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IRS PROVIDES GUIDANCE ON FFCRA TAX CREDITS

April 1, 2020

The Families First Coronavirus Response Act (FFCRA), which becomes effective today, provides businesses with tax credits to cover certain costs of providing employees with required paid sick leave and expanded family and medical leave for reasons related to COVID-19. Eligible employers may claim tax credits for qualified leave wages paid to employees on leave due to emergency paid sick leave (EPSL) or expanded family and medical leave (E-FMLA) for reasons related to COVID-19 for leave taken beginning on April 1, 2020, and ending on December 31, 2020.

Who Can Claim the Tax Credits?

Employers (including tax-exempt organizations) may claim the refundable tax credits if they have fewer than 500 employees, and are required under the FFCRA to pay “qualified sick leave wages” and/or “qualified family leave wages.”

A business is considered to have fewer than 500 employees if, at the time an employee’s leave is to be taken, the business employs fewer than 500 full-time and part-time employees within the United States, which includes any State of the United States, the District of Columbia, or any Territory or possession of the United States. The IRS does not specify when related employers should be treated separately or aggregated for FFCRA threshold purposes, but it directs employers to U.S. Department of Labor (DOL) guidance on this point.

DOL states that, typically, a corporation (including its separate establishments or divisions) is considered to be a single employer, and its employees must each be counted towards the 500-employee threshold. Where a corporation has an ownership interest in another corporation, the two corporations are separate employers unless they are joint employers under the Fair Labor Standards Act (FLSA) with respect to certain employees. If two entities are found to be joint employers, all of their common employees must be counted in determining whether paid sick leave must be provided under the Emergency Paid Sick Leave Act and expanded family and medical leave must be provided under the Emergency Family and Medical Leave Expansion Act.

Further, two or more entities are separate employers unless they meet the integrated employer test under the Family and Medical Leave Act of 1993 (FMLA). If two entities are an integrated employer under the FMLA, then employees of all entities making up the integrated employer will be counted in determining employer

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coverage for purposes of paid sick leave under the Emergency Paid Sick Leave Act and expanded family and medical leave under the Emergency Family and Medical Leave Expansion Act.

What is the Amount of Available Tax Credits?

The tax credits cover 100% of up to 10 days of qualified sick leave wages and up to 10 weeks of qualified family leave wages (and any qualified health plan expenses allocable to those wages) that an eligible employer paid during a calendar quarter, plus the amount of the eligible employer's share of Medicare taxes imposed on those wages. Eligible employers may only claim a credit for FFCRA qualified leave wages, not any other pay or benefits that already provide to affected employees under another employer program.

Example: An eligible employer pays \$10,000 in qualified sick leave wages and qualified family 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 allocable to the qualified leave wages). This amount may be applied against any federal employment taxes that the eligible employer is liable for on any wages paid in Q2 2020. Any excess over the federal employment tax liabilities is refunded in accord with normal procedures. *Eligible employers must still withhold the employee's share of Social Security and Medicare taxes on the qualified leave wages paid.*

What Do the Tax Credits Cover?

The FFCRA provides that employers may claim a tax credit for amounts they are required to pay for qualified sick leave wages, qualified family leave wages, costs associated with providing health care during qualified leaves, and the employer's share of the Medicare tax. The IRS refers to qualified sick leave wages and qualified family leave wages collectively as qualified leave wages.

Qualified sick leave wages are wages that the FFCRA requires an employer to pay to an employee who is unable to work or telework because of either the employee is under COVID-19 quarantine or self-quarantine or has COVID-19 symptoms and is seeking a medical diagnosis; or the employee needs to care for someone with COVID-19 or for a child whose school or place of care is closed or child care provider is unavailable due to COVID-19.

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Qualified family leave wages are wages that the FFCRA requires an employer to pay to an employee who is unable to work or telework because the employee is caring for a child whose school or place of care is closed or child care provider is unavailable due to COVID-19-related reasons.

Qualified health plan expenses are amounts paid or incurred by an Eligible employer to provide and maintain a group health plan that are allocable to the employee's qualified leave wages.

Medicare Tax. The FFCRA also adds to the tax credits the amount of the Hospital Insurance tax, also known as Medicare tax, that Eligible employers are required to pay on qualified leave wages. The rate for this tax is 1.45% of wages. Eligible employers subject to Railroad Retirement Tax Act do not get this credit.

An employer will not get a credit for its share of OASDI tax, also known as Social Security tax, that eligible employers are required to pay on the qualified leave wages because the qualified leave wages are not subject to this tax.

