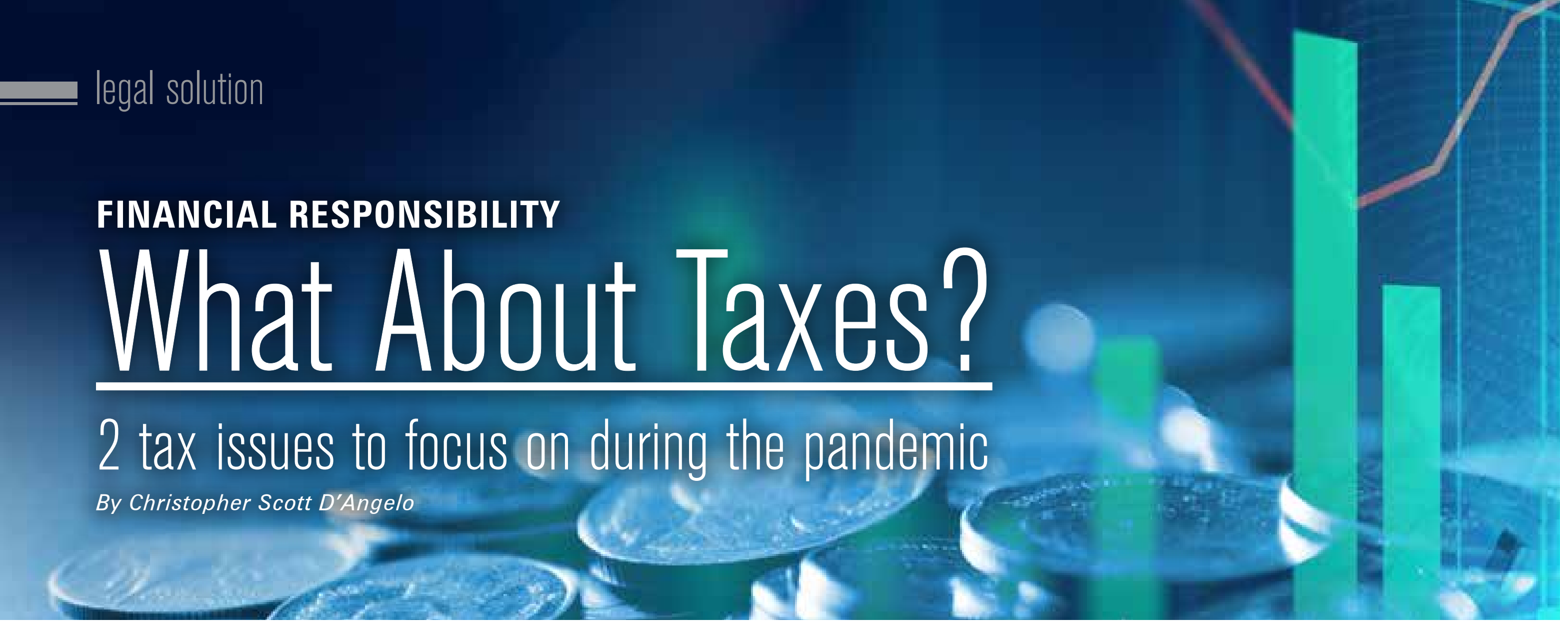

FINANCIAL RESPONSIBILITY

What About Taxes?

2 tax issues to focus on during the pandemic

By Christopher Scott D'Angelo

In the July 2020 article, I focused on contractor responsibilities for operations and worksite safety relating to COVID-19 and the pandemic and government requirements or recommendations as construction projects opened up and returned to work. As noted there, the understanding in the medical and public health communities as to how the coronavirus spreads and the best way to combat such spread is continually evolving and how it is crucial for contractors to be vigilant about keeping current with such developments. To that end, some resources were provided.

In this article, I concentrate on two issues on which contractors need to focus. The first is the payroll taxes holiday; the second deals with Paycheck Protection Program (PPP) forgiveness-related taxes.

PAYROLL TAXES HOLIDAY

Contractors—like all employers—are responsible for withholding federal and—where applicable—state and local income taxes from employees' paychecks, as well as the employees' contribution to payroll taxes (Social Security, Medicare, etc.), and to timely submit such withholdings to the relevant taxing authority. There are civil and criminal penalties for failing to do so timely and correctly, but the details therefor are beyond this article. Here the focus is on the "pandemic holiday" on certain federal payroll taxes adopted by the federal government.

On August 8, 2020, the president directed the secretary of the treasury to defer the withholding, deposit, and payment of certain payroll tax obligations. Accordingly, the secretary determined that employers that are required to withhold and pay the employee share of Social Security tax are deemed "affected by the COVID-19 emergency for purposes of the relief described in the Presidential Memorandum and this notice" and directs employers who participate in the program to not withhold the 6.2 percent employee contribution to Social Security taxes. The benefit is available for employees earning less than $4,000 bi-weekly (or the equivalent threshold amount with respect to other pay periods). The determination of "applicable wages" is made on a pay period-by-pay period basis, i.e., eligibility is determined for each pay period irrespective of the amount of wages or compensation paid to the employee for other pay periods.

