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Coronavirus Laws Contain Employment Tax Relief, and Mixed Messages

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Introduction

This article describes three employment tax subsidies that are meant to help keep employees paid during the coronavirus pandemic:

1. Refundable tax credits for a portion of the newly expanded sick leave and family medical leave (with a similar credit for the self-employed). See §§7001–7005 of the Families First Coronavirus Response (Families First) Act (Pub Law 116–127, 134 Stat 178), as modified by §3606 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (Pub Law 116–136, 134 Stat 281).
2. Long-term deferral of the employer’s obligation to pay the employer’s half of the Social Security tax (with similar treatment for the self-employed). See §2302 of the CARES Act, as modified by §4(a) of the Paycheck Protection Program Flexibility (Flexibility) Act of 2020 (Pub Law 116–142, 134 Stat __).
3. The refundable Employee Retention Credit (up to \$5000 in dollar-for-dollar matching pay, for economically impacted employers). See §2301 of the CARES Act.

1. Credits for Newly Mandated Sick or Family Leave

In the Families First Act, Congress created two new types of mandatory paid leave. For details, visit the Department of Labor website at <https://www.dol.gov/agencies/whd/pandemic>. In brief, for an employer with fewer than 500 employees, an employee is eligible for:

- Up to 2 weeks (80 hours) at their regular rate of pay, when they cannot work because they are quarantined and/or experiencing COVID-19 symptoms and awaiting diagnosis;
- Up to 2 weeks (80 hours) at two-thirds their regular rate of pay, when they cannot work due to the need to care for someone in quarantine or a child whose school or child care provider is unavailable due to COVID-19 (collectively, “Paid Sick Leave”); and
- For employees employed for at least 30 calendar days: Up to an additional 10 weeks at two-thirds their regular rate of pay, when they cannot work due to the need to care for a child whose school or child care provider is unavailable due to COVID-19 (“Expanded Family and Medical Leave”).

Small businesses with fewer than 50 employees may qualify for exemption from the requirement to provide leave due to lack of school or child care, if these requirements would jeopardize the viability of the business as a going concern.

These mandatory payments can get expensive. In addition, the payments incur Medicare taxes (3.8 percent). To ease this burden, the Families First Act provides tax credits to reimburse the employer for all or most of the direct economic costs of these new types of leave, including the additional Medicare taxes. From a tax perspective, it is as though the federal government is paying the credited amounts directly to the employee.

Tax Credit for Paid Sick Leave

The government will pay 100 percent of an employer’s Paid Sick Leave expenses, plus allocable health plan expenses and Medicare taxes, subject to these limits:

- **Start and Stop Dates:** The credit only applies to workdays between April 1, 2020, and December 31, 2020.
- **Daily Cap:** The credit only applies to the first \$200 or \$511 of Paid Sick Leave expenses per day (depending on whether the employee’s sick leave qualifies for full pay, or two-thirds pay, as described above).
- **Lifetime Cap:** The credit is available for up to 10 sick leave days total (out of the mandated 2 weeks).

A similar subsidy is available for self-employed persons, with these modifications:

- **Credit Amount:** Instead of basing the credit amount on actual wages paid, we take the person’s net earnings from self-employment for the entire year, and apportion this over the number of days they are sick (assuming a 260-day work year).
- **Additional Daily Cap:** For sick days that (for employees) would have earned two-thirds wages, the tax credit for the self-employed will cover no more than two-thirds of an average day’s pay.

Tax Credit for Expanded Family and Medical Leave

The government will pay 100 percent of an employer’s Expanded Family and Medical Leave expenses, plus associated health plan expenses, with a similar subsidy for self-employed persons (again defined in terms of average daily earnings). For both employers and the self-employed, the following limits apply:

- **Start and Stop Dates:** Same as above (only available for workdays between April 1, 2020, to December 31, 2020).
- **Daily Cap:** The credit only applies to the first \$200 of Expanded Family and Medical Leave expenses per day.
- **Lifetime Cap:** The credit is available for up to \$10,000 (per employee) or 50 days (for the self-employed).

According to an Internal Revenue Service (IRS) Q&A, to substantiate eligibility for these credits, the employer must receive a written leave request from the employee containing

(1) the employee's name, (2) the date(s) for which leave is requested, (3) a statement of the COVID-19-related reason they are requesting leave and support for such reason, and (4) a statement that they are, therefore, unable to work, including by telework. For a leave request based on a quarantine order or self-quarantine advice, the statement should include the name of the governmental entity ordering quarantine or the health care professional advising self-quarantine, and, if the person subject to quarantine or self-quarantine is not the employee, that person's name and relation to the employee. For a leave request based on a school closing or child care provider unavailability, the statement should include the name and age of the child(ren), the name of the school or place of care, a representation that no other person will be providing care for the child during the leave period, and, for a child older than 14, during daylight hours, a statement that special circumstances exist requiring the employee to provide care.