Qualified Health Plan Expenses

Generally, the tax credits for qualified sick leave wages and qualified family 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 to the qualified sick or family leave wages if the allocation is made on a pro rata basis among covered employees (for example, the average premium for all employees covered by a policy) and pro rata on the basis of periods of coverage (relative to the time periods of leave to which such wages relate).

The amount of qualified health plan expenses taken into account in determining the credits generally includes both the portion of the cost paid by the eligible employer and the portion of the cost paid by the employee with pre-tax salary reduction contributions. However, the qualified health plan expenses should not include amounts that the employee paid for with after-tax contributions.

If an employer sponsors more than one plan, the qualified health plan expenses are determined separately for each plan. Then, for each plan, the employer should allocate expenses to the employees who participate in that plan. In the case of an employee who participates in more than one plan (e.g., a group health plan and a health flexible spending arrangement (HFSA), the allocated expenses of each plan in which the employee participates are aggregated for that employee.

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Fully insured plans. An eligible employer who sponsors a fully insured group health plan may use any reasonable method to determine and allocate the plan expenses, including:

- the COBRA applicable premium for the employee typically available from the insurer,
- one average premium rate for all employees, or
- 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.

If an eligible employer chooses to use one average premium rate for all employees, it may determine the allocable amount for each day an employee covered by the insured group health plan is entitled to qualified leave wages as follows:

Divide the eligible employer's overall annual premium for the employees covered by the policy by the number of employees covered by the policy to determine the average annual premium per employee. Then divide that amount by the average number of work days during the year by all covered employees (treating days of paid leave as a work day and a work day as including any day on which work is performed) to determine the average daily premium per employee.

For example, a full-year employee working five days per week may be treated as working 52 weeks x 5 days or 260 days. Calculations for part-time and seasonal employees who participate in the plan should be adjusted as appropriate. Eligible employers may use any reasonable method for calculating part-time employee work days. The resulting amount is the amount allocated to each day of qualified sick or family leave wages.

Example: An eligible employer sponsors an insured group health plan that covers 400 employees, some with self-only coverage and some with family coverage. Each employee is expected to have 260 work days a year. (Five days a week for 52 weeks.) The employees contribute a portion of their premium by pre-tax salary reduction, with different amounts for self-only and family. The total annual premium for the 400 employees is \$5.2 million. This includes both the amount paid by the eligible employer and the amounts paid by employees through salary reduction.

For an eligible employer using one average premium rate for all employees, the average annual premium rate is \$5.2 million divided by 400, or \$13,000. For each employee expected to have 260 work days a year, this results in a daily average premium rate equal to \$13,000 divided by 260, or \$50. That \$50 is the amount of qualified health expenses allocated to each day of paid sick or family leave per employee.

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Self-funded Plans. An eligible employer who sponsors a self-insured group health plan may use any reasonable method to determine and allocate the plan expenses, including:

- the COBRA applicable premium for the employee typically available from the administrator, or
- any reasonable actuarial method to determine the estimated annual expenses of the plan.

If the eligible employer uses a reasonable actuarial method to determine the estimated annual expenses of the plan, then rules similar to the rules for insured plans are used to determine the amount of expenses allocated to an employee. Thus, the estimated annual expense is divided by the number of employees covered by the plan, and that amount is divided by the average number of work days during the year by the employees (treating days of paid leave as work days and any day on which an employee performs any work as work days). The result is the amount allocated to each day of qualified sick or family leave wages.

Health Spending Account (HSA) and Archer Medical Savings Account (Archer MSA). The amount of qualified health plan expenses does **not** include eligible employer contributions to HSAs or Archer MSAs. Eligible employers who sponsor a high-deductible health plan (HDHP) should calculate the amount of qualified expenses in the same manner as an insured group health plan, or a self-insured plan, as applicable.

Health Reimbursement Arrangement (HRA), Health FSA (HFSA), Qualified Small Employer Health Reimbursement Arrangement (QSEHRA). The amount of qualified health plan expenses may include contributions to an HRA (including an individual coverage HRA), or a health FSA, but does **not** include contributions to a QSEHRA. To allocate contributions to an HRA or a health FSA, eligible employers should use the amount of contributions made on behalf of the particular employee.

How to Claim the Tax Credits

Eligible employers will claim the credits on their federal employment tax returns (e.g., Form 941, Employer's Quarterly Federal Tax Return), but they can benefit more quickly from the credits by reducing their federal employment tax deposits.

Eligible employers can fund qualified leave wages (and allocable qualified health plan expenses and the eligible employer's share of Medicare tax on the 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, eligible employers can retain the federal employment taxes that they otherwise would have

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deposited, including federal income tax withheld from employees, the employees' share of social security and Medicare taxes, and the eligible 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.