The theory is that this would put more money in employees' hands to help during the pandemic's restrictions and to help get the economy moving again, assuming that they spend it rather than wisely saving it. After all, despite what has been written in some channels or bandied about over beers at the virtual bar, this is not a reduction or forgiveness of such payroll taxes, but merely a deferral. And there's the rub.

The participating employer's obligation to withhold and pay the taxes is merely postponed until the period beginning on January 1, 2021, and ending on April 30, 2021. The employer must withhold and pay the total "Applicable Taxes that the Affected Taxpayer deferred under this notice"—translation, what the employer otherwise would have been required to withhold during that September to December period—ratably from wages and compensation paid between January 1, 2021, and April 30, 2021, or interest, penalties, and additions to tax will begin to accrue on May 1, 2021, with respect to any unpaid "Applicable Taxes." "If necessary, the [participating employer] may make arrangements to otherwise collect the total [deferred taxes] from the employee."

There has not been any guidance issued as yet on how to implement the program, though the treasury secretary has stated that it is optional for non-government employers. So, if you have not yet, should you do it?

No.

As noted above, it is not an elimination of the tax liability, but merely a deferral, and it is fraught with administrative headaches. First, as to the administrative headaches, the employer will need to

make adjustments to its payroll systems now and in the 2021 catch-up period (and back after that), or if some employees want to do so and others do not, or they change their minds during the period, or their pay and therefore their eligibility fluctuates during these months. Second, and more important, the employee who happily pockets the extra money today will need to pay it back in equal installments in the first few months after the new year. Will the employee be happy about receiving a paycheck that is not only reduced back to what it had been previously—and that he or she had been used to—but reduced yet further to recoup that 6.2 percent not paid in the affected 2020 pay periods. The employer will have to field any grumbling at that point. Memories are short and pointing at the government is a weak deflection.

According to the IRS, for employees who leave during the deferral period (Sept. 1 to Dec. 31, 2020), employers may combine all of missed withholdings into the departing employees' last paychecks. But that of course would substantially cut into employees' take-home pay for that last period. Happy Holidays. This could affect many employees in the construction industry given the cyclical or temporary nature of such employment.

And what happens when that employee is no longer working for the same employer in 2021? Or that last paycheck is not sufficient to cover current and deferred withholding? Will the employer get stuck holding the bag? Silly question—of course it will.

PPP FORGIVENESS AND TAXES

The PPP loan program has been helpful for a number of employers. And the fact that forgiveness of the PPP loan does not result in taxable income for federal income taxes makes it even more so. At least for most.

However, so far at least, expenses paid with the PPP loan being forgiven will not be deductible on the business' federal income tax returns. For those who considered this in their business and financial planning in deciding to obtain or how they are using the loan proceeds, there is no issue. Others who did not or who failed to truly appreciate the net result of these factors will want to visit the issue currently, now well before the end of the year to plan accordingly.

The IRS's position is that, based on existing tax law intended to prevent such "double-dipping"—that is, otherwise deductible business expenses that are paid with forgiven PPP funds will be disallowed as tax deductions in computing the recipient's taxable income. The nondeductible treatment applies to expenses paid with PPP monies to the extent of the loan forgiveness. Additional information is available in the IRS notice: www.irs.gov/pub/irs-drop/n-20-32.pdf.

This does mean that some businesses may have higher taxable income in 2020 due to not being able to write off as many expenses. Of course, it will have the PPP monies which were not included in taxable income or subject to tax. However, it would be prudent to plan for now and anticipate the potential for higher taxes and the need for the cash to pay it.

Likewise, it would be prudent for businesses to work with their tax accountants and lawyers presently to be sure that any allocation or use of the funds to be forgiven do not affect—or maybe even take advantage of possibly better treatment under—other provisions of the federal tax code.

CLOSING THOUGHT

Last for now, it must be remembered that the non-taxable nature of the PPP loan forgiveness is at the federal level. Businesses should investigate and plan for the treatment at the state level. Even states that conform to the Internal Revenue Code may still treat the forgiveness as taxable income since the CARES Act (the federal act that addresses this point) did not amend the federal tax code. ■

about the author

Christopher Scott D'Angelo is a partner and chair of both the Business Disputes & Products Liability Practice and International Practice at Montgomery McCracken Walker & Rhoads LLP, based in Philadelphia and New York City. His practice involves business, products liability, construction, class action, and insurance counseling and litigation, including his role as national counsel for several major U.S. clients and his representation of foreign concerns in the United States and U.S. concerns abroad. He is a member of the Construction Law and Litigation Committee of the International Association of Defense Counsel. He can be reached at cdangelo@mmwr.com.