President Issues Executive Order Allowing Temporary Deferral of Payroll Taxes

After three large acts were passed by Congress and signed into law in the spring, the Coronavirus Preparedness and Response Supplemental Appropriations Act (P.L. 116-123), the Families First Coronavirus Response Act (P.L. 116-127), and the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136), 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 further. As July turned to August, negotiations began between Congress 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 payroll professionals is for a temporary 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.

EXECUTIVE ORDER ISSUED AFTER NEGOTIATION IMPASSE

The President issued the Memorandum on Deferring Payroll Tax Obligations in Light of the Ongoing COVID-19 Disaster on August 8, 2020 (85 FR 49,587, August 13, 2020). The order allows for the deferral of the employee portion of payroll (Social Security) taxes through the end of the year. The deferral applies to Federal Insurance Contributions Act (FICA) and Railroad Retirement Tax Act (RRTA) taxes. It does not apply to withheld federal income tax. FICA refers to the combined taxes withheld for Social Security (6.2%) and Medicare (1.45%). However, note that the directive does not refer to, nor apply to, Code Sec. 3101(b) which covers the Medicare tax (1.45%). In addition, the Secretary of the Treasury was directed to, and has issued guidance, to implement the order. The Secretary was also directed to explore avenues, including legislation, to eliminate the obligation to pay the taxes deferred pursuant to the memorandum. The specific sections state:

Sec. 2. Deferring Certain Payroll Tax Obligations. The Secretary of the Treasury is hereby directed to use his authority pursuant to 26 U.S.C. 7508A to defer the withholding, deposit, and payment of the tax imposed by 26 U.S.C. 3101(a), and so much of the tax imposed by 26 U.S.C. 3201 as is attributable to the rate in effect under 26 U.S.C. 3101(a), on wages or...
compensation, as applicable, paid during the period of September 1, 2020, through December 31, 2020, subject to the following conditions:

(a) The deferral shall be made available with respect to any employee the amount of whose wages or compensation, as applicable, payable during any bi-weekly pay period generally is less than $4,000, calculated on a pre-tax basis, or the equivalent amount with respect to other pay periods.

(b) Amounts deferred pursuant to the implementation of this memorandum shall be deferred without any penalties, interest, additional amount, or addition to the tax.

The deposit obligation for employee Social Security tax does not arise until the tax is withheld. Accordingly, by postponing the time for withholding the employee Social Security tax, the deposit obligation is delayed by operation of current IRS regulations.

Critics have questioned the President’s authority to order the payroll tax deferral. The memorandum relies on the Internal Revenue Code provision that authorizes the postponement of deadlines by reason of a presidentially-declared disaster determined to warrant assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Code Sec. 7508A). On March 13, 2020, the President issued an emergency declaration under the Stafford Act in response to the COVID-19 pandemic, and that declaration was subsequently used to support the extension of the April 15 individual income tax filing deadline to July 15, as well as other deadline postponements (see IRS Notice 2020-17, 2020-15 I.R.B. 590 (March 18, 2020)). The Presidential Memorandum invokes the same authority with respect to the payroll tax deferral.

IRS GUIDANCE ISSUED

The IRS issued guidance on the President’s executive order on the deferral of payroll taxes. The guidance states that employers that are required to withhold and pay the employee share of Social Security tax under the order are “Affected Taxpayers.” However, the due date for the withholding and payment of the tax is postponed until the period beginning on January 1, 2021, and ending on April 30, 2021. According to the IRS, the deposit obligation for employee Social Security tax does not arise until the tax is withheld. Accordingly, by postponing the time for withholding the employee Social Security tax, the deposit obligation is delayed by operation of current IRS regulations. Thus, the Notice does not separately postpone the deposit obligation. (IRS News Release IR-2020-195; IRS Notice 2020-65, August 28, 2020).

Applicable wages

“Applicable Wages” means wages as defined in IRS Code Sec. 3121(a) or compensation as defined in Code Sec. 3231(e) paid to an employee on a pay date during the period beginning on September 1, 2020, and ending on December 31, 2020, but only if the amount of such wages or compensation paid for a bi-weekly pay period is less than the threshold amount of $4,000, or the equivalent threshold amount with respect to other pay periods. The determination of Applicable Wages is made on a pay period-by-pay period basis.

Payment of deferred taxes

Employers must withhold and pay the total taxes that were deferred 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, on any unpaid taxes. If necessary, employers may make arrangements to otherwise collect the total taxes from the employee.

