

2020 Payroll Tax Deferral Order



August 10, 2020

Highlights

- ✓ Executive Orders Issued After CARES 2 Negotiations Stall
- ✓ Four-Month Payroll Tax Deferral Applicable to Annual Salaries Under \$104,000
- ✓ Many Unknown Issues Await IRS Guidance

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SPECIAL REPORT

President Issues Executive Order Deferring Payroll Taxes Beginning September 1, 2020

As the COVID-19 (coronavirus) pandemic continues to surge in multiple regions of the United States, the economy continues to flounder. While some economic recovery has occurred in the aftermath of large shutdowns in the spring, job losses continue to mount while state and local governments struggle with increased costs from battling outbreaks and reduced tax revenue.

"CARES 2" OVERVIEW

After three large Acts were passed by Congress and signed into law in the spring (including the \$2 trillion CARES Act), it was generally agreed that a fourth large bill (colloquially known as CARES 2) would have to be passed to provide more relief and to help stimulate the economy. In May, the House passed the \$3 trillion HEROES Act (almost entirely along party lines) which provided relief for state and local governments, increased funding for COVID-19 testing, another round of economic stimulus payments, and much more. The bill received little attention in the Senate, due to its high cost.

In late July, the Senate GOP released the \$1 trillion HEALS Act. The bill provided some additional relief for testing, an extension of the moratorium on evictions, continued, but reduced, enhancement of unemployment benefits, more Paycheck Protection Program funding, a second round of stimulus payments, as well as new and expanded employment tax credits. The bill was met with a lukewarm response from Senate Democrats as well as many GOP members. Notably, the bill did not include a payroll tax cut, long-demanded by the White House and long-refused by members of Congress on both sides of the aisle.

As July turned to August, negotiations began between Democratic leadership and the White House to try to find common ground. However, on August 7, 2020, it was determined the impasse could not be broken, and on August 8, 2020, the President issued four Executive Orders to provide some needed relief. The most significant order for tax professionals is for a deferral of payroll taxes from September 1, 2020 through December 31, 2020. The remaining three orders addressed enhanced unemployment payments, eviction moratoriums, and student loan relief.



PAYROLL TAX BACKGROUND

The term “payroll tax” is commonly used interchangeably with the term “employment tax,” and both refer generally to taxes imposed under the Federal Insurance Contributions Act (FICA) on employee wages. The employer withholds the employee share of FICA tax from wages it pays to the employee, and also pays the employer share of FICA tax based on those wages. Whether the FICA tax applies depends on whether a worker is an employee and is paid wages under the FICA tax rules. The FICA tax has two components:

1. The 6.2% Social Security tax—also called the old-age, survivors and disability insurance (OASDI) tax—applies to wages paid up to the annual Social Security wage base (\$137,700 for 2020).
2. The 1.45% Medicare tax—also called the hospital insurance (HI) tax—applies to all wages paid.

“Treasury guidance will be essential to understanding how the deferral will actually work in practice, as numerous questions remain unanswered.”

An elimination of the payroll tax has been on the White House wish list for months as a form of economic stimulus. The idea is that a reduction or elimination of the FICA tax would allow for more wages to pass through to employees, thereby providing more spending ability.

Q COMMENT. *Congressional Democrats and Republicans have been against using any sort of payroll tax holiday as an economic stimulus because it is inefficient and slow. Obviously, it would only provide a benefit to individuals who are employed at a time when millions are unemployed. Also, any benefits employees receive is done so paycheck to paycheck, instead of as one lump-sum such as the economic impact payment made to individuals earlier in 2020.*

DEFERRAL OF PAYROLL TAXES

Under the terms of the President’s “Memorandum on Deferring Payroll Tax Obligations in Light of the Ongoing COVID-19 Disaster,” withholding, deposit, and payment of the **employee’s** share of the 6.2% Social Security tax

under Code Sec. 3101(a) (as well as the similar provision applicable to railroad employees under the Railroad Retirement Tax Act) are deferred on wages paid during the period beginning September 1, 2020 and ending December 31, 2020. Amounts are to be deferred without any penalties, interest, additional amount, or addition to the tax. The Treasury is ordered to issue guidance implementing the deferral.

ICON IMPACT. *The order does not address the employee’s share of the 1.45% Medicare tax on wages under Code Sec. 3101(b), which will still need to be withheld, deposited and paid during the deferral period.*

ICON COMMENT. *The authority under which this deferral is ordered is Code Sec. 7508A, which allows only for the granting of a delay in payments or other actions in response to a disaster declaration. This was the same authority under which the payment of taxes and filing of tax returns for the 2019 tax year were delayed to July 15, 2020. There is no grant of authority in the Internal Revenue Code to entirely abate any tax as a result of a disaster.*

The deferral of the employee’s share of FICA taxes only applies with regard to employees with bi-weekly, pre-tax income for less than \$4,000, or a similar amount where a different pay period applies. This roughly equates to an annual salary of \$104,000.

The Treasury is also ordered to explore avenues under which the deferred taxes can be eliminated completely, through either administrative means or legislation.

ICON IMPACT. *If the deferral expires on December 31, 2020, then presumably an employer would have to begin paying the four months’ worth of FICA taxes in January 2021. This would be on top of deferral of the employer’s share of FICA taxes under the CARES Act from March 27, 2020, to December 31, 2020. The CARES Act allows employers to pay the deferred amounts over two years. It is uncertain if the deferral of the employee’s share of FICA taxes would follow a similar payment schedule.*

UNCERTAIN IMPLEMENTATION

As mentioned above, the Treasury is ordered to issue guidance to implement the deferral. This Treasury guidance will be essential to understanding how the deferral will

actually work in practice, as numerous questions remain unanswered. Additionally, it is unclear how much effect on the economy the deferral will actually have given that the taxes will eventually have to be paid.

Given these uncertainties and without implementing guidance it is not clear that an employer would take advantage of the deferral. It is also unclear at this stage whether there is any requirement that employers **must** temporarily cease withholding the employee's share of the tax in addition to not depositing and paying the tax. IRS guidance would have to be issued that requires an employer to do all three steps, otherwise an employer could simply continue to withhold the amounts from employee wages and just hold on to the withheld amounts, which would negate any stimulating effect on the economy.

 **COMMENT.** Whether the deferral is optional or not raises important issues with state laws. Some state employment laws provide that an employer

must have an employee's written permission to withhold anything from their wages that the employer is not required to withhold.

Also unclear is how employers should implement the deferral in the case of job changes. If Employer A implements the deferral, and an employee changes jobs to Employer B during the deferral period, Employer A would be unable to recover the deferred taxes from a former employee, but would still be liable for the payment of the deferred taxes beginning in January 2021. The employee ultimately remains liable for his or her own taxes.

As it does not appear that the tax can actually be eliminated without an act of Congress, and since temporary elimination of the tax does not enjoy broad support in Congress, it is questionable whether employers will take advantage of the deferral, given the likelihood that it will result in a large payment of taxes at the beginning of 2021.