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Executive Order Payroll Tax Deferral: Guidance and Considerations

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On August 8, 2020, the President of the United States issued a Presidential Memorandum directing the Secretary of the Treasury to use his authority pursuant to section 7508A of the Internal Revenue Code to defer the withholding, deposit, and payment of certain payroll tax obligations for the remainder of 2020. In Notice 2020-65, the IRS provides guidance implementing the payroll tax deferral.

What wages are eligible? Eligibility is subject to income limits. The IRS has clarified that "Applicable Wages" for purposes of the Executive Order means wages or compensation subject to the Social Security Tax 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. Amounts excluded from wages or compensation subject to the Social Security Tax are not included when determining Applicable Wages.

The threshold amount is determined on a payroll by payroll basis, which means that timing of compensation can impact eligibility for deferrals. This is particularly significant for contingent compensation and bonuses because bonuses paid at the end of the year might make some otherwise eligible employees ineligible. Employers making discretionary bonuses for 2020 may want to delay those bonuses until 2021 if the Employer wants to qualify its wages for deferral.

In terms of planning, employers and employees should note that such wages and compensation in a payroll period will be reduced by certain retirement plan and cafeteria plan contributions such as salary deferrals into a 401(k) plan or salary reductions to pay for medical insurance or contributed to a health or dependent care flexible spending account. Employers may want to provide employees flexibility in timing those contribution in order to ensure that employees have the ability when it is possible to reduce "Applicable Wages" for a payroll where the employee might otherwise exceed the $4,000 threshold.

How does repayment work? The IRS guidance states that amounts deferred must be paid ratably from wages and compensation paid between January 1, 2021 and April 30, 2021. If deferrals are not repaid by April 30, 2021, interest, penalties, and additions to tax will begin to accrue on May 1, 2021, with respect to any unpaid repayments. The IRS guidance also states that, if necessary, the employer may make arrangements to otherwise collect the total from the employee. An employment lawyer should be consulted before making such arrangements to ensure that the arrangements do not violate labor law or state law employment protections.

Whose choice is it to opt out, when should that election be made, and how can it be revoked? The IRS guidance does not answer this question. Advice from Treasury Secretary Mnuchin has indicated that the employer can opt in or out, but the Executive Order indicates that the employee makes that choice. In either case, the employer is responsible for repayment and for making arrangements to otherwise collect the total from the employee if necessary. There is no guidance on how those arrangements might be made and how state law restrictions on garnishing wages and recovering amounts from workers who have left an employer's employment will impact such arrangements. Additionally, collective bargaining agreements and specific state law protections may prevent enforcement of such arrangements. There is a significant risk that, even with careful planning, employers will end up responsible for some repayment amounts because of an inability to withhold or collect from the employee.

What options do employers have? Employers have five options that they should consider and many employers will look for creative ways to secure the tax deferral while minimizing risk.

1. Allow employees to choose whether to opt in or out. For most employers, this is the least attractive option because it places a burden on the employer to provide notices and guidance to employees about the program, to administer the program without any standard forms or guidance on how to collect elections and revocations, and to make and enforce arrangements to collect repayment amounts when withholding may not be possible in 2021.

2. Opt out. On August 18, 2020, a coalition of more than 30 business groups, including the U.S. Chamber of Commerce, stated in a letter to Speaker Pelosi, Majority Leader McConnell, and Secretary Mnuchin that, "many of [its] members will likely decline to implement deferral, choosing instead to continue to withhold and remit to the government the payroll taxes required by law." Given the uncertainty and difficulty in an election to participate, this seems to be the easiest solution. Unfortunately, this solution may create employee relations problems if employees are seeking relief from immediate financial pressures. Additionally, if the deferral is eventually forgiven, these employers' employees will have paid as much as $2,232.00 that they did not have to pay.[1]

3. Opt in. Employers who opt in may be faced with practical difficulties in 2021. If the amounts deferred are not forgiven, the employees will have as much as $248 deducted from each bi-weekly paycheck during January, February, March, and April of 2021. For many households, this deduction could result in financial hardship. As the coalition's August 18 letter states, "Many of [its] members consider it unfair to employees to make a decision that would force a big tax bill on them next year." Additionally, employers opting in risk having to assume responsibility for repayment in some circumstances.

[1] The following chart included in the coalition's August 18th letter (and an additional fifth column) demonstrates the magnitude of the potential tax bill, the immediate benefit of deferral, and the per pay period repayment amount in 2021.

Income	**Bi-Weekly Pay**	**Increase Per Pay Period**	**Tax Bill Due in 2021 (based on 9 pay periods)**	**Repayment Per Pay Period during 2021**
$35,000	$1,346.15	$83.46	$ 751.15	$83.46
$50,000	$1,923.08	$119.23	$1,073.08	$119.23
$75,000	$2,884.62	$178.85	$1,609.62	$178.85
$104,000	$4,000.00	$248.00	$ 2,232.00	$248.00

4. Opt in and plan 2021 bonuses paid ratably over the first four months of 2020. Employers considering discretionary bonuses of at least the amount of tax deferrable could address the issue by opting into the deferral program and structuring bonuses in 2021 so that the bonus amounts will cover the repayment. If the amounts are forgiven, the employees would receive an actual cash bonus from the employer in 2021. If the amounts are not forgiven, the bonus would cover the repayment. Alternatively, employers could pay discretionary bonuses in 2021 only if the deferrals are not forgiven.

5. Opt in and wait for guidance. Employers may want to opt in now, but reverse or change course as more information becomes available, particularly if it looks likely that the amounts will not be forgiven. This minimizes the risk to the employee and employer because repaying one or two of the payments will be less of a burden than repaying all of the payments. At this time, it is not clear whether an employer can take advantage of the deferral now, but begin withholding later in 2020. Although nothing in the Executive Order or IRS guidance would prevent that, a "wait and see" approach still has some risk.

The novel coronavirus presents novel challenges and as such, employers are well advised to engage experienced employment counsel to help navigate these complex and delicate considerations and the myriad laws implicated. Buchalter Attorneys have decades of experience providing counsel to employers on complex workplace issues and applicable laws and are uniquely equipped to help clients adapt and navigate these specific challenges. If we can be of assistance, please feel free to contact any of the Buchalter Attorneys below.

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