



# TaxNewsFlash

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## KPMG report: Initial analysis of Notice 2020-65, guidance on employee payroll tax deferral

The IRS and Treasury Department late on Friday, August 28, 2020, released an advance version of Notice 2020-65 providing guidance on an employee payroll tax deferral as directed by President Trump's August 8 memorandum.

[Notice 2020-65](#) [PDF 18 KB] provides employers with the option to defer withholding the employee portion of social security tax payments from September 1, 2020, through December 31, 2020, with the deferred payroll taxes to be repaid from January 1, 2021, through April 30, 2021.

While Notice 2020-65 provides an option for an up to four-month payroll tax deferral for certain employees, it appears such employees may be obligated to make increased payroll tax payments for four months beginning January 2021, absent alternative arrangements with employers. Such alternative arrangements may prove necessary in the event an employee terminates or is furloughed prior to the full tax obligation being withheld and paid. If the taxes are not withheld and deposited by April 30, 2021, the employer could be subject to penalties and interest.

### 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.

There is an additional 0.9% Medicare tax applicable to the employee's wages that 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 Treasury Secretary:

*...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) is the employee portion of Social Security (i.e., 6.2% of wages up to \$137,700 of wages for 2020).

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 could apply to all U.S. taxpayers.

### Notice 2020-65

Notice 2020-65 responds to the direction in the president's memorandum. The notice allows—but does not require—an employer to defer the withholding and payment of the employee share of social security tax on wages paid during the period of September 1, 2020, through December 31, 2020, for employees earning below a threshold amount.

Notice 2020-65 provides that an employer that defers must withhold and pay the deferred taxes ratably from wages paid during the period from January 1, 2021, through April 30, 2021. However, the employer may make alternative arrangements to collect the taxes from the employee if necessary.

Similar to other IRS guidance postponing tax due dates for taxpayers affected by COVID-19, Notice 2020-65 identifies an employer that is required to withhold and pay an employee share of social security is referred to as an "Affected Taxpayer." The notice specifically provides that for Affected Taxpayers, the due date for withholding and payment of the section 3101(a) employee portion of social security on applicable wages is postponed until the period from January 1, 2021, through April 30, 2021.

"Applicable Wages" are wages as defined in section 3121(a) or compensation as defined in section 3231(e), that are paid to an employee on a pay date from September 1, 2020, through December 31, 2020. While the president's memorandum used more vague language stating generally less than \$4,000 per bi-weekly pay period, Notice 2020-65 has stated a specific limit for Applicable Wages. Amounts payable for a pay period are only considered Applicable Wages if they are less than the threshold amount of \$4,000 paid for a bi-weekly pay period or the equivalent threshold amount with respect to other pay periods.

The Applicable Wages are determined on a pay-period-by-pay-period basis. If the amount of wages is less than the threshold amount, then the employee portion of social security on these wages may be deferred. If the amount of wages is equal to or greater than the threshold, the deferral is not available for that pay period. Therefore, withholding for an employee whose wages fluctuate over and under the threshold is only eligible to be deferred during a payroll period below the threshold. Notice 2020-65 provides that the deferral is determined based on the specific payroll period and does not look to the amount of wages in prior payroll periods.

An employee's Applicable Wage limit will vary based on the payroll period used by the employer. Generally, the employee wage limit appears to be:

- Weekly pay-period wages of less than \$2,000
- Biweekly pay-period wages of less than \$4,000
- Bimonthly pay-period wages of less than \$4,333
- Monthly pay-period wages of less than \$8,666

Nonrecurring compensation amounts such as overtime, bonuses, and equity awards may increase the amount of wages during a pay period. If an employee who is normally below the threshold receives additional compensation (such as a bonus), the employee's wages may become ineligible for deferral during the pay period wages exceed the threshold.

Notice 2020-65 indicates that if an Affected Taxpayer chooses to defer withholding and payment of the employee portion of Social Security, the "Applicable Taxes" (the taxes that were deferred) must be withheld and paid ratably from wages and compensation paid between January 1, 2021, and April 30, 2021. Therefore, employees benefiting from the deferral may have additional payroll taxes withheld during that four-month period in 2021. If the applicable taxes are not fully repaid by April 30, 2021, interest and penalties and additions to tax will accrue to the employer starting on May 1, 2021. If necessary, the Affected Taxpayer may make other arrangements with the employee to collect the applicable taxes from the employee.

