Late Friday, August 28th, the IRS issued the long-awaited guidance to implement the President's directive to defer employee payroll taxes. In the notice, the IRS answered a few questions and created a few questions. The guidance also does not address some of the most important questions for employers.

In the notice, the IRS provided that the deferral applies to the 6.2% employee side of Social Security and the Railroad Retirement Tax. It does not apply to 1.45% employee side of Medicare. As directed by the President, the deferral period is September 1, 2020, to December 31, 2020, for wages paid in a bi-weekly pay period of less than $4,000 or the equivalent amount for other pay periods.

One of the questions answered by the guidance is how the pay period compensation limit is to be applied. Under the guidance the limit is for each pay period standing alone. In other words, whether the taxes are deferred is determined for each pay period and can change for an employee if their compensation goes up or down from one pay period to the next.

Another question answered by the notice is when do the deferred taxes become due? The notice provides the same four-month period to start 2021 to withhold the deferred taxes. This avoids having to withhold the entire amount from the employee’s first paycheck in January of 2021. The withholdings are spread ratably from January 1, 2021, to April 30, 2021. No interest or penalties will be incurred by the company until May 1, 2021.

However, the notice does not specifically address what an employer should do if an employee quits or is terminated before April 30, 2021. There is a vague sentence in the notice that states the company “may make arrangements to otherwise collect the total Applicable Taxes from the employee.” This begs the question, what does this mean? Does this mean that the company does not have to defer the taxes as suggested by Treasury Secretary Mnuchin a few weeks ago? Does it mean the company can withhold the entire deferred amount from the employee’s last paycheck if the employee leaves before April 30, 2021? Does it mean the
company can execute a promissory note with the employee before deferring the taxes so there is a payment plan in place if the employee leaves before April 30, 2021?

For many companies, the possibility of being responsible to pay a withholding tax that was never withheld from the employee is too much for the company to take on, especially during a pandemic when many employers are struggling financially. As a result, employers may decide to continue to withhold the tax and forgo the deferral. However, what kind of an employee relationship problem does this create for the employer?

In the President’s memorandum to Secretary Mnuchin, the President requested that Mnuchin find ways to eliminate the liability, even working with Congress to enact legislation. However, as we have seen over the last several months, the negotiations between the Democrats and the Republicans have stalled. So, whether they can come to an agreement to eliminate the deferred taxes is anyone’s guess at this point. In the meantime, companies must decide if they are going to defer the taxes. If they do not, they need to communicate with employees in a way to maintain relationships. If they do defer, what do they do if an employee leaves?

There are a number of open questions on the deferred taxes and how they should be handled. Please contact your Somerset advisor at 317.472.2200 or info@somersetcpas.com with any questions. As always, we are here and ready to help.