Example: An eligible employer paid \$5,000 in qualified sick leave wages and qualified family leave wages (and allocable health plan expenses and the eligible employer's share of Medicare tax on the qualified leave wages) and is otherwise required to deposit \$8,000 in federal employment taxes, including taxes withheld from all of its employees, for wage payments made during the same quarter as the \$5,000 in qualified leave wages. The eligible employer may keep up to \$5,000 of the \$8,000 of taxes the eligible employer was going to deposit, and it will not owe a penalty for keeping the \$5,000. The eligible employer is then only required to deposit the remaining \$3,000 on its required deposit date. The eligible employer will later account for the \$5,000 it retained when it files Form 941, Employer's Quarterly Federal Tax Return, for the quarter.

Because quarterly returns are not filed until after qualified leave wages are required to be paid, some eligible employers may not have sufficient federal employment taxes set aside for deposit to the IRS to fund their required qualified leave wages. Accordingly, the IRS has a procedure for obtaining an advance of the refundable credits.

The eligible employer should first reduce its remaining federal employment tax deposits for wages paid in the same quarter to zero. If the permitted reduction in deposits does not equal the qualified leave wages (and allocable qualified health plan expenses and the eligible employer's share of Medicare tax on the qualified leave wages), the eligible employer can file a Form 7200, Advance Payment of Employer Credits Due to COVID-19, to claim an advance credit for the remaining qualified leave wages (and any allocable qualified health plan expenses and the eligible employer's share of Medicare tax on the qualified leave wages) it has paid for the quarter for which it did not have sufficient federal employment tax deposits.

If an eligible employer fully reduces its required deposits of federal employment taxes otherwise due on wages paid in the same calendar quarter to its employees in anticipation of receiving the credits, and it has not paid qualified leave wages (and any allocable qualified health plan expenses and the eligible employer's share of Medicare tax on the qualified leave wages) in excess of this amount, it should not file the Form 7200. If it files the Form 7200, it will need to reconcile this advance credit and its deposits with the qualified leave wages on Form 941 (or other applicable federal employment tax return such as Form 944 or Form CT-1), and it may have an underpayment of federal employment taxes for the quarter.

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Example: An eligible employer paid \$10,000 in qualified leave wages (and allocable qualified health plan expenses and the eligible employer's share of Medicare tax on the qualified leave wages) and is otherwise required to deposit \$8,000 in federal employment taxes, including taxes withheld from all of its employees, on wage payments made during the same quarter. The eligible employer can keep the entire \$8,000 of taxes that the eligible employer was otherwise required to deposit without penalties as a portion of the credits it is otherwise entitled to claim on the Form 941. The eligible employer may file a request for an advance credit for the remaining \$2,000 by completing Form 7200.

The credits are fully refundable because the eligible employer may get a refund if the amount of the credits is more than certain federal employment taxes the eligible employer owes. That is, if for any calendar quarter the amount of the credits the eligible employer is entitled to exceeds the employer portion of the social security tax on all wages (or the employer portion of the social security tax and Medicare tax on all compensation for employers subject to RRTA) paid to all employees, then the excess is an overpayment and refunded to the eligible employer under sections 6402(a) or 6413(a) of the Internal Revenue Code.

An eligible employer will not be subject to a penalty under section 6656 of the Internal Revenue Code for failing to deposit federal employment taxes relating to qualified leave wages (and allocable qualified health plan expenses and the eligible employer's share of Medicare tax on the qualified leave wages) in a calendar quarter if:

- the eligible employer paid qualified leave wages to its employees in the calendar quarter before the required deposit,
- the amount of federal employment taxes that the eligible employer does not timely deposit is less than or equal to the amount of the eligible employer's anticipated tax credits for these qualified leave wages (and allocable qualified health plan expenses and the eligible employer's share of Medicare tax on the qualified leave wages) for the calendar quarter as of the time of the required deposit, and
- the eligible employer did not seek payment of an advance credit by filing Form 7200, Advance Payment of Employer Credits Due to COVID-19, with respect to any portion of the anticipated credits it relied upon to reduce its deposits.

Documenting Tax Credit Eligibility

Eligible employers claiming the available tax credits must retain records and documentation related to and supporting each employee's leave to substantiate the claim for the credits, and retain the Forms 941,

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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.

An eligible employer will substantiate eligibility for the sick leave or family leave credits if the employer receives a written request for such leave from the employee in which the employee provides:

- The employee's name;
- The date or dates for which leave is requested;
- A statement of the COVID-19 related reason the employee is requesting leave and written support for such reason; and
- A statement that the employee is unable to work, including by means of telework, for such reason.

