

COVID-19 Economic Stimulus: Business Payroll Tax Cuts

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The economic fallout from coronavirus disease (COVID-19) has accelerated rapidly. Policymakers continue to evaluate tax policy economic relief options. Payroll tax cuts for businesses are one option that would provide economic assistance to business activities.

Business Payroll Taxes

Payroll taxes are collected to finance certain entitlement programs, including [Social Security](#), [parts of Medicare](#), and [Unemployment Compensation \(UC\)](#). Social Security's old age, survivors, and disability insurance (OASDI) payroll tax is paid by both employers and employees, and it finances the [Social Security trust funds](#). The tax equals 6.2% of wages on the taxable earnings base ([\\$137,700 in 2020](#)). This tax is paid by both employers and employees (with self-employed individuals paying both the employer and the employee share, or 12.4%). The primary source of funding for Medicare Part A is a separate payroll tax paid by employers and employees. Each pays a tax of 1.45% on the employee's earnings; the self-employed pay 2.9%.

Employers typically [deposit payroll taxes](#) with the Internal Revenue Service semiweekly or monthly, and report employment taxes paid on [quarterly federal tax returns](#) filed no later than 30 days after the end of the calendar quarter. Some employers with small payrolls may file annually.

Employment payroll taxes generally are paid by all types of employers: businesses, nonprofits, and government employers. Thus, tax relief that is provided through payroll tax reductions may be [available to nonprofits](#), which generally do not benefit from income tax reductions.

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If maintaining Social Security or Medicare Part A trust fund balances is a policy objective, these funds can be made whole through a transfer of general revenue. In this case, the revenue loss from a payroll tax cut would add to the deficit, but not decrease amounts available for Social Security or Medicare benefits. Temporary cuts to payroll taxes enacted in past recessions have [protected trust funds from any impact](#) in such a manner.

Options for Payroll Tax Cuts

There are a number of options for how to structure and implement payroll tax reductions. The Relief for Individuals, Families, and Businesses portion (i.e., Division B) of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (S. 3548) proposes a payroll tax deferral for employers. Employers and self-employed individuals would be able to defer, or postpone, the employer share of the Social Security payroll tax. Deferred tax liability would be paid in two installments: one due by December 31, 2021, and the second by December 31, 2022. The Social Security trust funds would not be affected.

Another option is to provide a [payroll tax rebate](#). This option would return 2020 payroll taxes already paid by employers. It could be targeted to small businesses, with [small businesses identified](#) using an employee threshold, a gross receipts threshold, or some other measure. A rebate could be capped at a fixed amount per employee, or given for a certain number of employees. A payroll tax rebate could also apply only to businesses who have been ordered by federal, state, or local government officials to cease operations due to COVID-19, or these types of businesses could be given a larger rebate. A payroll tax rebate payment could improve cash flow, helping businesses with limited financial resources. Depending on how the policy was designed, a portion of the lost federal revenue may also support employers whose business activities were unaffected by the COVID-19 economic shock.

A third option is to suspend business payroll taxes (provide a payroll tax holiday). The [Trump Administration](#) has expressed interest in this option. The [business community](#) has also [expressed support](#) for a payroll tax suspension. How long the payroll tax would be suspended is one policy choice. It could be suspended for three months, for the rest of the year, or for some other period of time. There is also the question of whether employee payroll tax collections would be suspended entirely or instead reduced by some amount (e.g., reduced by two percentage points). Suspending payroll taxes would reduce the cost of keeping employees on the payroll, and thus could promote worker retention. A payroll tax suspension only helps employers with paid employees; if an employer has already been forced to lay off its workforce, a payroll tax suspension will not provide financial assistance.

Past Experience and Potential Effectiveness

Employer payroll tax cuts have been enacted in the past. The Hiring Incentives to Restore Employment (HIRE) Act of 2010 (P.L. 111-147), enacted during the Great Recession, suspended the employer's share of the 2010 payroll tax (6.2% of the worker's earnings) for qualified workers (generally unemployed individuals) hired between February 3, 2010, and January 1, 2011. The policy was [estimated to reduce federal revenue by \\$7.6 billion](#). One difference between the past policy and the current proposals is that the past policy was intended to spur hiring; current proposals have the goal of preventing layoffs.

The provision's effectiveness will depend on how the additional cash flow is utilized. According to [CBO](#) models run during the Great Recession, an employer payroll tax reduction would provide a small incentive to increase employment or hours worked. The empirical literature generally agrees with the results from the CBO model, finding that during economic turmoil businesses are prone to favor holding cash or reducing debt over making investments ([Eisfeldt and Muir 2016](#), [Bolton, Chen and Wang 2013](#), and [Dobridge 2016](#)). The last study also found that the use of refunds to improve a firm's cash flow reduced the firm's bankruptcy risk and the probability of a future credit-ratings downgrade. One caveat to

this empirical literature is that those studies examined a different cash flow incentive—[net operating loss carrybacks](#)—that would be equivalent to a payroll tax refund.

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