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IRS ADDS NEW FAQS ON CARES ACT PAYROLL TAX DEFERRALS

The IRS recently added numerous frequently asked questions (FAQs) on the [payroll tax deferrals] under the Coronavirus Aid, Relief, and Economic Security (CARES) Act ([P.L. 116-136]). Although the FAQs cannot *be relied upon as legal authority, they are an indication of the IRS's thinking.*

Background

Section 2302 of the CARES Act provides that, through December 31, 2020, employers may defer the deposit and payment of the employer's portion of Social Security tax and certain railroad retirement taxes. Half of the deferred amount is due on December 31, 2021, and the other half is due on December 31, 2022.

All employers, even those with forgiven Paycheck Protection Program loans, and self-employed individuals may use the payroll tax deferral, since there is no need-based eligibility. Moreover, since there is no interest charge on the deferral, businesses will immediately be infused with positive cash flow. Deferral is also available for employers remitting payroll taxes through payroll agents, such as a third-party payroll service provider or a certified professional employer organization. In these instances, the employers must instruct the payroll agents to defer applicable tax payments. Notably, employers will be solely liable for paying the deferred taxes timely under the deferred deadlines, including worksite employees performing services for a certified professional employer organization customer.

Although there is no dollar limit on the wages included in calculating the taxes that may be deferred, the payroll tax deferral does not apply to federal income tax withholding, the Medicare tax, or the employee's portion of Social Security tax.

Insight:

Separately, on August 8, 2020, the president issued an executive order stating that the employee's portion of Social Security tax could be deferred effective September 1, 2020, through December 31, 2020. Employers and employees will not be able to take advantage of this relief until the secretary of the treasury issues guidance on how to implement it. According to Treasury Secretary Steven Mnuchin, the employee Social Security tax deferral will not be mandatory, but he thinks that many small businesses will participate. There are currently no details on how the statutory responsibility and penalties would be applied or waived for an employer who chooses to facilitate the employee tax deferral. Nor are there any details on how or when the employees would repay the deferred amounts.

On July 30, 2020, the IRS updated its FAQs concerning the Social Security tax deferral option to reflect additional changes and clarifications. Our summary below includes both the new and updated questions and answers.

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Learn more about the changes under the updated Social Security tax deferral FAQs to help your business navigate and access the benefits:

- **FAQ #3** - Clarifies the distinction between a deposit and a payment towards an employment tax liability. Employers that do not have to make deposits under the CARES Act payroll tax deferral but fail to pay their employment taxes timely on the employment tax returns (e.g., Form 941) will generally owe a failure-to-pay penalty.
- **FAQ #5** - Clarifies that an employer does not need to make a special election to defer its share of Social Security tax, but can do so by simply reducing its required deposits or payments for a calendar quarter by an amount up to the maximum amount of the employer's share of Social Security tax for the return period, to the extent the return period falls within the "payroll tax deferral period" (i.e., the period beginning on March 27, 2020, and ending on December 31, 2020). Additionally, if employers are entitled to refundable tax credits for paid leave under the Families First Coronavirus Response Act (FFCRA) or for qualified wages under the CARES Act employee retention credit, the employer's required deposits could be reduced even further. Employers should report the deferred taxes on the appropriate line on Form 941, *Employer's Quarterly Federal Tax Return*, such as line 13b.
- **FAQ #6** – Explains how an employer can inform the IRS that it deferred deposit or payment of its share of Social Security tax due after March 27, 2020, for the first calendar quarter of 2020 under Section 2302 of the CARES Act because Form 941 was not revised for that period, thus it will show a discrepancy between the amount of the liability reported and the deposits and payments made.

Insight:

Employers that deferred their share of Social Security tax for the first calendar quarter of 2020 will have a discrepancy on their first quarter Form 941 between the liabilities reported and the deposits made for such quarter. Employers should closely monitor their mailboxes for an IRS notice regarding the Form 941 discrepancy. Employers should review the notice timely and follow the instructions on how to inform the IRS that they deferred deposit of their share of Social Security tax for the period March 27, 2020, through March 31, 2020, in order to avoid penalty and interest.