In the case of a leave request based on a quarantine order or self-quarantine advice, the statement from the employee should include the name of the governmental entity ordering quarantine or the name of the health care professional advising self-quarantine, and, if the person subject to quarantine or advised to self-quarantine is not the employee, that person's name and relation to the employee.

In the case of a leave request based on a school closing or child care provider unavailability, the statement from the employee should include:

- the name and age of the child (or children) to be cared for,
- the name of the school that has closed or place of care that is unavailable,
- a representation that no other person will be providing care for the child during the period for which the employee is receiving family medical leave and,
- with respect to the employee's inability to work or telework because of a need to provide care for a child older than fourteen during daylight hours, a statement that special circumstances exist requiring the employee to provide care.

An eligible employer will substantiate eligibility for the sick leave or family leave credits if, in addition to the information set forth above, the employer creates and maintains records that include the following information:

- Documentation to show how the employer determined the amount of qualified sick and family leave wages paid to employees that are eligible for the credit, including records of work, telework and qualified sick leave and qualified family leave.

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- Documentation to show how the employer determined the amount of qualified health plan expenses that the employer allocated to wages.
- Copies of any completed Forms 7200, Advance of Employer Credits Due To COVID-19, the employer submitted to the IRS.
- Copies of the completed Forms 941, Employer's Quarterly Federal Tax Return, that the employer submitted to the IRS (or, for employers that use third party payers to meet their employment tax obligations, records of information provided to the third party payer regarding the employer's entitlement to the credit claimed on Form 941).

An eligible employer should keep all records of employment taxes for at least four years after the date the tax becomes due or is paid, whichever comes later. These should be available for IRS review.

Coordinating FFCRA Tax Credits and Coronavirus Aid, Relief, and Economic Security Act (CARES Act) Relief

If an eligible employer also meets the requirements for the employee retention credit provided for by the CARES Act, it may receive those credits as well as the FFCRA tax credits, but not for the same wage payments.

Section 2301 of the CARES Act allows certain employers subject to a full or partial closure order due to COVID-19 or experiencing a significant decline in gross receipts a tax credit for retaining their employees. This employee retention credit is equal to 50% of qualified wages (including allocable qualified health plan expenses) paid to employees after March 12, 2020, and before January 1, 2021, up to \$10,000 in qualified wages for each employee for all calendar quarters. However, qualified wages for the employee retention credit do not include the amount of qualified leave wages for which the employer received FFCRA tax credits.

The IRS has said that it will issue FAQs on the employee retention credit under the CARES Act during April 2020.

Eligible employers also may receive a small business interruption loan under the CARES Act, but if an Eligible employer receives tax credits for qualified leave wages, those wages are not eligible as "payroll costs" for purposes of receiving loan forgiveness under section 1106 of the CARES Act.

What are the Tax Consequences to the Employer?

An eligible employer must include the full amount of the tax credits for qualified leave wages (and any allocable qualified health plan expenses and the eligible employer's share of the Medicare tax on the qualified leave wages) in gross income.

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Also, an eligible employer's payments of qualified leave wages (and any allocable qualified health plan expenses and the eligible employer's share of the Medicare tax on the qualified wages) are deductible by the eligible employer as ordinary and necessary business expenses in the taxable year that these wages are paid or incurred. An eligible employer may deduct as a business expense the amounts paid to an employee for qualified leave wages (and any allocable qualified health plan expenses and the eligible employer's share of Medicare tax on the qualified leave wages) for which the eligible employer expects to claim the tax credits under sections 7001 or 7003 of the FFCRA, if the eligible employer is otherwise eligible to take the deduction.

Generally, an employer's payment of certain federal employment taxes is deductible by the employer as an ordinary and necessary business expense in the taxable year that these taxes are paid or incurred, and the amount deductible is generally reduced by credits allowed. Although the tax credits under sections 7001 and 7003 of the FFCRA are allowed against the eligible employer's portion of the social security tax, the credits are treated as government payments to the employer that must be included in the eligible employer's gross income. If the employer is otherwise eligible to deduct its portion of the Social Security tax on all wages, the proper amount deductible by the employer is the amount of federal employment taxes before reduction by the tax credits.

Conclusion

These are extraordinary times, and the ramifications of COVID-19 will continue to evolve rapidly in the coming weeks. We will continue to monitor developments, including further departmental and agency guidance as we receive them and will provide the latest updates as they become available.

We express to all of our clients and friends our deep appreciation for our ongoing relationships, and we look forward to strengthening those ties as we work through this shared adversity. Stay safe and be well.

EPIC Employee Benefits Compliance Services

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