



# COMPLIANCE ALERT



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## IRS Releases FAQs on Employer Tax Credits for FFCRA Paid Leave and CARES Act Employee Retention

### Introduction

Effective April 1, 2020 (ending December 31, 2020), the Families First Coronavirus Response Act (H.R. 6201, “the FFCRA”) requires private employers with fewer than 500 employees (and public agencies with one or more employee) to provide paid sick leave for six COVID-19 related purposes and up to 12 weeks of FMLA leave for school closures or where childcare is not available as a result of the COVID-19 crisis. It provides tax credits to offset the cost of these two provisions. (See [Alert 2020-05](#).) Implementing the law has required fast action by both the Department of Labor (DOL) and Internal Revenue Service (IRS). DOL clarified several key features of the law through a [series of FAQs](#). (See [Alert 2020-07](#) and [Alert 2020-09](#)), and has since issued comprehensive temporary regulations, an Alert on which will be sent simultaneously with the one.

On April 1, IRS released 66 [FAQs](#) on a wide range of topics including the tax credits to offset the cost of the FFCRA’s two new paid leave provisions. A separate set of IRS FAQs also addressed an employee retention tax credit under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The FAQs on the tax credit for paid leaves are available in full [here](#). The FAQs on the Employee Retention Credit are available [here](#). Employers should reach out to their tax advisors as quickly as possible to discuss their eligibility for these new tax credits.

### Executive Summary of Tax Credits

**Paid Sick Leave.** An employer that provides paid sick leave under the following circumstances, can receive a dollar for dollar tax credit not to exceed an aggregate of \$5,110 per employee. Note the amount of paid sick leave will vary by employee based on individual circumstances as set forth below and in our [Coronavirus Compliance Guide](#).

- When the employee is subject to a Federal, State, or local quarantine or isolation order related to COVID-19
- To comply with the directive of a healthcare provider to self-quarantine due to COVID-19 related concerns
- To obtain a medical diagnoses or care is experiencing COVID-19 symptoms

An employer that provides paid sick leave under the following circumstances, can receive a dollar for dollar tax credit not to exceed an aggregate of \$2,000 per employee. Note the amount of paid sick leave will vary by employee based on individual circumstances as set forth below and in our [Coronavirus Compliance Guide](#).

- To care for an individual who is subject to a Federal, State, or local quarantine or isolation order related to COVID-19 or has been advised by a healthcare provider to self-quarantine due COVID-19 related concerns
- To care for a child if a school or place of care is closed, or the child care provider is unavailable, due to COVID-19

- The employee is experiencing any other substantially similar condition specified by Health and Human Services

**Expanded FMLA.** An employer that provides paid leave under the expanded FMLA provisions can receive a dollar for dollar tax credit not to exceed an aggregate of \$10,000 per employee. Note the amount of paid FMLA leave will vary by employee based on individual circumstances as set forth below and in our [Coronavirus Compliance Guide](#).

Both credits are available for paid leave provided under the FFCRA beginning **April 1, 2020, and through December 31, 2020.**

**CARES Act Employee Retention Credit.** Eligible employers receive a tax credit equal to 50% of qualified wages paid to their employees after **March 12, 2020, and before January 1, 2021.** The maximum amount of qualified wages taken into account for each employee is \$10,000 (for all calendar quarters), so **\$5,000 is the maximum credit** an employer can receive for any one employee.

There are a number of key nuances and specific provisions employers should know about how these tax credits work, but of particular note the credits under both the FFCRA and the CARES Act are available as an advanced payment from IRS under certain circumstances, and the IRS has created [Form 7200](#) for this purpose. In addition, an employer can avail itself of both tax credits where applicable. We discuss these and other relevant issues in detail below.

## Overview of FFCRA Tax Credits

The FFCRA provides that employers subject to the emergency paid sick leave (EPSL) and expanded FMLA (EFMLA) leave requirements are entitled to fully refundable tax credits to cover the cost of the qualified sick leave wages and qualified family leave wages (“qualified leave wages”). This credit includes qualified health plan expenses and the employer’s share of Medicare tax on the qualified leave wages. The credit is allowed against the federal employment taxes imposed on employers on all wages and compensation paid to employees. If the amount of the credit exceeds the employer portion of these federal employment taxes, then the excess is treated as an overpayment and refunded to the employer. The tax credits apply to qualified leave wages paid beginning April 1, 2020, and ending December 31, 2020.

