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IRS Issues Clarifying Guidance Regarding Covid-19-Related Leave Tax Credits

Summarized by Felhaber Larson

The “Families First Coronavirus Response Act” or “FFCRA” provides a number of tax credits for small and mid-sized businesses to utilize in order to recoup the added expense of providing FFCRA-required paid sick leave/emergency family and medical leave. The Internal Revenue Service (“IRS”) issued further guidance on March 31, 2020, in the form of Frequently Asked Questions, providing employers with information regarding the steps necessary to claim the credit, including, notably, information regarding what documentation must be collected from employees and maintained by employers in order to qualify.

Requirements of the FFCRA

The FFCRA provides two different benefits to employees, emergency paid sick leave and family medical leave related to COVID-19. Both of the FFCRA’s leave provisions only apply to employers with fewer than 500 employees at the time an employee’s leave is to be taken. The IRS FAQs reference previously issued Department of Labor FAQs on counting employees, which can be viewed here [<https://www.dol.gov/agencies/whd/pandemic/ffcra-questions>].

Depending on the type of leave taken, and further depending on the reason the employee must take leave, employees remain entitled to some, or all, of their regular wages. Recognizing the financial burden that this would place on covered-employers, the FFCRA provides employers with the ability to seek reimbursement for wages paid to employees on leave in the form of a fully reimbursable tax-credit. The FFCRA was later amended by the CARES Act to provide tax advances so employers do not have to wait to receive reimbursement. This advance requires completion of IRS Form 7200, which is discussed more below.

Questions Answered by the IRS FAQs

As indicated above, the IRS’s recent FAQs clarify how employers can claim the above-credits for qualified COVID-19 related leave taken from April 1, 2020 through December 31, 2020.

1. Employers can benefit from the tax credit now



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The IRS FAQs note that employers can claim the credits on their quarterly federal tax returns filed using IRS Form 941, reducing the amount of taxes paid. However, employers can benefit more quickly from the credit by reducing their federal employment tax deposits in order to cover the wage payments. Should employers utilize this option, such a reduction should be reflected on the employer's Form 941 filed for the quarter wherein the deposits are utilized to cover FFCRA-related leave. The IRS has indicated that the Form 941 will contain instructions regarding how to reflect this activity, but as of April 1, 2020, this guidance has not yet been issued.

In the event that there are insufficient taxes in the employer's quarterly deposit bank to cover the wages, the IRS has provided a new form, the Form 7200 [<https://www.irs.gov/forms-pubs/about-form-7200>] under which employers can request an *advance* payment of these credits from the IRS. However, in order to seek an advance payment an employer must first reduce its federal employment tax deposits for wages paid in the same quarter to zero. The IRS FAQs provide the following 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.

Additionally, the FFCRA leave-related tax credits are fully refundable, meaning that if for any calendar quarter the employer's payments to employees on leave exceeds the employer portion of the social security tax on all wages paid to all employees, the excess is treated as an overpayment and refunded to the employer.

The IRS FAQs provide the following example to show how employers are able to claim the credit:

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



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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.

2. Documentation which must be received from the employee taking leave.

The IRS FAQs provide criteria regarding what information an employee must provide in order to substantiate their need for leave. Employers are instructed to maintain the documentation received from employees for IRS review, upon request, for at least four years after the date the tax becomes due or is paid, whatever is later.

The IRS notes that an employee's request for leave, regardless of whether it is for COVID-19-related paid sick leave or family medical act leave, must be made in **writing**.

Regarding the content of the leave request in order to substantiate the tax-credit claim, the IRS indicates that the request must include:

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

Regarding the required "support" needed to show an employee's need for leave, the IRS guidance clarifies what this would look like, depending on the reason the employee is seeking covered-leave.

Leave needed as a result of quarantine/self-quarantine advice

If the employee is requesting leave based on a quarantine order or upon self-quarantine advice, the employee should include the name of the governmental entity ordering quarantine or the name of the health care professional advising self-quarantine.

If the person who is subject to the quarantine order/recommendation is **not** the employee, for example, if the employee's spouse has been placed under a quarantine



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order, the employee must also provide the name of the individual subject to the order and their relationship to the employee.

Leave based on child-care

If the employee is requesting leave based on a school closing or child care provider unavailability, the employee's statement should include:

- 1) The name and age of the child to be cared for;
- 2) The name of the school that has closed or place of care that is unavailable; and
- 3) 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.**

Notably, the additional information regarding the need to care for a child over the age of fourteen is something that was absent from prior guidance issued by either the IRS or the Department of Labor regarding this leave, and the FFCRA itself does **not** contain any limitation regarding the age of the minor child. The IRS FAQs do not define what would constitute a "special circumstance" requiring an employee to care for a child older than fourteen, but seems to reflect a common-sense determination that most children age 15 and up do not need constant adult supervision during the workday which would otherwise prevent the employee from working.

Further, the IRS appears to be taking the position that the employee alone is providing care for the child, and therefore if any other person is available to provide care then the leave is not qualified.

Additional documentation to be maintained by the employer

In addition to the documentation indicated above provided by the employee to substantiate the need for covered-leave, employers are also instructed to create and maintain the following information/documents:

- 1) 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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- 2) Documentation to show how the employer determined the amount of qualified health plan expenses that the employer allocated to wages.
- 3) Copies of any completed Forms 7200, Advance of Employer Credits Due To COVID-19, which the employer submitted to the IRS.
- 4) 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).

3. Relationship to other credits

The IRS FAQ notes that an employer may receive tax credits for both FFCRA-covered leave wage payments as well as the Employee Retention Credit under the CARES Act, but cannot receive both credits for the same wage payments (in other words, an employee cannot "double dip").

The FAQ additionally notes that the IRS expects to issue additional FAQs regarding the CARES Act Employee Retention Credit during April 2020.

4. Taxation issues involving FFCRA-leave taxation

The IRS FAQs note that employers must include the full amount of the credits for qualified leave wages (and any allocable qualified health plan expenses and the employer's share of the Medicare tax on the qualified leave wages) in their reported gross income, and further 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 employer's share of Medicare tax on the qualified leave wages) for which the employer expects to claim the tax credits under sections 7001 or 7003 of the FFCRA, if the employer is otherwise eligible to take the deduction.

The FAQs additionally clarify that leave wages should otherwise be treated as regular wages to the employee who receives them, and therefore, are subject to withholding of federal income tax and the **employee's** share of social security and Medicare taxes. Additionally, the FAQs note that leave wages should also be considered wages for the purpose of other benefits that the employer provides, such as 401(k) contributions.

5. Self-employed individuals



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Finally, the IRS FAQs note that self-employed individuals are able to claim the tax credit as well, in the same manner if the self-employed individual was otherwise employed by a covered employer. Self-employed individuals can claim credits equal to the leave benefit when they file their annual individual income tax return.

BOTTOM LINE

The guidance provided by the IRS will hopefully allow companies to weather the financial burden of providing leave as required by the FFCRA. The full IRS FAQs guidance is available here [<https://www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs>].