COMMENT: The authority under which the deferral is allowed is Code Sec. 7508A, which allows only for the granting of a delay in payments or other actions in
response to a disaster declaration. As noted, this was the same authority under which the payment of taxes and filing of personal income 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 and there is no authority to stop employers from withholding and paying taxes timely under the law. The President’s directive does not mandate employers to participate nor does the IRS News Release or IRS Notice. It allows employers to defer and makes relief available. **In other words, it’s up to the employers to participate or not.**

**Eversheds Sutherland Observation:**
Designation as an “Affected Taxpayer” in published IRS guidance with respect to a particular disaster is required to trigger deferral of an obligation under Code Sec. 7508A (See Code Sec. 7508A(a); Treas. Reg. § 301.7508A-1(b)(1) & (d)(1); Rev. Proc. 2018-58, § 4.01). Because the Notice does not designate employees as “Affected Taxpayers,” it appears that the IRS did not intend to grant employees an independent right to defer withholding, deposit and payment of the employee portion. This is consistent with case law holding that employees do not have a private right of action against their employers under the Social Security provisions (See, e.g., McDonald v. Southern Farm Bureau Life Insurance Co., 291 F.3d 718 (11th Cir. 2002)). However, there appears to be no prohibition on an employer providing an employee with the option to defer (or not defer) the employee portion. (IRS Gets to the Point in Brief Payroll Tax Deferral Guidance, August 31, 2020; [https://us.eversheds-sutherland.com/NewsCommentary/Legal-Alerts/234904/IRS-gets-to-the-point-in-brief-payroll-tax-deferral-guidance](https://us.eversheds-sutherland.com/NewsCommentary/Legal-Alerts/234904/IRS-gets-to-the-point-in-brief-payroll-tax-deferral-guidance)).

There will be changes to payroll forms

Form 941, Employer’s Quarterly Federal Tax Return, is used by employers to report, among other items, withheld federal income taxes and the employer and employee portions of Social Security and Medicare taxes.

The CARES Act allowed for the deferral of the employer portion of Social Security taxes and the IRS subsequently modified Form 941 to handle the reporting of it. Likewise, in this situation, Form 941 will be modified again in time for third and fourth quarter reporting. The form is due by the last day of the month following the end of each quarter. The most recent draft of Form 941, posted by the IRS on August 28, 2020, includes a line to report any employee Social Security taxes that were deferred under the President’s directive on Line 24.

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The President’s directive does not mandate employers to participate nor does the IRS News Release or IRS Notice. It allows employers to defer and makes relief available.

Form W-2, Wage and Tax Statement, is sent to the Social Security Administration (SSA) and also provided to each employee. Inevitably, the form will have to be changed to report any deferred employee Social Security amounts. Speculation in the payroll industry is that employers would be required to report the full amount of employee Social Security wages in Box 3 and either the full amount of Social Security tax that should have been withheld or the amount reduced by any deferred amount in Box 4. In addition, the IRS would then add a Code to Box 12 to report any deferred amount. There is an upcoming conference call between SSA and the wage reporting community (stakeholders) on September 16, 2020. One of the agenda items listed is: SSA is working with IRS to determine the impact of the President’s memorandum on annual wage reporting (W-2s, W-3s and EFW2) for Tax Year 2020.

As we go to press, there is no draft Form W-2 posted on the IRS website.
PAYROLL INDUSTRY REACTIONS

Prior to the IRS guidance, several payroll associations and others submitted comments requesting guidance to be issued on specific issues. Some issues were resolved but others remain.

Guidance does not address several industry concerns

**APA/NPRC**

The National Payroll Reporting Consortium (NPRC), a non-profit trade association of organizations that provide payroll processing and employment tax services directly to employers, and the American Payroll Association (APA), a nonprofit association serving the interests of about 21,000 payroll and accounts payable professionals nationwide, jointly issued recommendations to the Treasury and IRS regarding the implementation of the tax deferral. The organizations, whose members will be directly responsible for implementing and administering the employee Social Security tax deferral, identified priorities for the Treasury and IRS to consider as they develop guidance on the Executive Order. Some of these issues that remain unaddressed by the IRS guidance issued on August 28 include:

- Whether employees should be required to opt in or out of the deferral, and in what form. Any requirement that employees opt in or out could result in employers having to manage informational notices and election forms of potentially over 100 million affected employees in the coming weeks. Regardless of whether any election is required, the guidance should permit it to be electronic.
- Clarifying that employers will not be held liable for employee Social Security taxes deferred. Employees should pay any deferred amount with their 2020 income tax return, IRS Form 1040.
- Minimizing related reporting requirements. Optimally there should be no new entry boxes on Forms W-2 or 941. Qualifying Social Security wages paid from September 1 – December 31, and/or Social Security tax deferred, could be a coded entry in Box 12 of Form W-2.
- Clarifying that employers should apply only a per-pay period amount (e.g., $4,000 bi-weekly) to determine eligibility. Each payment of wages should be evaluated in isolation. Conversely, employers should not be required to calculate average wages over a time period to determine whether to apply the deferral.
- There should be no phase-out formula for employees near the $4,000 bi-weekly level.
- If an employer implements the deferral program after September, there should be no adjustments for prior payrolls.

