

Payroll tax deferral guidance leaves unanswered questions



David M. Kall, Adam Grais, Christian D. Sorensen | Wednesday, September 2, 2020

President Donald Trump issued a [directive](#) on Saturday, August 8, 2020, to defer collection of certain payroll taxes normally withheld from employees' paychecks. The benefit would last from September 1 through the end of the year. The directive left open questions about how the order would be implemented. Many companies expressed reluctance to implement the deferral, because of difficulties administering it and the greater burden for employees next year.

The IRS and U.S. Treasury issued guidance on August 28, 2020, implementing the President's order ([Notice 2020-65](#)). The notice allows employers to defer withholding the employee portion of certain payroll taxes from certain employees' compensation during the last four months of 2020 and then withhold those deferred amounts during the first four months of 2021. However, the guidance also left a number of questions unanswered that may make it difficult for employers to elect this option.

Under the guidance, employers can defer the withholding, deposit, and payment of Social Security taxes on wages paid from September 1 through Dec. 31, 2020. The deferral applies to the employee portion of Social Security tax and Railroad Retirement Act Tier I tax. The due date for withholding and payment of these taxes is postponed until the period beginning Jan. 1, 2021, and ending April 30, 2021.

The deferral applies to any employee whose pretax wages or compensation during any biweekly pay period is less than \$4,000. This does not mean that the deferral would apply to employees with compensation "up to" that amount. Rather, it only applies to any pay period in which the employee is paid

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less than \$4,000, with testing done separately for each pay period. The notice leaves unclear whether this limit applies to wages and compensation or if items such as bonuses, commissions, or overtime hours should be included. For those workers that qualify, the deferral applies to the employee's portion of Social Security and Railroad Retirement Act Tier I tax. Workers generally pay these taxes at a rate of 6.2% as the employee.

Notice 2020-65 puts the burden of repaying any deferred taxes on the employer, not on the employee. If an employer elects to defer withholding under the notice, then the employer must withhold and pay the deferred taxes from wages and compensation paid during the period from Jan. 1, 2021, to April 30, 2021 (the "Catch-Up Period"). Interest, penalties, and additions to tax will begin to accrue on May 1, 2021, with respect to any unpaid taxes.

This structure may lead to several problems. Employees may pushback when they realize that the employer is withholding at a higher than normal rate (essentially double) during the Catch-up Period. While Notice 2020-65 allows employers to "make arrangements to otherwise collect the total applicable taxes from the employee," it does not provide any details on allowable alternatives. Another significant issue is what employers should do about an employee who leaves the company after having taxes deferred or does not make enough money to pay back the tax, such as seasonal employees who might work more during the holiday season than during the first quarter of the year. In those situations, it would be difficult if not impossible for the employer to recoup the deferred taxes from wages paid to the employee in the Catch-Up Period, leaving the employer responsible for the deferred taxes which would otherwise have been the employee's obligation.

Notice 2020-65 does not address deferral of Social Security tax for self-employed persons, so it remains unclear if they may take advantage of the deferral. In addition, Notice 2020-65 does not indicate whether or not employers are required to defer or whether, as Treasury Secretary Mnuchin has stated publicly prior to issuance of the notice, deferral is optional.

Additional practical issues remain as well. The directive would require businesses to quickly re-tool their payroll systems to withhold the proper amount of tax from certain employees' paychecks. The notice also does not address how this would have to be coordinated with state and local tax withholding. Certain employers, such as those with collective bargaining agreements, will also need to confirm if they are permitted to adjust withholding under those agreements before implementing any changes.

While Notice 2020-65 clarifies certain issues related to the payroll tax deferral under the president's directive, many questions remain and employers should carefully consider if the possible short-term cash flow benefit to their employees is worth the cost of retooling their payroll systems, the potential confusion or unhappiness of their employees from increased withholding in the Catch-Up Period and the possibility of the employer being responsible for deferred taxes if an employee leaves or has insufficient wages in the Catch-Up Period to fully pay the deferred taxes. These will be important questions for employers to have answered before they adjust their payroll systems. Unless additional guidance makes it clear that the deferral is mandatory, it may be better for companies to wait and see if the program is optional before deciding whether or not to defer the withholding.



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