In addition, the employer should maintain records that include (a) documentation of how the employer determined the amount of qualified leave wages paid to employees eligible for the credit, including records of work, telework and qualified sick leave and qualified family leave; (b) documentation of how the employer determined the amount of qualified health plan expenses allocable to wages; and (c) copies of submitted IRS Forms 7200 and 941 (or, for employers that use third party payers, records of information provided to them). The employer should keep such records for at least 4 years after the date the tax becomes due or is paid, whichever comes later.

2. Long-Term Deferral of Obligation to Pay Employer's Social Security Tax

Generally, employers must deposit employment taxes at least monthly. IRC §6302. Late payments are subject to a penalty. IRC §6656.

Under CARES Act §2302, employers get an extension for depositing payroll taxes on wages paid for the last three quarters of 2020. This applies only to the 6.2 percent Social Security tax on employers—which is imposed on wages up to \$137,700—as well as to an equivalent amount of self-employment taxes. However, it does not defer the employee's half of the Social Security tax, nor does it defer the 3.8 percent Medicare tax. Also, it only applies to deposits that would be required between March 27, 2020, and December 31, 2020.

Think of this as an interest-free loan. Effectively, the amount of the loan is equal to 5.5 percent of total payroll costs (wages plus taxes) for the last three quarters of 2020. Half the amount is due by December 31, 2021, which is 17 months from now. The other half is due by December 31, 2022, which is 29 months from now. There is no cap: If the amount of credits exceeds the employer's tax obligation, new IRS Form 7200 (Advance Payment of Employer Credits Due to COVID-19) can be used to request a refund. See IRS Notice 2020-22, 2020-17 Int Rev Bull 664, available at <https://www.irs.gov/pub/irs-drop/n-20-22.pdf>.

There are no limits on how the employer can spend the cash. This is because the deferral does not touch the employee's half of the Social Security tax. In the case of the employee's half of taxes, if an employer willfully fails to pay these over, the IRS can pursue the owners individually. See IRC §3102 (employee's tax is withheld from wages), §7501 (imposing a "trust fund" obligation on withholding taxes), §6672 (permitting IRS to pierce the entity veil). The IRS does not have this authority for the employer's half. See Internal Revenue Manual 5.17.7.1.6. Thus, if the company goes bankrupt over the next few years or otherwise defaults on these taxes, the tax liability is simply a general liability of the business; the IRS has no special ability to pursue the owners individually.

In the CARES Act as originally passed, employers ceased to be eligible for this deferral as soon as they received forgiveness of a loan under the SBA's Paycheck Protection Program. This shouldn't have affected employer behaviors, because deferral remained available prior to the moment of forgiveness. Nevertheless, anecdotally I have heard of some employers who declined to take PPP loans, or took PPP loans but declined to defer their payroll, with this limitation in mind. Thus, it is worth mentioning to clients that the Flexibility Act, passed on June 5, 2020, removed this limitation: Payroll tax deferral is now available regardless whether the employer had a PPP loan forgiven.

3. Employee Retention Credit

Think of this as a matching wage program for employees: The government will match the wages and health plan expenses paid by employers, dollar for dollar (up to \$5000), in order to help struggling employers not fire their employees.

An employer can qualify (as "struggling") in either of two ways. First, an employer will qualify if it had a significant decline in income compared to the previous year. (Specifically, a decline in gross receipts of over 50 percent, compared to the corresponding quarter in 2019.) The Q&As clarify that (for example) if an employer starts a business in the fourth quarter of 2019, it should use that quarter as the base period to determine whether it had a significant decline in gross receipts for any quarter in 2020. Alternatively, an employer will qualify if its business was suspended due to coronavirus. (Literally: "[T]he operation of the ... business ... is fully or partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to ... COVID-19.")

In its April FAQs, the IRS clarifies what counts as "orders from an appropriate governmental authority." This includes an order shutting "non-essential businesses" (but only as to those non-essential businesses); a proclamation that residents other than essential employees must shelter-in-place; and an order imposing a curfew—if the curfew is COVID-19-related. It does not include:

- Curfews that are not COVID-19-related;
- Mere “statements from a governmental official, including comments made during press conferences or in interviews with the media”;
- A declaration of emergency that does not limit commerce, travel, or group meetings; and
- A declaration that contained such a limitation, when the limitation did not “affect the employer’s operation of its trade or business.”

Also, if an employer’s workplace is closed by a governmental order, but the employer is able to continue comparable operations by requiring its employees to telework, the employer’s operations are not considered to have been fully or partially suspended as a consequence of a governmental order.

