

Professional Perspective

**CARES Act:
Tax Deferral Opportunities
for Employers**

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CARES Act: Tax Deferral Opportunities for Employers

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The Coronavirus, Aid, Relief and Economic Security Act creates several important payroll tax opportunities under Subtitle C of the Internal Revenue Code for employers adversely impacted by the Covid-19 pandemic. One such opportunity is available to every employer in the U.S. regardless of size, industry or the extent of the impact of the Covid-19 pandemic on its business.

In particular, Section 2302 of the CARES Act allows all employers to defer the deposit and payment of the employer's portion of Social Security taxes for a minimum of 12 months and, for some deferrals, a period of more than 32 months. Despite the confusion among some advisers, unlike the employee retention tax credit available under the CARES Act, this opportunity to defer employer Social Security taxes is even available for those employers applying for Small Business Administration loans, as explained below.

Compared to the other provisions of the CARES Act impacting Subtitle C payroll taxes, the deferral rules are fairly straightforward. Nevertheless, confusion has arisen with respect to the payroll tax rules, including their:

- Interaction with the SBA loans
- Possible penalties for failure to deposit
- Personal liability for executives and board members for unpaid deferred taxes
- Interaction with the leave and employee retention credits
- How to report the deferred taxes to the Internal Revenue Service

To address some of these areas of confusion, the IRS issued FAQs on April 10, 2020 with primary focus on the interaction with SBA loans.

The Basics

The Federal Insurance Contributions Act imposes two significant payroll taxes: Social Security taxes and Medicare taxes. Social Security taxes are the most significant and largest component of FICA taxes as they are imposed at the rate of 6.2% of the wages paid up to the taxable wage base, which is \$137,700 for 2020. While these Social Security taxes may be deferred under the CARES Act, the employer Medicare taxes cannot be deferred.

The payroll tax deferral period offered under the CARES Act applies to deposits and payments of the employer's share of Social Security tax that would otherwise be required to be made during the period beginning on March 27, 2020, and ending Dec. 31, 2020. Instead of their normal next-day deposit or semi-weekly deposit due dates, these deferred Social Security taxes have deferred statutory deposit payment dates. Fifty percent of the Social Security deferred taxes must be deposited on Dec. 31, 2021 and the remaining fifty percent must be deposited on Dec. 31, 2022—all without the imposition of statutory interest. These extended deposit dates are referred to by the CARES Act and IRS guidance as the "applicable dates."

Who Can Defer 'Social Security' Taxes?

When the subject of Social Security taxes is raised, most employers and advisors think only of the employer Social Security taxes that are imposed under Code Section 3111(a). The Code actually imposes several types of "social security" taxes. Different but comparable taxes to the Social Security taxes are imposed upon railroads (i.e., RRTA taxes) and self-employed individuals (i.e., SECA taxes) for which the Social Security components are granted the same deferral opportunities by the CARES Act.

All employers, including self-employed individuals such as partners who pay SECA taxes as part of their quarterly estimated tax liabilities, can take advantage of these payroll tax deferral rules. Employers are not required to make a special election to take advantage of these generous deferred deposits and payments of the employer Social Security taxes.

SBA Loans and Payroll Tax Deferrals

Tens of thousands of employers are seeking Section 7(a) loans or Paycheck Protection Program loans from the SBA. Despite fairly clear statutory language from Congress, some advisors have counseled that an employer applying for and receiving a PPP loan are ineligible for the payroll tax deferrals. That position is incorrect—all employers may defer the deposit and payment of the employer's share of Social Security tax, even those receiving PPP loans from the SBA.

The misinterpretation arises from Section 2202(a)(3) of the CARES Act, which admittedly contains an important rule addressing the interaction of the employer payroll tax deferrals and the PPP loans. Section 2202(a)(3) provides that employers that receive an SBA loan, as provided in section 1102 of the CARES Act, may not defer the deposit and payment of the employer's share of Social Security tax due on or after the date that the PPP loan is forgiven.

This language clearly does not prevent an employer from benefiting under both statutory provisions. Instead, it means that employers that receive a PPP loan may not defer the deposit and payment of the employer's share of Social Security tax that is otherwise due after the employer receives a decision from the lender that the loan has been forgiven. More specifically, employers who have received a PPP loan, but whose loan has not yet been forgiven, may continue to defer deposits and payment of the employer's share of Social Security tax through the date the lender issues a decision to forgive the loan in accordance with paragraph (g) of section 1106 of the CARES Act.

In plain English, once the employer receives a decision from its lender that its PPP loan is forgiven, the employer is no longer eligible to defer the deposit and payment of the employer's share of Social Security tax due after that date. However, the amount of the deposit and payment of the employer's share of Social Security tax that was deferred through the date that the PPP loan is forgiven continues to be deferred and will be due on the applicable due dates in 2021 and 2022.

Penalties and Penalty Relief

Three potential payroll deferral penalties exist that can be traps for the uninformed, but are very easily avoided while still fully benefiting from the CARES Act's generous payroll tax deferrals.

Payroll Tax Deposit Penalty

The deferred deposits of the employer's share of Social Security tax must be deposited on the applicable dates in 2021 and 2022. If the taxes are deposited after those dates, they will be late deposits subject to late deposit penalties under Code Section 6656 with varying liability amounts ranging from 2% up to 15% of the late deposit amount, with the typical deposit penalty being 10%. Late deposit penalties can be waived for reasonable cause—although reasonable cause may be difficult to assert given the generous deferrals of 12 to 32 months.