### **KPMG observation**

Notice 2020-65 provides implementation by an employer is optional but is silent regarding whether the employee has any choice if the employer decides to implement the deferral. Notice 2020-65 appears to provide employers broad latitude in determining whether and how to implement the deferral.

As with all employment relationships, there are state law matters that employers need to consider if implementing the payroll deferral. Employers also need to consider any applicable collective bargained arrangements. State law and/or union contracts may limit an employer's ability to seek repayment from employee compensation if there is no enforceable agreement with the employee in place. Employers may want to consult with legal counsel to determine options for repayment of deferred amounts, specifically from severance payments or final paychecks.

Employers need to consider whether alternative arrangements for payment are necessary in the event of terminations, furloughs or leaves of absence or to collect taxes on any schedule other than ratably over the January to April 2021 period (for example, one-time withholding from a bonus). Consideration should be given regarding whether these arrangements need to be agreed to with an employee prior to implementing a deferral or whether the arrangements could be implemented later. An employer that wishes to implement the deferral may want to consider having an employee make an election to defer. This would allow the employer and employee to agree prior to deferral regarding the future payment obligations of the parties.

If an employer ultimately pays the employee's deferred tax obligation, whether to provide an additional benefit or because the employee has terminated employment and there is no compensation from which to withhold, the employer's payment of the employee's taxes is additional compensation to the employee. As a result, the employer will have reporting and withholding obligations related to the payment of the employee's deferred tax obligation in 2021.

Companies may have different approaches and considerations on how to handle the issues relating to payroll tax deferral. Tax professionals expect to see a variety of approaches adopted by taxpayers based on the needs of the company and workforce, including, but not limited to, the following situations when employers:

- Elect not to defer and continue to withhold and deposit the employee's payroll tax obligation
- Permit deferrals only at the employee's election
- Require deferral for all employees
- Continue withholding and depositing, but offer employees a nominal bonus to acknowledge the lack of deferral benefit while easing the company's own administrative burden of a short-term implementation

Notice 2020-65 appears to provide employers with flexibility (subject to state legal requirements) to determine their own approach.

Regardless of the approach taken by an employer, employee communication is going to be very important. Notice 2020-65 provides for a four-month deferral—not a forgiveness—so the benefit to the employee absent further legislation is effectively the time value of the money. It is important to manage employee expectations and keep employees informed of their obligations prior to making the election to defer. For employers that implement the deferral, employees need to be aware of the additional payroll tax deductions that start in January 2021 and run through April 30, 2021.

There are also many practical considerations related to payroll systems. Payroll systems may need to be manually adjusted in order to implement the payroll deferral. In addition, taxpayers that use a third-party payroll service for tax filings/deposits may need to coordinate with their provider on timing and logistics of implementation, based on the provider requirements/limitations. Further, it is anticipated that the Form 941 will need to be updated for the third and fourth quarters (Q3 and Q4) of 2020, as well as the first and second quarters (Q1 and Q2) of 2021 in order to properly report deferrals and repayments.

Despite the issuance of Notice 2020-65, there remain many outstanding questions on the implementation of the deferral. The multitude of technical and practical inquiries related to this deferral include, but are not limited to, the following

- How will 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 (e.g., research and development tax credits, work opportunity tax credits, etc.)?
- Will there be a retroactive adjustment process in the event companies or third-party payroll providers cannot align their systems in time to permit deferral? To the extent there are errors or delays in deferrals, would there be an opportunity for correction, such as on Form 941-X?
- How does the payroll system defer the tax? Must changes be made manually?
- Will the IRS issue a new Form 941 for Q3 and Q4 of 2020 to reflect deferral and for Q1 and Q2 of 2021 to reflect the deferral of taxes and the subsequent payment of deferred taxes?
- How will the deferral impact the 2020 Form W-2 process? Will the IRS provide a separate Form W-2, Box 12 code for deferral?
- If there are legislative changes forgiving or further delaying repayment of the deferral, how will those changes affect taxpayers (both those that defer as well as those that do not defer)?

These questions present just a few of the many practical considerations that remain after the release of Notice 2020-65.

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