## Eligible Employers

Eligible employers are businesses and tax-exempt organizations with fewer than 500 employees that are required to comply with the FFCRA paid leave provisions. For information on how to count employees for this purpose, see our [Coronavirus Compliance Guide](#). These tax credits are not available to employers with 500 or more employees that provide similar leave. In addition, the FFCRA requires most government employers to provide paid leave, but does not entitle those governmental employers to tax credits.

## How Employers Claim the FFCRA Tax Credit

**Background.** Understanding the FFCRA tax credit requires a basic understanding of how employers report wages and pay federal employment taxes. In general, employers must deposit the federal income tax withheld from employees, and both the employer and employee social security and Medicare taxes monthly or semi-weekly. Employers are required to determine at the beginning of each calendar year which deposit schedule they can use, and each quarter must file Form 941 (or other applicable tax return such as Form 944 or Form CT-1) to report wages paid and tips employees reported, as well as employment taxes (federal income tax withheld, social security and Medicare taxes withheld), and the employer’s share of social security and Medicare taxes. Form 941 is generally due by the last day of the month following the end of the quarter. For example, an employer required to file Form 941 by April 30 wages paid during the first quarter—January through March.

**Process.** In anticipation of receiving the credits, employers can fund qualified leave wages by accessing federal employment taxes related to wages paid between April 1, 2020, and December 31, 2020, including withheld taxes, that would otherwise be required to be deposited with the IRS. This means that in anticipation of claiming the credits on the Form 941, employers can retain the federal employment taxes they otherwise would have deposited (without incurring a penalty—see [IRS Notice 2020-22](#)), including federal income tax withheld from employees, the employees' share of social security and Medicare taxes, and the employer's share of social security and Medicare taxes with respect to all employees. The Form 941 will provide instructions about how to reflect the reduced liabilities for the quarter related to the deposit schedule.

**Advanced Payment Requests.** If the federal employment taxes to be deposited are not sufficient to cover the cost of qualified leave wages, the employer can file a request for an advance payment from the IRS via [Form 7200](#), Advance of Employer Credits Due To COVID-19. Note that an employer should first reduce its remaining federal employment tax deposits for wages paid in the same quarter to zero before seeing an advanced payment. The IRS expects to begin processing these requests in April 2020.<sup>1</sup> The employer will account for the amounts received as an advance when it files its Form 941 for the relevant quarter.

**Fully Refundable.** In the event an employer's the credit is more than the federal employment taxes the employer owes, the excess is treated as an overpayment and refunded to the employer, which is why the credit is referred to as fully refundable.

### Record Retention Requirements

Employers claiming the credits must retain records and documentation related to and supporting each employee's leave in order to substantiate the claim for the credits, as well as retain the Forms 941, Employer's Quarterly Federal Tax Return, and 7200, Advance of Employer Credits Due To COVID-19, and any other applicable filings made to the IRS requesting the credit. The employer should keep all records of employment taxes for at least 4 years after the date the tax becomes due or is paid, whichever comes later. These should be available for IRS review.

### Credit Amounts and Examples

The FFCRA tax credit covers 100 percent of up to 80 hours of the qualified EPSL leave wages and up to ten weeks of the EFMLA wages paid during a calendar quarter, plus the amount of the employer's share of Medicare taxes imposed on wages, which is generally 1.45% of wages. Note also that qualified leave wages include qualified health plan expenses allocable to those wages, discussed in greater detail below. Employers may only claim a credit for qualified leave wages, and not for any other paid leave provisions in place. Note there is no credit for the employer portion of OASDI tax, also known as social security tax, because the qualified leave wages are not subject to this tax.

