

President's Program Permitting Deferral of Employees' 6.2% Social Security Tax for Four Months Presents Complexity and Risk for Employers and Uncertain Benefits for Employees

by Christian Davis and Tim Goodman

On August 8, 2020, President Trump signed a Presidential Memorandum entitled "Memorandum on Deferring Payroll Tax Obligations in Light of the Ongoing COVID-19 Disaster," effective as of September 1, 2020 (the "Memorandum"). Late on Friday, August 28, 2020, in Notice 2020-65 (the "Notice") the Secretary of Treasury provided the guidance that was directed by the Memorandum. As described in more detail below, the Memorandum and the Notice provide that employers may suspend withholding the employee portion of Social Security payroll taxes for eligible employees with respect to wages paid to them from September 1, 2020, to December 31, 2020, but that the deferred taxes generally must be paid over to the Internal Revenue Service ratably during the period January 1, 2021, to April 30, 2021.

Employers are asking:

- Must employers stop withholding the employee portion of Social Security payroll taxes?
- Are there risks to employers if they do suspend the withholding of the employee portion of Social Security Taxes?

The short answers are:

- No, employers are not required to suspend withholding (it is optional in the employer's discretion).
- Yes, employers are at risk of owing additional amounts if they do suspend withholding; they are liable for any amounts not ultimately collected from the employee (for example, if an employee terminates employment before the amount is withheld from the employee the employer is liable).

Based on this, and the complexity of adjusting payroll systems, we expect that many, if not most, employers will decide not to suspend withholding. This update provides more detail on the intent of the Memorandum, a few points to note surrounding the implementation of the Memorandum, and the options for responding to the Memorandum.

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The Presidential Memorandum

On March 13, 2020, the President determined that the COVID-19 pandemic necessitated an emergency declaration under section 501(b) of the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. 5121-5207. The President signed the Memorandum pursuant to that emergency declaration and in response to the breakdown in negotiations between Democrats and Republicans over the next phase of COVID-19 stimulus legislation. In the Memorandum, the President instructed the Secretary of the Treasury to use the Secretary's authority pursuant to 26 U.S.C. 7508A to defer the withholding, deposit, and payment of the employee's 6.2% Social Security tax on wages (or the Railroad Retirement tax equivalent) paid during the period of September 1, 2020, through December 31, 2020, subject to the conditions that (a) the deferral shall only be available for any bi-weekly payroll period for employees whose gross wages payable during the period are less than \$4,000 (or the equivalent threshold amount if employees are paid for different pay periods than bi-weekly periods), and (b) the amounts deferred shall be without penalties, interest, additional amount, or addition to the tax.

In providing for deferral of this tax, the President has sought to increase the take-home pay of every eligible worker for the last four months of the calendar year by 6.2%. This, as the Presidential Memorandum states, "will put money directly in the pockets of American workers and generate additional incentives for work and employment, right when the money is needed most."

Notice 2020-65 provides that employers must pay the deferred taxes to the Internal Revenue Service between January 1, 2021 and April 30, 2021, otherwise interest, penalties, and additions to tax will begin to accrue on May 1, 2021 with respect to any unpaid taxes.

The Notice provides that employers must withhold and pay the deferred taxes ratably during the four-month "payback" period. The Notice also provides that if necessary, the employer may make "other arrangements" to collect the deferred taxes from employees, such as if the employee has left employment.

It is important to note that the four-month payback period equals the four-month deferral period. Thus, roughly speaking at least, and subject to the complications discussed below, an employee who had 6.2% more take-home pay during the deferral period would have their net pay go down by twice that amount during the period the deferred taxes must be paid.

Points to Note Regarding the Presidential Memorandum and the Notice

First, a deferral of a tax obligation is not the same as forgiveness of, or exemption from, a tax obligation. Eliminating the tax obligation entirely would require Congress to pass legislation that retroactively establishes a tax "holiday" beginning on September 1, 2020. While possible, Congress has not shown an appetite to enact a payroll tax holiday for employees during their previous rounds of negotiation regarding COVID-19 relief bills.

