



## EMPLOYER PAYROLL TAX DEFERRAL AND MODIFICATIONS FOR NET OPERATING LOSSES - CARES ACT

The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was signed into law on March 27, 2020. The CARES Act introduces tax relief for businesses intended to bolster liquidity and ease the tax burden. The CARES Act provides relief in the form of payroll tax credits, payroll tax deferment, and enhanced net operating loss ("NOL") deductions.

Below is a high-level summary of provisions relating to employer payroll tax deferral (Section 2302) and modifications of NOL deductions (Section 2303). The Gordon & Rees team has previously summarized Section 2301 of the CARES Act or the Employee Retention Tax Credit ("ERTC"), which can be found [here](#).

### EMPLOYER PAYROLL TAX DEFERRAL

The CARES Act allows an employer to defer certain payroll taxes, specifically the employer contribution of Federal Insurance Contributions Act ("FICA") taxes—with respect to their employees. Typically, the employer is obligated to remit its share (6.2%) of Social Security taxes for each employee's covered wages to the Treasury electronically on a semi-weekly or monthly basis.

The employer payroll tax deferral, which is found in Section 2302 of the CARES Act, allows employers to defer certain payroll taxes incurred between March 27, 2020 (date of enactment) and December 31, 2020. Under Section 2302, employers can defer their 6.2% share of the Social Security tax on each employee's covered wages for the rest of the year and pay half at the end of 2021 and half at the end of 2022.

It is important to note that Section 2302 does not cover other payroll taxes such as the Medicare tax (1.45%) or employee's share of the Social Security tax. In addition, there is no dollar cap on the total amount of employer social security taxes that may be deferred through December 31, 2020.

In similar fashion, the provision outlines tax deferrals in an equivalent amount for self-employed individuals subject to the Self Employment Contributions Act ("SECA") and employers and employee representatives subject to the Railroad Retirement Tax Act ("RRTA"). Specifically, Section 2302 allows self-employed individuals to defer 6.2% of their SECA tax on net earnings from self-employment (50% of the 12.4% portion attributable to Social Security) and enables employers and employee representatives to defer their 6.2% share of the Tier 1 tax (treated as a Social Security benefit for federal income tax purposes).

## EMPLOYER TAX DEFERRAL AND MODIFICATION FOR NET OPERATING LOSSES

While the payroll tax deferral may be attractive to most employers (and parties subject to SECA and RRTA tax liability), it is important to note that the tax relief addressed in Section 2302 constitutes a deferral, rather than a waiver of tax obligations. Notwithstanding section 6302 of the Internal Revenue Code, an employer's payments shall be treated as timely only if fifty percent of the deferred taxes are paid by December 31, 2021 and the remaining fifty percent are paid by December 31, 2022.

### Who qualifies for tax deferral under Section 2302?

Unlike the employee retention tax credit (Section 2301 of the CARES Act), the payroll tax deferral is available to all employers regardless of size. As stated above, Section 2302 allows employers to defer payment of their share of social security taxes (or portions of SECA or Tier 1 tax attributable to the social security benefit) owed through the end of calendar year 2020. Despite Section 2302's loosened eligibility requirements, there is one noteworthy caveat — employers who receive loan forgiveness under other provisions of the CARES Act are ineligible for the payroll tax deferral. **Employers who have indebtedness forgiven under the Paycheck Protection Program ("PPP") or Section 1109 of the CARES Act are not eligible for the payroll tax deferral.** Employers must decide on which relief program they qualify for and wish to use because use of the PPP disqualifies the use of the both the payroll deferral and employee retention programs.

### When will deferral be available to employers?

Immediately. The deferral period began as soon as the CARES ACT was signed into law on March 27, 2020 and will end on December 31, 2020.

### How will deferral be available to employers?

Employers should maintain concise records of their tax deferrals and be prepared to pay the sum of their deferred payroll taxes to Treasury when it comes due. Employers should alert company comptrollers, third party payroll providers, and accountants of the deferral

### What if an employer remits payroll taxes via an agent under Section 3504 of the Internal Revenue Code or a certified professional employer organization?

An employer will be solely liable for the timely payment of the employment taxes before the applicable date, where it directs a third party to defer the applicable tax payments on its behalf. The employer will be on the hook if an agent or certified professional employer organization fails to make payments to Treasury before the applicable date.

## NET OPERATING LOSS MODIFICATIONS

The CARES Act also relaxes the limitations on a company's use of Net Operating Losses ("NOL's") to offset taxable income. Section 2303(b) of the CARES Act amends Section 172(b) of the Internal Revenue Code to allow companies in a loss position at the end of 2018, 2019, or 2020 to carryback losses to each of the five years preceding the tax year of such loss. The provision enables businesses with unused net operating losses in 2018, 2019, or 2020, that paid taxes in one or more of the preceding five years, to immediately amend their prior returns and seek a refund for taxes paid—providing a potential source of cash flow for companies during the COVID-19 crisis.