**Amount of EPSL Wages.** With respect to the amount of qualified EPSL wages, of the six reasons an employee can take EPSL, three pay at 100% of the regular rate of pay and three pay at 2/3 of the regular rate of pay. Employers must pay up to 80 hours for full-time employees, and part-time employees are entitled to the number of hours of PSL the employee works, on average, in a two-week period, or if the employee's normal scheduled hours are unknown or variable, under other alternative determinations. See our [Coronavirus Compliance Guide](#) for additional information on how determine part-time employee sick leave hours. The total amount an employer will pay for any one employee's EPSL will vary depending on the reason the employee is unable to work or telework, the duration of the employee's absence, the employee's hours, and the employee's regular rate of pay. The maximum amount of PSL wages an employer will pay at

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<sup>1</sup> An Eligible Employer may obtain the Form 7200, Advance Payment of Employer Credits Due to COVID-19, and may fax its completed form to 855-248-0552.

100% is \$511 per day and \$5,110 in the aggregate, and the maximum amount an employer will pay at 2/3 the regular rate of pay is \$200 per day and \$2,000 in the aggregate.

**Amount of EFMLA Wages.** Under the new EFMLA provisions, the employer is required to pay at least 2/3 of the employee's regular rate of pay, multiplied by the number of hours the employee otherwise would have been scheduled to work, not to exceed \$200 per day and \$10,000 in the aggregate for the calendar year.

**Example 1.** Employer pays \$10,000 in qualified leave wages in Q2 2020. It does not owe the employer's share of social security tax on the \$10,000, but it will owe \$145 for the employer's share of Medicare tax. Its credits equal \$10,145, which include the \$10,000 in qualified leave wages plus \$145 for the Eligible Employer's share of Medicare tax (this example does not include any qualified health plan expenses). This amount may be applied against any federal employment taxes the employer owes for wages paid in Q2 2020. Any excess over the federal employment tax liabilities is refunded pursuant to standard IRS procedures. The employer must still withhold the employee's share of social security and Medicare taxes on the qualified leave wages paid.

**Example 2.** Employer paid \$5,000 in qualified sick leave wages and qualified family leave wages and is otherwise required to deposit \$8,000 in federal employment taxes for wage payments made during the same quarter as the \$5,000 in qualified leave wages. The employer may keep up to \$5,000 of the \$8,000 of taxes it was going to deposit, and will not owe a penalty for keeping the \$5,000. The employer is then only required to deposit the remaining \$3,000 on its required deposit date, and will later account for the \$5,000 it retained when it files Form 941 for the quarter.

**Example 3.** Employer paid \$10,000 in qualified leave wages and is otherwise required to deposit \$8,000 in federal employment taxes on wage payments made during the same quarter. The employer can keep the entire \$8,000 of taxes it was otherwise required to deposit without penalties as a portion of the credits it is entitled to claim on the Form 941. The employer may file a request for an advance credit for the remaining \$2,000 by completing Form 7200.

### Qualified Health Plan Expenses

As noted above, qualified leave wages for which an employer can seek a credit include any qualified health plan expenses paid or incurred by an employer to provide and maintain a group health plan.<sup>2</sup> In other words, the tax credits for qualified leave wages are increased by the qualified health plan expenses allocable to each type of qualified leave wages. Qualified health plan expenses are properly allocated on a pro rata basis among covered employees, and pro rata on the basis of periods of coverage. Qualified expenses include both the employer and employee portion of the cost, but should not include amounts that the employee paid for with after-tax contributions.

**Calculating Expenses for More than One Plan.** Where an employer sponsors more than one plan for its employees, which is most often the case, qualified health plan expenses will be determined separately for each plan. Those expenses are then allocated to the employees who participate in that plan. In the case of an employee who participates in more than one plan, the allocated expenses of each plan in which the employee participates are aggregated for that employee. For example, qualified expenses would include both the medical plan and the health-FSA.

**Fully Insured Group Health Plan Expenses.** An employer sponsoring a fully-insured group health plan may use any reasonable method to determine and allocate the plan expenses, including (1) the COBRA applicable premium for the employee typically available from the insurer, (2) one average premium rate for

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<sup>2</sup> The term group health plan means a plan (including a self-insured plan) of, or contributed to by, an employer or employee organization to provide health care (directly or otherwise) to the employees, former employees, the employer, others associated or formerly associated with the employer in a business relationship, or their families.

all employees, or (3) a substantially similar method that takes into account the average premium rate determined separately for employees with self-only and other than self-only coverage.