Second, the Notice defers the employer's obligations to pay the portion of the employee's taxes that is covered under the Memorandum. Neither the Memorandum nor the Notice provides any relief for employers that are unable to recover the deferred taxes through increased withholdings in 2021. Accordingly, if an employee were to terminate employment during the deferral period, or during the payback period before the employer had the opportunity to recover the deferred tax obligation, the employer would still be required to pay the employee's taxes.

Third, neither the Memorandum nor the Notice explicitly requires an employer to take action to discontinue withholdings. Indeed, Treasury Secretary Mnuchin has been widely quoted in numerous press reports as stating that an employer's decision whether to participate in the four-month deferral program is entirely voluntary. Presumably, absent more explicit guidance, employers will be free to continue withholdings as provided for in statutory law. The decision to alter withholdings comes, for many employers, with an investment in retooling existing payroll systems. An employer may decide that the costs associated with implementing such a change, to decrease withholdings for four months, then to increase withholdings when the payback period begins, then to decrease withholdings back to ordinary levels when the appropriate amount is recovered from the employee, outweigh any short-term benefits to employees offered by the deferred taxes.

Possible Approaches for Companies in Light of the Presidential Memorandum

Three possible approaches for employers to respond to the Memorandum and Notice present themselves: (1) continue to withhold, (2) adopt the tax deferral pursuant to the Notice, either for all eligible employees or for employees who consent to participate and (3) wait and see.

The simplest approach is to continue to withhold. This avoids the need to modify payroll systems and avoids the risk of liability if an employee terminates employment prior to the corrective amount being deducted from employees. It also avoids employees asking why additional amounts are being deducted from their pay during the first four months of 2021.

If an employer wishes to adopt the tax deferral, the employer will no longer withhold the 6.2% Social Security tax from eligible employees (or from participating employees if the employer adopts tax deferral only for employees who wish to participate). This will provide an employee with increased cash during the deferral period, but will require a greater withholding during the beginning of 2021 to cover the deferred tax obligation. As mentioned above, the employer will still be obligated to pay the deferred taxes even if they are unable to be recovered from the employee during the payback period. This approach would require adjusting the employer's payroll systems at least twice. There are further complications to this adjustment if an employee is hired during this period or the employee's compensation changes during this period (complications in assuring that the correct amount is deducted to replace the amount that would have been deducted). An additional complication is only employees with gross pay less than \$4,000 during a bi-weekly payroll period are eligible for the tax deferral for that period.

A third approach may be available, but goes against the reason for the tax deferral

outlined in the Memorandum (allowing employees to retain more pay during the remainder of 2020). Under the third approach, an employer may decide to take a “wait and see” approach to the Notice. This would mean that the employer continues to withhold the 6.2% of wages from the employee, but it does not remit the payment to the Internal Revenue Service until the payback period. If Congress enacts a payroll tax holiday, the employer may return the money to the employees as appropriate; if no further government action is taken, the employer will remit the withheld wages to the IRS during the payback period. This approach will not provide any extra cash to employees, but it would prevent any adverse consequences to the employees when the deferred tax obligations come due. This approach would require some retooling of the employer’s tax infrastructure, but the employer will not have to alter any systems that are in place to withhold from employees. Under this approach there is no risk to employers that they will be unable to recover deferred tax obligations from employees during the payback period, although there is a cursory suggestion in the Notice that failure to deposit penalties could be imposed as a result of the fact that taxes were, in fact, withheld from employees.

For Further Discussion

Many employers are receiving questions from employees about the payroll tax deferral provided for in the Memorandum. If you would like assistance in answering these questions or in determining what approach to take in response to the Memorandum and Notice, please contact any one of us or any of the Dorsey attorneys with whom you work.