## EMPLOYER TAX DEFERRAL AND MODIFICATION FOR NET OPERATING LOSSES



Prior to the passage of the Tax Cuts and Job Acts (“TCJA”) in 2017, businesses in a loss position at the end of the tax year could carryback losses to offset prior income, creating a cash-infusion when the IRS issued a refund). The 2017 legislation eliminated the carryback provision and placed restrictions on companies’ ability to offset taxable income providing that a company’s NOL deduction cannot exceed 80% of taxable income.

Section 172(a) of the Internal Revenue Code provides that the amount of the NOL deduction is equal to the lesser of (a) the aggregate of the NOL carryovers to such year and NOL carrybacks to such year, or (b) 80% of taxable income computed without regard to the deduction allowable in Section 172(a). In effect, NOL’s are typically subject to an 80% limitation and cannot fully offset the taxpayer’s income. Section 2303 of the CARES Act temporarily lifts this 80% limitation, allowing businesses to utilize unused losses to fully offset income (in the five years preceding the taxable year in which the NOL arises).

The new rule regarding NOL’s will enable businesses to apply incremental adjustments to taxable income through accumulated NOL carrybacks. Although these modifications will enable businesses to apply NOL’s in more tax-efficient ways, business will need to amend prior tax returns in order to reap the benefit of the Section 2303 carryback. Lastly, it is also worth noting that Section 2303 includes unique NOL carryback rules for Real Estate Investment Trusts (“REIT’s”), life insurance companies and the application of NOL carryback in relation to Repatriation Tax (IRC Section 965).

**Example:** The COVID-19 pandemic causes a net operating loss in your business for 2020. You lose \$150,000 and you report a NOL of \$150,000 on your 2020 tax return. The new rule under Section 2303 allows you to take this \$150,000 Net Operating Loss and apply it as a deduction against your amended 2017 tax return. If in 2017, you reported \$500,000 in taxable income, the provision enables you to amend your 2017 tax return — this time with an extra \$150,000 tax deduction. Your 2017 taxable income falls from \$500,000 to \$350,000 and creates a significant tax refund.

### **Which businesses qualify for potential NOL carryback treatment?**

All employers qualify for this relief, regardless of size.

### **When will the refunds be available?**

Businesses may immediately file amended returns seeking refunds for taxes paid, but it is unclear when NOL refund claims will be processed.

### **What if the deadline to file a tentative refund based on a NOL in 2018 or 2019 has passed?**

The Treasury and IRS granted a six-month extension of time to file a Form 1045 or Form 1139 to taxpayers that have an NOL that arose in a taxable year that began during calendar year 2018 and that ended on or before June 30, 2019. For example, in the case of an NOL that arose in a taxable year ending on December 31, 2018, a taxpayer normally would have until December 31, 2019 to file the Form 1045 or Form 1139, but due to this relief, will now have until June 30, 2020 to file the applicable form.

In order to take advantage of the extension of time, the taxpayer must perform the following actions: (a) File the applicable form (Form 1045 or Form 1139, as applicable) no later than 18 months after the close of the taxable year in which the NOL arose (that is, no later than June 30, 2020, for a taxable year ending December 31, 2018); and (b) Include on the top of the applicable form “[Notice 2020-26](#), Extension of Time to File Application for Tentative Carryback Adjustment.”

## Authors:

- Jonathan M. Boulahanis, Partner – Gordon Rees Scully Mansukhani Gordon
- W. Kent Carter, Partner– Gordon Rees Scully Mansukhani Gordon
- Craig S. Heryford, Partner– Gordon Rees Scully Mansukhani Gordon

## Gordon Rees Scully Mansukhani - Your 50 State Partner™

As the only law firm with offices and attorneys in all 50 states, Gordon & Rees delivers maximum value to our clients by combining the resources of a full-service national firm with the local knowledge of a regional firm. Featuring more than 950 lawyers nationwide, we provide comprehensive litigation and business transactions services to public and private companies ranging from start-ups to Fortune 500 corporations. Founded in 1974, Gordon & Rees is recognized among the fastest growing and largest law firms in the country. The firm is currently ranked among the 35 largest law firms in the U.S. and the top 50 firms for diverse and female attorneys in the AmLaw 200.

## Source: GRSM COVID-19 HUB

<https://www.grsm.com/publications/2020/cares-act-employer-payroll-tax-deferral-and-modifications>