**Self-insured Group Health Plan Expenses.** An employer sponsoring a self-insured group health plan may use any reasonable method to determine and allocate the plan expenses, including (1) the COBRA applicable premium for the employee typically available from the administrator, or (2) any reasonable actuarial method to determine the estimated annual expenses of the plan.

**Alliant Note:** For administrative simplicity, the COBRA applicable premium is likely the preferable method to determine plan expenses for both fully insured and self-insured plans. Employers interested in exploring other methods should review the [IRS FAQs 33-34](#).

**Account Based Plans.** Qualified health plan expenses may include contributions to an HRA, or a health-FSA, but do not include contributions to a QSEHRA. To allocate contributions to an HRA or a health-FSA, employers should use the amount of contributions made by or on behalf of the particular employee. Qualified health plan expenses do not include employer contributions to HSAs or Archer MSAs.

**Employee Pre-tax Payments for Benefits While on Paid Leave.** On a somewhat related note, the IRS guidance indicates that the FFCRA does not distinguish qualified leave wages from other wages, and the same rules that generally apply to an employee's regular wages would apply. In that regard, and to the extent that an employee has a salary reduction agreement in place with the employer, the FFCRA does not prohibit the employer from taking salary reduction contributions for benefits (e.g., employer sponsored health plan, a 401(k) or other retirement plan) out of qualified leave wages.

### Coordination with Other Employer Tax Breaks and Assistance under the CARES Act

The CARES Act (commonly known as the stimulus package) provides a tax credit to employers subject to a full or partial closure order due to COVID-19 or experiencing a significant decline in gross receipts, if they retain their employees. This Employee Retention Tax Credit is discussed in more detail below, but is equal to 50% of qualified wages paid to employees after March 12, 2020, and before January 1, 2021, up to \$10,000 for each employee for all calendar quarters. Employers that meet the respective requirements may receive both the Employee Retention Tax Credit and the FFCRA tax credits, but not for the same wage payments. In other words, qualified wages for the employee retention credit do not include the amount of qualified leave wages for which the employer received tax credits under the FFCRA (no "double dipping").

In addition to the employee retention credit, the CARES Act provides for certain small business interruption loans. An employer may receive both the tax credits and the loan. Note, however, that tax credits for qualified leave wages not eligible as "payroll costs" for purposes of receiving loan forgiveness under section 1106 of the CARES Act.

### FFCRA Tax Implications for the Employee

The employer is required to take federal employment taxes out of qualified leave wages, and these wages are taxable to the employee.

### Overview of Employee Retention Credit under the CARES Act

The Employee Retention Credit is a fully refundable tax credit for eligible employers (of any size) equal to 50% of qualified wages paid to their employees. As with the FFCRA tax credit, qualified wages include qualified health plan expenses. The credit applies to qualified wages paid after March 12, 2020, and before January 1, 2021. The maximum amount of qualified wages taken into account with respect to each employee for all calendar quarters is \$10,000, so that the maximum credit an employer can receive for any employee is \$5,000.

**Eligible Employers.** For purposes of the Employee Retention Credit, an eligible employer is defined fairly broadly as one that carries on a trade or business during calendar year 2020, including a tax-exempt organization, that either:

- Fully or partially suspends operation during any calendar quarter in 2020 due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19; or
- Experiences a significant decline in gross receipts during the calendar quarter.

Governmental employers and self-employed individuals are not eligible for this tax credit.

**Suspended Operations and Significant Decline in Gross Receipts.** The operation of a trade or business may be partially suspended if an appropriate governmental authority imposes restrictions upon the business operations by limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19 such that the operation can still continue to operate but not at its normal capacity.

A significant decline in gross receipts begins with the first quarter in which an employer's gross receipts for a calendar quarter in 2020 are less than 50 percent of its gross receipts for the same calendar quarter in 2019. The significant decline in gross receipts ends with the first calendar quarter that follows the first calendar quarter for which the employer's 2020 gross receipts for the quarter are greater than 80 percent of its gross receipts for the same calendar quarter during 2019.

