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KPMG report: Initial impressions about presidential memorandum on deferring payroll tax obligations (COVID-19)

President Trump on August 8, 2020 signed an executive action in the form of a memorandum directing "the Secretary of the Treasury to use his authority to defer certain payroll tax obligations with respect to the American workers most in need." The intent of the memorandum is to provide economic relief in response to the coronavirus (COVID-19) pandemic

In substance, the **memorandum** directs the Secretary of the Treasury to defer the obligation for certain payroll tax withholdings and deposits on amounts paid from September 1, 2020, through December 31, 2020, as well as determine whether such obligation may be forgiven through legislative or other action.

Background

Payroll taxes generally include old-age, survivor, and disability insurance ("OASDI") and hospital insurance (commonly referred to as "Social Security" and "Medicare" separately or collectively as Federal Insurance Contributions Act—FICA—taxes). These payroll taxes apply at a rate of 15.3% for wages up to $137,700 for the 2020 calendar year, with the obligation for these taxes equally divided between employers and employees at 7.65% (6.2% for Social Security and 1.45% for Medicare). Above $137,700, the payroll tax obligation is limited to Medicare. Sections 3101 and 3111.

There is an additional 0.9% Medicare tax applicable to the employee's share depending on the employee's threshold amount. Read a list of **questions and answers** on the IRS website. However, employers do not withhold this additional 0.9% until the employee's wages exceed $200,000 in a calendar year.

Although the ultimate tax obligation is shared between employers and employees, employers have the responsibility for withholding the employee's share from wages and depositing such amounts under sections 3102 and 3121.

Memorandum of August 8

The memorandum (or executive action) directs the Secretary of Treasury:

> *…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....*

The tax imposed by section 3101(a) includes the employee portion of Social Security (i.e., 6.2% of wages up to $137,700 of wages for 2020). The proposed deferral would apply with respect to amounts paid (not earned) beginning on September 1, 2020—for example, applicable taxes on wages earned during the last two weeks of August and paid the first week of September would be subject to the deferral.

Section 7508A allows the Secretary of Treasury to delay the deadline for certain actions required under the Internal Revenue laws by up to one year for any taxpayer affected by a Stafford Act disaster. Under an earlier presidential declaration, this includes the current COVID-19 national emergency and essentially applies to all U.S. taxpayers.

The memorandum indicates that 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." That breaks down to taxable wages of approximately $104,000 for 2020.

KPMG observation

It's important to note that deferring a tax does not relieve one of the obligation to ultimately pay the relevant payroll taxes. The memorandum indicates that "[a]mounts deferred pursuant to the implementation of this memorandum shall be deferred without any penalties, interest, additional amount, or addition to the tax." In other words, the relevant payroll taxes can be paid later without penalty. In addition, the memorandum states "The Secretary of the Treasury shall explore avenues, including legislation, to eliminate the obligation to pay the taxes deferred pursuant to the implementation of this memorandum."

The technical aspects of how the deferral and payment process would be implemented remain for the Secretary of Treasury to determine. Treasury has until September 1 to outline the details. However, payroll providers (as well as employers) often need extended lead time to implement such changes. Without advance guidance, there may be some practical pitfalls for payroll systems to implement the necessary changes to defer these taxes.

The multitude of inquiries related to this potential deferral include, but are not limited to, the following:

- Would these proposed deferrals be optional or required? Would there be a formal notification requirement or election process, e.g., for employees to opt in to or out of the deferral?

- If employers must defer actual withholding, then what funds would they use for such obligations in the future? Would the future obligation to withhold and deposit remain with the employer or shift to the employee? What happens in the event an individual is no longer employed by the company that gave the deferral at the time the amounts are due? Who would be responsible for the payment? Could employers be caught in a "catch-22" situation if they do not withhold these taxes, but nonetheless would be ultimately obliged to deposit them and then do not have funds available to make such deposits?

- How would such a deferral affect existing credits under the "Coronavirus Aid, Relief, and Economic Security Act" (CARES Act) (e.g., the employee retention credit and payroll tax deferral), under the "Families First Coronavirus Response Act" (e.g., paid sick and family leave credits), and other payroll-related credits (research and development tax credits, work opportunity tax credits, etc.)?

- Would a payroll tax deferral apply to self-employed taxpayers?

- Would there be reasonable time allowed payroll providers to align with any new requirements? Would there be a retroactive process in the event companies or third parties cannot align their systems in time?

- Would guidance be provided by means of an IRS notice or revenue procedure that includes formal reliance for taxpayers or will it be included in informal "frequently asked questions" (FAQs) on the IRS website with no formal reliance?

- When would payments become due under the proposed deferral?

- To the extent there are errors or delay in deferrals, would there be an opportunity for correction, such as on Form 941-X?

Payroll tax deposits are essential to the collection of taxes in the United States. These questions present just a few of many practical considerations about which taxpayers would need guidance to effectively implement the August 8 memorandum's payroll tax deferral.

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