

## Tax Law Insights

A Burr & Forman **BLOG**

# Employee Payroll Tax Deferral—What Could Go Wrong?

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In March, Congress passed the Coronavirus, Aid, Relief and Economic Security Act (“CARES Act”) to aid businesses and individuals. One CARES Act relief provision offered the deferral of certain payroll taxes. In particular, Section 2302 provides that employers may defer the deposit and payment of the employer’s portion of the Social Security taxes arising between March 27, 2020, and December 31, 2020 (the “Employer Deferral”). Any deferred taxes are repaid over the following 2-year period. The CARES Act failed to offer similar deferrals for the employee portion of Social Security taxes.

As negotiations stalled in Congress regarding the fourth piece of major Coronavirus legislation, President Donald Trump sought to use his executive power to offer deferral of the employee portion, while adding a potential forgiving twist.

On Saturday, August 8, 2020, President Trump issued a memorandum authorizing the Treasury Secretary to use his authority under Section 7508A of the Internal Revenue Code (the “Code”) to “defer the withholding, deposit, and payment of the tax” imposed under Code Sections 3101(a) and 3201 (i.e., the employee Social Security tax portion) from September 1 through December 31 (the “Employee Deferral”) (the “Memorandum”). The Memorandum offers this deferral only for those who earn less than \$4,000 in a bi-weekly pay period on a pre-tax basis. Stated another way, the deferral only applies to those who earn less than \$104,000 in 2020, pre-tax.

While the Memorandum characterizes the Employee Deferral as a short-term deferral of the employee’s portion of the Social Security tax, this may not be the case in the long-term. President Trump, on the day he issued the Memorandum, stated that if he wins reelection, he intends to forgive the deferred taxes, making it a “permanent cut to the payroll tax.” Of course, Congress must generally go along with that.

Without further guidance from Treasury, the Memorandum provides more questions than answers for employers and employees alike. We address some of those questions below.

## Questions and Potential Answers/Interpretations

*How should an employer (or their advisor) interpret this Memorandum?*

For now, narrowly. Section 3 of the Memorandum states that the Treasury Secretary must issue guidance to implement the new Employee Deferral. With a mere two weeks before implementation, Treasury must work quickly.

*Will Treasury accept payments of the employee portion between September 1 and December 31?*

Probably. Section 2 of the Memorandum directs the Secretary of the Treasury “to use his authority” to “defer the withholding, deposit, and *payment*” (emphasis ours) of the employee portion. While some could perhaps interpret this as prohibiting the IRS from accepting payments of the employee portion, this is unlikely. Reading Section 2 in totality, it is more likely that the President intends for the Employee Deferral to be discretionary, as is the case with the Employer Deferral under the CARES Act. Buttressing this, Secretary Mnuchin publicly stated that the IRS does not have the power to force employers to stop withholding the employee portion of the Social Security taxes.

*Can an employee “force” its employer elect the Employee Deferral?*

Probably not. Despite language in the Memorandum stating that “[t]he deferral shall be made available with respect to any employee . . .” and an explicit purpose to “put money in the pockets of American workers and generate additional incentives for work and employment, right when money is needed most,” we think that the employer makes the call here. The reasons for that are fleshed out in the following questions.

*How hard could it be?*

Hard, depending on the employer’s size. To implement the Employee Deferral, employers (or their payroll service providers or accountants) will likely have to change the way their software withholds and remits the employee portion. Employers that decide to withhold the employee portion but defer remitting those amounts to the IRS must, of course, keep track of the amount withheld. We suspect that many will keep the withheld-but-deferred amounts in a separate account. Additionally, electing employers that fail to withhold the employee portion must ultimately restore the deferred amount over the deferral period before the tax becomes due, which leads to our next question.

*What could go wrong?*

A lot, potentially. Any employer electing the Employee Deferral, of course, still owes the underlying tax; the deferral is potentially helpful and provides certain time-value-of-money benefits, sure, but the liability remains. Thus, electing employers that also choose to forgo withholding from an employee’s paycheck must necessarily consider how they will eventually fund the ultimate liability. Will they merely hope that the President’s forgiveness promise receives Congressional approval? Will they pay off the liability with increased withholdings in later years? Is this practical from an employer-employee relationship perspective, or even feasible with current payroll software?

On the other hand, electing employers that decide to withhold the employee portion, but not remit it has other issues to consider. Even employers that properly track the amount withheld and separate it from normal operating funds may find that creditors have no trouble accessing the funds, or see it as

a tempting source of capital during slow times. When the deferred liability comes due, we do not expect the IRS to recognize the defense that the funds were lost to creditors or otherwise used in normal business operations. Remember, as the withholding agent, the employer is on the hook for the employee portion. Yes, the employee is also, but, when given the choice, the IRS has always pursued one employer versus dozens, or even thousands, of employees.

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