- **FAQ #7** – Provides that employers that file annual employment tax returns, such as Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees,* Form 944, *Employer's Annual Federal Tax Return*, and Form CT-1, *Employer's Annual Railroad Retirement Tax Return*, may defer deposit and payment of the employer's share of Social Security tax as long as the deposits relate to the tax imposed on wages paid on or before December 31, 2020, during the payroll tax deferral period.
- **FAQ #8** – Clarifies that an employer may only defer its share of Social Security tax that is equal to or less than their liability for its share of Social Security tax that was due to be deposited during the payroll tax deferral period or was for payment due on wages paid during the payroll tax deferral period.

- **FAQ #9** – Clarifies that an employer that has already deposited all or any portion of its share of Social Security tax during the payroll tax deferral period may not subsequently defer payment of the tax already deposited. However, to the extent an employer reduces its liability for all or part of its share of Social Security tax based on credits already claimed on Form 941, including the Research Payroll Tax Credit, the FFCRA paid leave credits, and the CARES Act employee retention credit, the employer may receive a refund of such tax already deposited.

Insight:

Prior to the release of these updated FAQs, it has been unclear to employers whether an employer is permitted to defer payment of the tax already deposited by claiming a refund or credit on Form 941. This FAQ clarifies that employers may not do so. However, the question of whether an employer is permitted to defer deposit of tax that was previously deposited by reducing the amount of tax deposit that is required for a current liability remains.

- **FAQ #10** – Confirms that an employer that receives a PPP loan is entitled to defer the payment and deposit of the employer's share of Social Security tax, even if the loan is forgiven, per the PPP Flexibility Act that was enacted on June 5, 2020.
- **FAQ #11** – Confirms that an employer described within Internal Revenue Code Section 3401(d)(1) or 3512(b)(1) may defer deposit and payment of its share of Social Security tax for which it is liable.
- **FAQ #14** – Confirms that an employer may defer deposit and payment of its share of Social Security tax prior to applying the Research Payroll Tax Credit. Employers may claim this credit regardless of whether they defer deposit and payment of some or all of their share of Social Security tax and may also carry forward any excess amount of the Research Payroll Tax Credit to subsequent quarters. Employers can claim the Research Payroll Tax Credit by filing Form 8974, *Qualified Small Business Payroll Tax Credit for Increasing Research Activities*, and attaching it to their employment tax return (typically Form 941).
- **FAQ #15** – Confirms that a tax-exempt employer may defer deposit and payment of its share of Social Security tax prior to applying the Work Opportunity Tax Credit. Tax-exempt employers can claim this credit regardless of whether they defer deposit and payment of some or all of its share of Social Security tax. Tax-exempt employers can claim the Work Opportunity Tax Credit by filing Form 5884-C, *Work Opportunity Credit for Qualified Tax-Exempt Organizations Hiring Qualified Veterans*.
- **FAQ #16** – Explains that the $100,000 next-day deposit rule is applied without regard to the deferral of the employer's share of Social Security tax; however, the amount deposited may be reduced by the deferred portion of the employer's share of Social Security taxes. The IRS provides the following example: Assume an employer accumulates $110,000 of employment tax liabilities, including federal income tax withholding and the employee's share of Social Security tax, and defers deposit of $20,000 for its share of Social Security tax. The employer must still deposit $90,000 the next day under the $100,000 rule (i.e., $110,000 minus $20,000).

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- **FAQ #17** –The IRS explains that the $100,000 next-day deposit rule is also applied without regard to the FFCRA paid leave credits and the CARES Act employee retention credit. The FFCRA paid leave credits and the CARES Act employee retention credit are applied against the employer's share of Social Security tax imposed on wages paid for the calendar quarter, with the excess being treated as an overpayment that is refunded pursuant to Section 6402 of the Internal Revenue Code. The IRS provides a similar example as in FAQ #16: If an employer accumulates $110,000 of liabilities and anticipates a $20,000 employee retention credit, the employer must still deposit the next day under the $100,000 rule but is only required to deposit $90,000. If the employer also defers the employer's share of Social Security tax, the next-day deposit will also be reduced by the amount of the employer's share of Social Security tax deferred.

Insight:

Employers should confirm with the payroll service provider or IT department that the payroll tax system is configured to handle the next-day deposit rule in connection with the payroll tax credits and deferral correctly in order to avoid late deposit penalty.

