 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.

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 Section 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 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 Dec. 31, 2020.

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