Money Talks by Dave Helscher

October 2020

On August 8, the President issued an executive order to allow the deferral of certain payroll taxes during the final four months of 2020, and the IRS recently provided related guidance. This has implications for both employers and employees. There are generally two separate contributions to the Social Security payroll tax, a 6.2% employer portion and a 6.2% employee portion. The CARES Act, signed into law in March 2020, already allowed eligible employers (and self-employed individuals) to defer the payment of the employer's 6.2% share of Social Security tax from March 27 to December 31, 2020. Any deferral of the employer Social Security payroll tax under the CARES Act must be repaid over a two-year period, with half of the deferred tax due by December 31, 2021, and the other half due by December 31, 2022.

The recent executive order and related IRS guidance expand the payroll tax deferral opportunity, generally allowing employers to defer withholding and payment of the employee's 6.2% share of the Social Security tax for payroll dates that fall on or between September 1 and December 31, 2020. While employers are eligible to defer the employee portion of the Social Security payroll tax, the IRS guidance does not address whether self-employed individuals are also able to do so. Additionally, the employee portion of the Social Security tax cannot be deferred for any employee with wages or compensation of $4,000 or more in a biweekly pay period (or the equivalent amount with respect to weekly, monthly, or other pay periods). The dollar threshold applies per pay period, so it's possible for an employee to qualify for deferral in some pay periods but not in others. It's important to note that nothing in the guidance indicates that payroll deferrals described here are mandatory. Employers can take advantage of the deferral provisions if they find them beneficial, but can continue to withhold and pay payroll taxes as normal if they wish. An employer may ask employees whether or not they wish to defer their 6.2% portion of the Social Security payroll tax, but the guidance released does not specifically require it.

If an employer defers the employee portion of the Social Security payroll tax during September, October, November, and December 2020, employees may receive larger paychecks, but this deferred payroll tax must be repaid in 2021 (absent new legislation that specifically forgives deferred amounts). Specifically, employers will have to withhold extra money from employee paychecks during the first four months of 2021, January through April, to make up for the four-month deferral. This is in addition to the payroll tax employees must normally pay during 2021. As a result, employees who benefit from deferral of payroll tax between now and year-end are likely to experience reduced paychecks during the first part of 2021. An employee in this situation may wish to consider putting any extra funds from a larger paycheck in 2020 into a savings account to compensate for a smaller paycheck in 2021.

While it's expected that many employers will opt not to defer payroll taxes, the Defense Finance and Accounting Service has announced that the Social Security payroll tax deferral will start automatically in mid-September for military members and civilian employees; they are not eligible to opt out. Many questions remain, and additional guidance is expected.

Each taxpayer, employer or employee, should seek independent advice from a tax professional based on his or her individual circumstances. To the extent this material concerns tax matters, it is not intended or written to be used by a taxpayer for purposes of avoiding penalties that may be imposed by law.