Failure to Pay Penalty

Although the primary penalty in the context of the deferred deposits is likely to be the failure to deposit penalty, Code Section 6651 imposes a failure to pay penalty that can equal up to 25% of the employer's share of Social Security taxes. If the deferred taxes are not paid by the applicable due date, the IRS can theoretically seek enforcement through the Section 6651 failure to pay penalty. As with late deposits, the failure to pay penalty can be waived for reasonable cause.

PPP Penalty

Actually, there is no such thing as the PPP penalty. However, as a practical matter, those employers with an SBA loan for which they seek and are extended forgiveness must be vigilant when applying the deferral rules. While all of the amounts deposited prior to receipt of the loan forgiveness remain subject to the applicable dates, the employer Social Security deposits due after the loan forgiveness dates must be deposited according to the normal payroll tax deposit rules which, depending on the employer, would likely be the next-day deposit rules or the semi-weekly deposit rules. Therefore, it will be incumbent upon the banks to be mindful of this rule to provide advanced alerts to borrowers of the upcoming loan forgiveness dates so that the employer has time to work with its payroll provider to ensure that the next deposit is timely.

Personal Liability for Executives and Board Members

The Covid-19 pandemic will undoubtedly have a long-term impact and effect on many businesses and their ongoing viability. Given widespread concern as to long-term viability, a recurring question is whether the executives and board members involved in the decision to defer the employer Social Security taxes have personal exposure if the company no longer exists or is otherwise unable to pay the deferred taxes on the applicable due dates in 2021 and 2022. This is an important question, since the deferred taxes for many such employers will involve millions of dollars and, in some cases, tens of millions of dollars.

Social Security taxes are trust fund taxes under Subtitle C. The protections and penalties associated with trust fund taxes are some of the most important in the Code. To illustrate, recognizing the fiduciary obligations associated with these trust fund taxes, the CARES Act takes the extraordinary step to extend protections to the trust funds themselves and holds them harmless for intragovernmental transfers necessary because of the CARES Act.

The more immediate question is whether such board members and executives might be considered “responsible persons” as it relates to deferred employer Social Security taxes. Code Section 6672 imposes trust fund recovery penalties equal to the unpaid taxes that can be levied on “responsible persons” for the failure to deposit Subtitle C payroll taxes. This typically occurs where the company withholds the applicable payroll taxes from employees but uses the funds for other purposes. The CARES Act does not address Code Section 6672 penalties.

While all of the above sounds ominous since board members and executives can arise to the level of “responsible persons” under Subtitle C depending on the facts and circumstances, the good news as it relates to the question presented is that the deferred taxes are the employer's share of Social Security taxes. It is clear that the responsible person penalty for full exposure of the undeposited taxes extends to employee Social Security taxes and withheld federal income taxes, but the same is not true for employer Social Security taxes. While the applicable rules are hard to follow and discern from the Code, employer Social Security taxes should not be considered subject to the Section 6672 trust fund recovery against responsible persons, whether a board member or an executive.

Deferring Payroll Taxes

The recent Covid-19 relief provisions enacted three important Social Security deferral provisions. An employer is entitled to defer deposit and payment of the employer's share of Social Security tax prior to determining whether the employer is entitled to the Families First Coronavirus Response Act's paid leave credits and the CARES Act's employee retention credits. Specifically, the employer may defer the amount of employment tax deposits that it may retain in anticipation of these credits, the amount of any advance payments of these credits, or the amount of any refunds with respect to these credits.

IRS [Notice 2020-22](#) provides relief from the failure to deposit penalty under Code Section 6656 for not making deposits of employment taxes, including taxes withheld from employees, in anticipation of the Families First paid leave credits and the CARES Act employee retention credits. The IRS's relaxed, practical, and empathetic approach to the Covid-19 pandemic expressed in Notice 2020-22 is unlikely to extend to the applicable dates for deferred payroll taxes paid past Dec. 31, 2021 and Dec. 31, 2022.

However, the tenor, tone, and approach of Notice 2020-22 relief is likely to be extended to late deposits for the SBA loans that are directly attributable to the timing of the loan forgiveness notifications that come just prior to or after the payroll processing dates. Such relief should be extended in recognition that those payroll processes and procedures do not generally have the flexibility to permit last minute deposits of employer Social Security taxes that are no longer subject to the deferral procedures.

IRS Reporting Guidance

The IRS FAQs have two important messages for processing and reporting the deferred payroll taxes. First, as anticipated, the IRS made it clear that Form 941, Employer's Quarterly Federal Tax Return, will be revised beginning for the second calendar quarter of 2020 (April-June, 2020). Second, since the first quarter's Form 941 has already been released and must be filed no later than April 30, 2020, the IRS will provide instructions in the very near future to instruct employers on how to reflect the deferred deposits and payments for the stub deferral period for deposits due on or after March 27, 2020 and before April 1, 2020.

IRS FAQs

The IRS FAQs are important guidelines for employers to follow, especially with the lack of formal guidance due to the fast-moving nature of the legislation and the effective dates of the statutory relief provisions. The IRS has consistently shown even-handed approaches in the scope and tenor of these FAQs and past FAQs addressing natural disasters, while also understanding the importance of the guidance being issued. Employers can and will rely on these FAQ guidelines in the absence of more formal guidance, such as revenue ruling and regulations.

While formal IRS and Treasury guidance is certainly preferred, employers and tax advisors must be cognizant that such guidance simply cannot be issued since the IRS National Office attorneys who are responsible for developing and issuing the guidelines in the past three weeks are operating under the same safety and stay-home guidelines as most of the rest of the country. While not all questions have been answered, or really can be answered, the IRS National Office has performed an extraordinary job under some of the most difficult circumstances and timelines imaginable. These are certainly important guidelines which employers should take comfort in when deferring the employer Social Security taxes.