Employers Have Little Incentive to Implement Social Security Tax Deferral Under New IRS Released Guidance

Description

By Russell J. Stein

On Friday August 28th the IRS issued limited guidance on the payroll tax deferral that was part of President Trump's August 8th executive order. Under IRS Notice 2020-65 (the "Notice"), employers are not required to withhold the employee share of Social Security taxes (the "Applicable Taxes") attributable to wages paid to an employee during the period beginning on September 1, 2020, and ending on December 31, 2020 (the "Deferral Period"). Under the Notice, the tax deferral only applies to employees who make less than $4,000 for a bi-weekly pay period (an annualized amount of $104,000).

The due date for withholding and deposit of Applicable Taxes to the IRS from the Deferral Period is postponed until the period beginning on January 1, 2021 and ending on April 30, 2021. The Notice does not apply to any taxes other than an employee's share of social security taxes (and the railroad tax equivalent).

The tax deferral appears to be optional; businesses do not have to defer withholding. If a business chooses not to defer and continues to withhold the Applicable Taxes from an employee's paycheck, it appears that such taxes are still required to be deposited with the IRS under the employer's normal deposit schedule.

If an employer chooses to defer withholding, the deferred amounts must be withheld "ratably from wages and compensation paid between January 1, 2021 and April 30, 2021 or interest, penalties, and additions to tax will begin to accrue on May 1, 2021, with respect to any unpaid Applicable Taxes."

Employees should be made aware that this is only a deferral of taxes, the taxes are still due in full under current laws by April 30, 2021.

If Applicable Taxes are withheld during the Deferral Period it is unclear what happens if the employee leaves the company prior to January 1st (or prior to the previously deferred taxes being fully withheld by the employer by April 30, 2021). Employers appear to still be responsible for collecting the previously deferred Applicable Taxes from any employees who leave prior to April 30, 2021. The Notice indicates that employers "may make arrangements to otherwise collect the total Applicable Taxes from the employee." It is uncertain what happens if an employer fails to make any such arrangement, the employer may be liable for such taxes, interests and penalties if not paid by April 30, 2021.

Key Takeaways for Employers

- Employers of all sizes are eligible to participate.
- For employees making under $4,000 per bi-weekly pay period, employers have the option beginning on September 1st to not withhold the employee's portion of Social Security taxes (i.e., 6.2%).
- As an example, an employee making $60,000 a year would ordinarily have approximately $143 in Social Security taxes withheld on a bi-weekly paycheck. During the four-month Deferral Period, if the employee's portion of Social Security taxes was not withheld the employee's take home pay would increase by close to $1,300.
- If the employee's portion of Social Security taxes are withheld by the employer during the Deferral Period, such taxes are not eligible for deferral and must be deposited with the IRS in accordance with the employer's normal schedule.

- The Notice does not provide any guidance regarding employee participation and if an employer chooses to defer withholding, whether such deferral must be for every eligible employee or whether the employer can limit the deferral to just those employees that request it.
- If an employee leaves prior to the previously deferred taxes being withheld in full, the employer is still responsible for collecting such amounts from the former employee. Thus, if an employer implements the deferral, it should require employees to sign an agreement authorizing the future payroll deductions and promising direct repayment to the employer should there be no wages to deduct the amounts from, along with payment of the employer's attorneys' fees for any collection costs associated with the employee's failure to pay.
- Given employers are not allowed to hold the money during the deferral period and the employer's potential liability if an employee leaves, is terminated or goes on unpaid leave prior to April 30, 2021, in most cases employers should not implement the deferral.

Key Takeaways for Employees

- The deferral is only available for employees making less than $4,000 per bi-weekly pay period.
- This is only a short-term deferral of taxes, not an exception from taxation. Under current law, 100% of the deferred taxes must be withheld and paid to the IRS by April 30, 2021.
- Only the employee's portion of Social Security taxes are eligible for deferral. All other taxes, including income taxes and applicable state taxes, are unaffected.
- The deferral appears to be solely at the option of the employer; an employee does not appear to have a right to "demand" to participate in the tax deferral and many employers will be likely to deny deferral requests.
- Starting on January 1st, the employer must start ratably withholding the deferred taxes from the employee's paycheck, in effect doubling up on the employee's portion of Social Security taxes for the period from January through April 2021. Accordingly, for the first four months of 2021 an employee's take-home pay will be less than the current take-home pay absent any regulatory changes.

Partridge Snow & Hahn counsel, Russell J. Stein, is ready to answer questions regarding the Notice or any other recently enacted tax changes attributable to COVID-19.

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