**U.S. Chamber of Commerce**

The U.S. Chamber of Commerce also reacted to the President’s Executive Order, issuing a letter to Secretary of Treasury Steven Mnuchin regarding the Implementation of the Executive Order Deferring Payroll Tax Obligations in Light of the Ongoing COVID-19 Disaster. Caroline Harris, vice president, tax policy and economic development, and chief tax policy counsel at the Chamber, noted in the letter that the Executive Order gives rise to significant questions about its implementation, specifically who elects the application of the deferral, and who ultimately is liable for the repayment of the deferred taxes.

Harris highlighted other issues which also exacerbate the challenges payroll processors and compliance departments already face in the short run.
period of time available to implement this order. These issues include how to handle:

- employees with fluctuating salaries or who receive bonuses;
- those employed for a short term, such as seasonal holiday workers; and
- employees who leave employment prior to the end of the deferral period.

Harris also expressed concern about the hardship that employees will face when the deferred tax becomes due, noting that without Congressional action to forgive the payroll tax, employees will face a large tax bill at the end of the deferral period, and she requested that the Treasury Department consider and address these issues when issuing further guidance.

**AICPA**

A letter issued by the American Institute of CPAs (AICPA), an association representing accounting professionals, also raises issues that remain unaddressed by current IRS guidance, and on which the association seeks further guidance. Specifically, they ask for:

- Guidance stating that the deferral is voluntary and that an “eligible employee” is responsible for making an affirmative election to defer the payroll taxes. By requiring employees to make an affirmative election, the employer is prevented from withholding and then failing to deposit and pay the tax (to the extent that an employee elects to defer). In addition, it protects the employer by placing the decision to elect to defer with the party primarily liable for payment of the tax.

- Guidance stating that an “eligible employee” can make an affirmative election at any time from September 1, 2020, to December 31, 2020, and be allowed only one election and one revocation of such election during the four-month period. The AICPA recommends that guidance also clarify that an affirmative election or revocation take effect as soon as administratively practicable but in no event later than the first paycheck date that is 14 days after receipt by the employer, and that the election should continue to apply until December 31, 2020, unless revoked by the employee.

- Guidance providing a model notice for employers to furnish to eligible employees to inform them that the election to defer Social Security taxes is available for the September 1, 2020, to December 31, 2020, period. The guidance should state that the model notice can be delivered to employees electronically.

- Guidance stating that the $4,000 limit should apply separately to each employer of an employee. Consider whether a related employer rule is needed.

- Guidance stating that it is the responsibility of the employee and not the employer to pay the deferred payroll taxes. The guidance should also explicitly state that an employer is not liable if an employee does not remit the deferred payroll taxes on the required payment date(s).

- Guidance stating which penalties are waived as a result of this deferral.

- Guidance addressing whether the increase in take-home pay attributable to the deferred taxes can be used to satisfy other employee obligations such as Code Sec. 401(k) loan repayments, garnishments, child support payments, etc.

- Guidance stating a payment due date(s) for the deferred taxes and a mechanism for employees to pay the deferred taxes. The AICPA recommends that the IRS require employers to report the deferred amount of taxes in Box 12 of Form W-2 (with a new code) and in Box 3 of the Form W-2, the compensation amount on which taxes are deferred. They further recommend that guidance state that employees are required to pay the deferred amounts as an additional tax payment on their applicable federal income tax return.

**COMMENT:** One large unanswered issue is what to do if an employee leaves employment before the end of the year and the employer has participated in the deferral. How does the employer recover the deferred taxes? Can the employer withhold the deferred taxes from the employee’s final paycheck? Under federal labor regulations, any deduction made in compliance with the requirements of federal, state, or local law, such as federal or state withholding income
taxes and federal Social Security taxes is allowed (see 29 CFR § 3.5). In addition, states have wage payment laws covering the timing of termination pay and authorized/unauthorized deductions. Employers are not required by federal law to give former employees their final paycheck immediately.

POLITICAL ACTION

So far on the political front, the following actions were introduced by the Democrats in the House on September 4, 2020:

- **H.R.8171** – to nullify certain executive actions to permit the delayed withholding and deposit of payroll taxes, and
- **H.J.Res.94** – providing for Congressional disapproval of the rule submitted by the Internal Revenue Service, Department of the Treasury, relating to “Relief with Respect to Employment Tax Deadlines Applicable to Employers Affected by the Ongoing Coronavirus (COVID-19) Disease 2019 Pandemic.”

The House Ways and Means Committee’s Republican leader said that he will introduce legislation that would forgive the payroll taxes deferred for the rest of the year.

Senator Schumer has sent a letter to the Government Accountability Office asking if the President’s order is a “rule” subject to the Congressional Review Act.

The President is on record saying that if he is reelected, he will forgive the taxes that are deferred over the next four months, though Congress would have to take action for that to happen.

During one hearing, Treasury Secretary Mnuchin reiterated that the President plans to ask for authority from Congress to forgive the deferred taxes. He said that any legislation Congress passes to forgive the deferred payroll taxes would include a transfer from the general fund to make the Social Security trust fund whole again.

With the uncertainty still surrounding the implementation of the tax deferral, employers, payroll administrators and advisors will need to pay close attention to additional guidance that may be released in the coming weeks and months.