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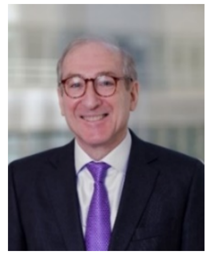
LEGAL ADVISORY

IRS Issues Guidance on Deferral of Employee Social Security Taxes

October 8, 2020



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On August 28, 2020, the Internal Revenue Service issued Notice 2020-65 (the "Notice") to provide guidance on implementing the employee payroll tax deferral contained in President Trump's Presidential Memorandum of August 8, 2020. The Notice authorizes, **but does not require**, employers to defer withholding and payment of the 6.2% employee-paid Social Security tax on wages paid between September 1, 2020 and December 31, 2020 ("the Deferral Period"), subject to employees satisfying certain wage thresholds discussed below.

Takeaways from the Notice:

- It is solely the employer's decision whether to agree to an employee's request for Social Security tax deferral.
- Employers apparently can permit deferrals company-wide or on a class basis (full-time vs. part-time employees; staff employees vs. consultants/temporary employees).
- The employee's Social Security tax liability is deferred but **not waived**. Waiver of the tax liability requires Congressional action, which is uncertain.
- Employers remain jointly liable with employees for payment of any deferred Social Security taxes.

Deferral Rules

Employers may defer the employee's Social Security tax on wages paid during the Deferral Period for any bi-weekly payroll period in which the employee's wages (including overtime, commissions, bonuses, and other incentive compensation) are less than $4,000, or the equivalent threshold amount for different pay periods ($4,333 if paid twice a month; $2,000 if paid weekly). Employees whose pay fluctuates above and below the threshold during the Deferral Period will be eligible for the deferral **only** during pay periods in which their wages are less than the threshold amount.

If an employer allows the deferral, it must withhold and remit payment of the deferred Social Security taxes on a pro-rated basis between January 1, 2021 and April 30, 2021 (the "Repayment Period"). However, it "may make arrangements to otherwise collect the total [deferred taxes] from the employee".[1]

Challenges for Employers

Besides the administrative challenges of implementing the Social Security tax deferral, employers will be liable for payment of any employee Social Security taxes they cannot collect from employees who resign, are terminated, or have insufficient wages during the Repayment Period – a significant problem for staffing firms whose consultants/temporary employees often work for uncertain durations. Patently, collecting deferred Social Security taxes from a departed employee will be difficult.

Although the Notice permits employers to enter into written repayment arrangements with employees, some states limit the deductions that can be made from paychecks, including deductions from final paychecks.[2]

Modest Benefit to Employees

If an employee's wages are $3,999 during each two-week payroll period of the Deferral Period (the maximum wage amount for which an employee is eligible for deferral), the maximum deferral for the employee would be $2,231 ($3,999 x 9 pay periods x 6.2%).

In deciding whether to permit eligible employees to defer their Social Security taxes during the Deferral Period, employers should consider whether the short-term cash flow benefit to their employees will outweigh the added repayment burden such employees will face during the Repayment Period next year if Congress does not forgive the deferred taxes, the administrative burden they will incur to implement the deferral, and the risk of being unable to withhold/recoup the deferred taxes.

Further Steps

Employers still considering whether to offer the tax deferral to their employees should take the following steps:

- Contact their payroll providers to determine the feasibility of implementing the Social Security tax deferral, particularly for consultants/temporary employees and other employees with fluctuating wages.

- Consider whether to allow employees to opt-in and opt-out during the Deferral Period.

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[1] It is unclear exactly what this language permits. For example, the requirement to withhold pro-rata during the Repayment Period appears to prohibit accelerated repayment.

[2] Section 195-3 of the New York Labor Law appears to permit such deductions for New York-based employees.

- Inform employees that deferral of their Social Security taxes will result in double Social Security tax deductions during the 2021 Repayment Period.

- If deferral of an employee's Social Security taxes is permitted, the employee should be required to sign a repayment agreement providing for additional withholding during the Repayment Period, payment of any shortfall from the employee's final paycheck (if permitted by applicable law), and repayment of any shortfall after termination of the employee's employment.

Our Analysis

Based on the administrative burdens and liability risks noted above, we believe that employers' burdens and risks of permitting the Social Security tax deferral – particularly for consultants/temporary employees – outweigh the modest cash flow benefit to employees.

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For more information about this Legal Advisory or assistance with compliance, please contact Paul Pincus at php@orllp.legal or (212) 588-0022.
