IRS issues FAQ clarifying payroll tax deferral

The IRS has released guidance in the form of frequently asked questions (FAQ) on the payroll tax deferral enacted by the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The FAQ clarifies several fundamental aspects of the new benefit, but most notably offers favorable guidance on its interaction with other COVID-19 relief provisions, such as the paid family and sick leave and employee retention credits and the Paycheck Protection Program (PPP).

Under the CARES Act, employers can defer their 6.2% share of the Social Security tax through the end of the year. Half of the deferred payment amount is due by Dec. 31, 2021, with the other half due by Dec. 31, 2022. Individuals paying self-employment tax are provided with equivalent relief. However, employers who have a loan forgiven under the PPP or Treasury Program Management Authority are no longer eligible to defer Social Security taxes after the forgiveness.

Key guidance provided by the FAQ is highlighted below. Taxpayers who may take the deferral or claim other benefits offered in response to the COVID-19 pandemic should carefully consider the guidance and weigh the available options.

**General clarifications**

The FAQ clarifies several fundamental and administrative aspects of the payroll tax deferral benefit, including:

- Employers are able to defer Social Security tax payments otherwise due to the government from March 27 through Dec. 31, 2020, referred to as the “payroll tax deferral period.”
- Employers will not be required to make a special election to claim the benefit.
- Form 941 will be revised to reflect the changes needed to report the deferred Social Security Tax, but the revised form will not be available until the second calendar quarter of 2020. Guidance is forthcoming regarding how to report deferrals for payments otherwise due between March 27 and March 31, 2020.
- Employers must pay 50% of the deferred payment by Dec. 31, 2021, and the remainder by Dec. 31, 2022, to avoid a failure to pay penalty under Section 6651.
- Self-employed individuals may defer the 50% of Social Security tax on net earnings from self-
employment income imposed under Section 1401(a).

- There is no penalty for failure to make estimated tax payments under Section 6654 for 50% of Social Security tax on net earnings from self-employment for any taxable year that includes any part of the payroll tax-deferral period.

**Interaction with PPP**
The FAQ provides that all employers may begin to defer the deposit and payment of their portion of Social Security tax on March 27. However, an employer who receives a PPP loan may no longer defer the Social Security tax after the employer is notified by its lender that the loan is forgiven. Employers may defer payments until receiving notification of the loan forgiveness and are not required to repay any prior deferrals early. Employers may continue to defer 50% of the previously deferred amount to Dec. 31, 2021, with the remaining amount due Dec. 31, 2022.

**Grant Thornton Insight:** Some employers did not defer their portion of the Social Security tax for payroll tax deposits made within the days and weeks following the enactment of the CARES Act for multiple reasons. Some third-party payroll service providers did not have the ability to defer payment for weeks after March 27. Other employers anticipated that they would not be eligible to defer the payroll tax because they anticipated receiving a PPP loan that would be forgiven. Any employer that failed to defer Social Security tax deposits for payrolls made on or after March 27, 2020, should be able to receive a refund of those deposit overpayments or reduce future deposits by the overpaid amounts. The FAQ indicates the IRS will provide information in the near future on how employers should address those deposit overpayments.

**Application of paid family and sick leave and employee retention credits**
The FAQ provides that an employer may defer its share of the Social Security tax prior to determining the application of the paid family and sick leave credits under the Families First Coronavirus Relief Act (FFCRA) or the employee retention credit under the CARES Act. This allows an employer to defer the full amount of its 6.2% share of Social Security tax to 2021 and 2022 and reduce its remaining payroll tax deposits by the fully refundable family and sick leave and employee retention credits.

**Grant Thornton Insight:** The family and sick leave credit under the FFCRA and the employee retention credit under the CARES Act are both fully refundable credits against the employer’s share of Social Security tax. The CARES Act was not clear about whether an employer that both deferred the Social Security tax and claimed one or both credits would be able to defer the full amount of the tax and claim a refund for the full amount of the credit, or whether the credits reduced the amount of the deferred tax the employer would have to pay in 2021 and 2022. The FAQ makes it clear that the employer can defer the full amount of the Social Security tax and receive an immediate refund for the full amount of the credits by reducing the remaining payroll tax deposits.

For example, an employer pays wages to employees on April 17 and is required to deposit $100,000 of payroll taxes, which includes $20,000 of the employer’s portion of Social Security tax. The employer also pays qualified wages during the payroll period and is entitled to a $30,000 employee retention credit. The employer may defer the $20,000 of Social Security tax to 2021 and 2022. In addition, the employer may reduce its remaining payroll tax deposit by the $30,000 employee retention credit, and as a result, deposits only $50,000 of payroll taxes with the government.
Penalty waiver
The IRS issued Notice 2020-22 in anticipation of employers claiming the paid family and sick leave credit under the FFCRA or the employee retention credit under the CARES Act. Notice 2020-22 generally waives the Section 6656 penalty for failing to deposit payroll taxes, including those withheld from employees, when certain conditions are met. The FAQ clarifies that the ability to defer payroll taxes under the CARES Act applies to all employers (except after they have had a PPP loan forgiven), not just those who are eligible to receive the paid leave and employee retention credits.

Next steps
The guidance is generally favorable and may provide employers with significant opportunities to pair payroll tax deferral with other COVID-19 relief to optimize their tax benefits. Employers that anticipated receiving a PPP loan that will be forgiven may not have deferred their portion of the Social Security tax. Other employers who began deferring the Social Security tax may not have reduced the rest of their payroll tax deposits by the full amount of the family and sick leave and employee retention credits. Employers in both scenarios are likely able to recoup those payroll tax overpayments to boost cash flow and the FAQ indicates the IRS expects to issue information in the near future on how employers should address those overpayments. Employers should act now to ensure they are taking full advantage of the payroll tax deferral and credits.

For more information, contact:

Jeffrey Martin  
Partner  
Washington National Tax Office  
Grant Thornton LLP  
D +1 202 521 1526  
E jeffrey.martin@us.gt.com

Keith Mong  
Managing Director  
Washington National Tax Office  
Grant Thornton LLP  
T +1 202 521 1554  
E keith.mong@us.gt.com

To learn more visit gt.com/tax

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