**Example.** An employer's gross receipts were \$100,000, \$190,000, and \$230,000 in the first, second, and third calendar quarters of 2020, respectively. Its gross receipts were \$210,000, \$230,000, and \$250,000 in the first, second, and third calendar quarters of 2019, respectively. Thus, the employer's 2020 first, second, and third quarter gross receipts were approximately 48%, 83%, and 92% of its 2019 first, second, and third quarter gross receipts, respectively. Accordingly, the employer had a significant decline in gross receipts commencing on the first day of the first calendar quarter of 2020 (the calendar quarter in which gross receipts were less than 50% of the same quarter in 2019) and ending on the first day of the third calendar quarter of 2020 (the quarter following the quarter for which the gross receipts were more than 80% of the same quarter in 2019). Thus the employer is entitled to a retention credit with respect to the first and second calendar quarters.

**Credit Amount.** The credit is 50% percent of the qualified wages paid in a calendar quarter. The maximum amount of qualified wages with respect to each employee for all calendar quarters is \$10,000, so that the maximum credit for qualified wages paid to any employee is \$5,000.

**Example 1.** Eligible Employer pays \$10,000 in qualified wages to Employee A in Q2 2020. The Employee Retention Credit available to the Eligible Employer for the qualified wages paid to Employee A is \$5,000.

**Example 2.** Eligible Employer pays Employee B \$8,000 in qualified wages in Q2 2020 and \$8,000 in qualified wages in Q3 2020. The credit available to the Eligible Employer for the qualified wages paid to Employee B is equal to \$4,000 in Q2 and \$1,000 in Q3 due to the overall limit of \$10,000 on qualified wages per employee for all calendar quarters.

**Determining Qualified Wages.** Qualified wages are generally wages and compensation—as defined in sections 3121(a) and section 3231(e) of the Internal Revenue Code (IRC)—that an eligible employer pays after March 12, 2020, and before January 1, 2021. Qualified wages include qualified health plan expenses that are properly allocable to the wages, determined in the same manner set forth above for purposes of the FFCRA tax credit.



The definition of qualified wages here also depends, in part, on the average number of full-time employees (as defined in section 4980H of the Code) employed during 2019. This full-time employee calculation is the same calculation used to determine if an employer is an applicable large employer under the Patient Protection and Affordable Care Act.

For larger employers, an employer that averaged more than 100 full-time employees in 2019—qualified wages are those paid to an employee for time the employee is not providing services due to either: (1) a full or partial suspension of operations by order of a governmental authority due to COVID-19, or (2) a significant decline in gross receipts. For these larger employers, qualified wages may not exceed what the employee would have been paid during the 30 days immediately preceding the period of economic hardship. For smaller employers (those averaging 100 or fewer full-time employees in 2019) qualified wages are those paid to *any employee* during any period of economic hardship described in (1) and (2) above. In other words, there is more flexibility for smaller employers to claim wages as qualified for this purpose.

**Process for Claiming Credit and Refundability.** The process for claiming this credit is the same as described above for claiming the FFCRA tax credit, including use of quarterly tax Form 941 and the request for advanced payment using new Form 7200. In addition, as is the case with the FFCRA tax credit, an employer may get a refund if the amount of this credit is more than certain federal employment taxes the employer owes.

**Coordination with other Tax Credits or CARES Act Programs.** As set forth above, an employer may receive the Employee Retention Credit and the FFCRA Tax Credit, as appropriate. An employer may not, however, receive the Employee Retention Credit if it receives Small Business Interruption Loan under the Paycheck Protection Program authorized under the CARES Act.

### Conclusion

The economic impact of the COVID-19 pandemic is wide ranging and diverse. Legislation passed thus far does provide certain relief depending on the specific circumstances of an operation. Employers should review these provisions and processes to determine what relief may be available to them. We will continue to monitor this very fluid situation and provide the latest information on the COVID-19 pandemic, including emerging legal challenges and practical recommendations. Our full suite of resources is available on [Alliant's COVID-19 Resource Page](#).

### Compliance Alert is presented by the Compliance Practice Group of Alliant Employee Benefits

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