- **FAQ #20** – Confirms that the IRS will issue reminder notices to employers before each applicable due date of the deferred taxes. Since each return period is treated separately for purposes of determining the amount of tax due for the period, Form 941 filers that deferred in all four quarters of 2020 may receive four reminder notices of the applicable dates in 2021 and 2022. The amounts for all four quarters will have the same due dates of December 31, 2021, and December 31, 2022.
- **FAQ #24** – Explains that self-employed individuals may use any reasonable method to allocate 50% of the Social Security portion of self-employment tax attributable to net earnings from self-employment earned during the payroll tax deferral period.
- **FAQ #25** – Confirms that a household employer that files Schedule H, *Household Employment Taxes*, with its individual income tax return may defer payment of the amount of its share of Social Security tax imposed on wages paid during the payroll tax deferral period.
- **FAQ #26** – Explains that an employer that is otherwise eligible to defer deposits and payments of its share of Social Security tax is entitled to do so, regardless of whether it uses a third party payer such as a reporting agent, payroll service provider, professional employer organization, certified professional employer organization, or Section 3504 agent, to report and pay its federal employment taxes. The IRS indicates that if an employer uses a third party to file, report, and pay employment taxes, different rules will apply depending on the type of third-party payer the employer uses.
- **FAQ #27** – Confirms that IRS will not revise Form CT-2, *Employee Representative's Quarterly Railroad Tax Return*, for the 2020 tax year. As a result, an employee representative that files Form CT-2 must include a statement

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with each Form CT-2 identifying the amount of Tier 1 tax equivalent to the employer portion of Social Security tax for which deposit and payment is deferred.

- **FAQ #28** – Explains the procedures in the event an employer that deposits monthly or semi-weekly initially decides to defer the deposit of its share of Social Security tax in a calendar quarter, but then deposits such tax later within that calendar quarter anyways. In this instance, the employer should not complete line 13b of Form 941. The IRS has established similar procedures for Form CT-1 and Form 943 filers.
    - IRS illustrates these procedures using the following example: Assume an employer is a Form 941 filer and a semi-weekly depositor with an employment tax liability of $10,000 every two weeks in the second calendar quarter. Further, assume that the employer defers $2,480 of its share of Social Security tax from its first deposit but deposits the amount of $2,480 with its last deposit of $10,000 during the same calendar quarter. This employer would report $7,520 ($10,000 minus $2,480) for its first tax liability on its Form 941, Schedule B, *Report of Tax Liability for Semiweekly Schedule Depositors*, and $12,480 ($10,000 plus $2,480) for its last liability on its Form 941, Schedule B.

Insight:

Employers that initially deferred the deposit of their share of Social Security tax in one calendar quarter and subsequently plan to deposit such deferred tax within the same calendar quarter should consult with their payroll service provider or payroll tax department to make sure that the IRS procedures are followed in order to avoid late deposit penalty.

- **FAQ #29** – Explains that an employer can pay the deferred Social Security tax it owes electronically using Electronic Federal Tax Payment System (EFTPS), by credit card or debit card, or by a check or money order. The IRS prefers that employers pay through EFTPS. If paying through EFTPS, an employer must select Form 941, the calendar quarter in 2020 to which its payment relates, and payment due on an IRS notice in EFTPS. An employer filing annual returns, like Form 943, 944, or CT-1 should select the return and 2020 tax year to make a payment.
- **FAQ #30** – Clarifies that self-employed individuals or household employers that defer payment of the employer's share of the Social Security tax or 50% of the Social Security tax on net earnings from self-employment are generally ineligible for a refund because the deferral amount is a deferral of payment, not a deferral of liability. However, household employers eligible for advanceable paid leave credits under the FFCRA may receive a refund of the paid leave credits even while deferring the employer's share of Social Security tax.
- **FAQ #31** – Confirms that employers that have already paid their share of Social Security tax on wages during the payroll tax deferral period may not subsequently defer the payment of the tax by filing Form 941-X, *Adjusted Employer's Quarterly Federal Return or Claim for Refund*. However, if the employer has FFCRA paid leave credits or employee retention credit, the employer may file Form 941-X to claim a refund or credit of the tax on such basis.

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