The credit has these further limits:

1. It is not available for the self-employed, with respect to their own self-employment earnings. However, a self-employed individual who employs other individuals may be eligible with respect to wages paid to those employees.
2. If the employer has more than 100 employees, it can only count wages paid to furloughed employees. For determining the number of employees, related employers are aggregated.
3. The credit is available for up to \$5000 per employee. For illustration, a low-earning employee might receive \$10,000 in wages (\$5000 of which is government-subsidized); an economic impact payment check for \$1200; wages earned in the first quarter of 2020; and perhaps some amount of unemployment from the state. For perspective, the 2020 federal poverty guideline is \$12,760 for a single person.
4. The credit only applies to days between March 13, 2020, and December 31, 2020.
5. No double-dipping: If an employee is earning credits on wages paid for sick or family leave as described above, those wages don’t also get these matched payments.
6. Tax-exempt organizations are eligible for this credit, but government employers are not.
7. In its initial guidance, the IRS did not permit any credit to an employer who paid health plan expenses but not wages. After pressure from Congress, the IRS modified its guidance; now, if an employee is paid only their health plan expenses, those health plan expenses will be eligible for the credit, even if the employee receives no wages.
8. An employer is not eligible for this credit if it receives a PPP loan (regardless of when, and whether, that loan is eventually forgiven). Before accepting a PPP loan, the employer should make a cost-benefit analysis ver-

sus the Employee Retention Credit, as these are mutually exclusive choices.

4. Conclusion: Mixed Messages

Credits for qualified leave wages. Compared to the other relief described in this article, the credits for qualified leave wages may seem unambitious. For perspective, it is helpful to remember that these leave-related credits appeared in the Families First Act. That law was introduced on March 14 and signed into law on March 18. The first U.S. lockdown, in northern California, was ordered on March 17, followed by a California-wide lockdown on March 19, and New York’s lockdown on March 20. The first federal disaster was declared on March 22. Finally, the CARES Act (containing the deferral of payroll taxes and the Employee Retention Credit) was introduced on March 25 and signed into law on March 27.

The Families First Act reflects our initial understanding of the pandemic as a disease that simply afflicts individual people. The CARES Act reflects our changed understanding of the pandemic as a disease that afflicts the economy as a whole. It only took 2 weeks for the Families First Act to feel downright anachronistic.

Deferral of employment taxes. Arguably, the deferral of employment taxes works at cross-purposes with the Employee Retention Credit and the leave credits: To the extent that an employer may defer paying employment taxes, the employer won’t perceive a credit against those taxes as an incentive (*i.e.*, the credit won’t generate additional immediate liquidity—at least not until the total amount of credits exceeds the amount of employment taxes owed, and the amount of credits becomes large enough to be refundable). While this won’t distort behaviors relating to the credits for sick and family leave (because paid leave is mandatory), it will distort the behaviors that Congress sought to promote by creating the Employee Retention Credit (*i.e.*, encouraging employers to keep employees on payroll). This distortion will have the greatest impact on employers who don’t have a reasonable prospect of generating credits in excess of taxes—that is, employers who expect to maintain significant payrolls, and who will incur payroll taxes faster than they can incur credits.

Employee Retention Credit. A commenter has described the Employee Retention Credit as providing relief for three types of businesses: “those with too many employees to receive a PPP loan,” “those that could not get a PPP loan because the money ran out,” and “PPP eligible businesses that have determined not to apply for or keep a PPP loan because of the risks of becoming a target for bad press or an SBA audit.” See “*IRS Issues New FAQs for Employee Retention Credit, the CARES Act Relief Provision for Employers Too Big, Too Late or Too Worried About PPP Loans*” (May 1, 2020), available at <https://www.lanepowell.com/Our-Insights/202928/IRS-Issues-New-FAQs-for-Employee-Retention-Credit-the-CARES-Act-Relief-Provision-for-Employers-Too-Big-Too-Late-or-Too-Worried-About>

t-PPP-Loans. I would propose a fourth category: those who are eligible to receive the loans, but who are unlikely to be eligible for forgiveness of these loans. This may happen because the forgiveness of a PPP loan is reduced if the employer does a lot of firing and furloughing. Specifically, forgiveness is reduced in relation to the reduction of full-time equivalent employees, in relation to the degree to which PPP loan expenditures are not allocated at least 60 percent to qualifying payroll, and in relation to the number of employees whose total salaries or wages are significantly reduced. None of this impacts eligibility for the retention credit. Thus, to the extent the employer plans to fire and furlough, the retention credit becomes comparably more appealing than a PPP loan.

The Flexibility Act, passed on June 5, 2020, shifts this calculus, by softening the requirements for having a PPP loan forgiven. Specifically:

- It gives borrowers the option of extending their “covered period” for spending loan money (from 8 to 24 weeks);
- It excuses a reduction in full-time equivalent employees, or a significant reduction in their wages, occurring between February 15 and April 26, 2020 (regardless of cause), if rectified by December 31, 2020;
- It excuses a reduction in full-time equivalent employees occurring between February 15 and December 31, 2020, if caused by either (1) a documented inability to restore prior business activity due to coronavirus-related safety requirements, or (2) a documented inability to both rehire persons who were employed on February 15 and to hire similarly qualified employees for those positions by December 31; and
- It specifies that only 60 percent of loan proceeds must be spent on payroll costs (in contrast to 75 percent in prior SBA guidance).

Consequently, employers who preferred the Employee Retention Credit over a PPP loan might find that the scales now tip in the other direction.