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What Employers Should Know About Deferring Employee Payroll Tax

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On Aug. 8, 2020, President Trump issued a memorandum calling for the Secretary of Treasury to allow for the deferral of payroll tax withholding on the employee portion of certain payroll taxes. This memorandum is separate from the ability of employers to defer their own payroll tax obligations under the CARES Act and is intended to provide stimulus to the economy by temporarily boosting take-home wages. On Aug. 28, 2020, the Department of Treasury and Internal Revenue Service issued Notice 2020-65, allowing employers to defer payroll tax withholding, but requiring all amounts not withheld to be paid between Jan. 1, 2021, and April 30, 2021.

The President's memorandum and the notice have caused significant confusion for employers about what they need to do, if anything.

Do I, as an employer, have to implement deferred withholding?

No, nothing in the memorandum from the President or the notice from the IRS indicates that deferral is mandatory. Treasury Secretary Mnuchin has informally indicated that he believes his department cannot force employers not to withhold, which is consistent with Section 7508A of the Internal Revenue Code. Section 7508A gives the IRS power to postpone deadlines, but does not give the IRS the power to prohibit employers from timely withholding and paying taxes. Even if one of your employees insists that they want you to defer the withholding, you, as the employer, are not required to do so. The IRS notice defines the employer as the "Affected Taxpayer." Thus, the notice itself supports the conclusion that it is the employer's right to choose to defer or not, and does not appear to create any right for the employee to demand an employer defer the withholding.

What employees are eligible for deferred withholding?

Employees must make less than $4,000 in wages for the applicable bi-weekly pay period or the appropriate amount at that rate if payroll taxes are withheld over a different payroll period. (As a rough guide this reaches anyone with an annual salary of $104,000 or less, but the measuring period is the payroll tax withholding period, not annual wages.) The term wages here refers to the term as it is used for payroll tax purposes and includes everything (commissions, bonuses, employee elective 401(k) deferrals) that is normally subject to the employee portion of social security tax.

How does the deferral and catch-up work?

Employers may choose not to withhold the employee portion of social security tax on qualifying employees from Sept. 1, 2020 through Dec. 31, 2020. All such amounts not withheld must be paid back by April 30, 2021, by ratably withholding over the period from Jan. 1, 2021, to April 30, 2021, or interest, penalties, and additions to tax will begin to accrue on May 1 2021. **The interest, penalties and additions to tax are imposed on the employer**Employers who defer withholding the taxes should get signed acknowledgments from employees that they understand the change in withholding is a deferral only and will result in less take-home pay from Jan. 1, 2021 through April 30, 2021.

What should I do if an employee leaves before the full amount of deferred payroll taxes has been withheld?

While the notice is silent on what is to be done in the case of an employee who leaves employment prior to the repayment of the amounts from 2020, employers should plan for such situations. For example, employers should review their state wage payment laws and determine if a signed authorization to withhold the amount from the final paycheck would be necessary and/or an effective method of addressing the situation.

Should I implement payroll tax deferral?

Each employer will need to weigh the pros and cons of implementing payroll tax deferral.

For advice, please contact Natalie Sanders or Josh Lingerfelt, linked below.

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