

Tax Aspects of the Families First Coronavirus Response Act

by Larry J. Brant, Steven D. Nofziger, and Peter A. Evalds

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Tax Notes State is excited to introduce Virtual Voice, a section in the magazine featuring the most cutting-edge online narratives from the state and local tax arena.

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In this installment of Virtual Voice, the authors outline the tax components of the Families First Coronavirus Response Act, highlighting provisions that apply to employers.

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President Trump signed the Families First Coronavirus Response Act on March 18. The act becomes effective April 1, 2020, and contains tax provisions that fund its mandatory paid-leave provisions.

This article summarizes the act's paid leave and associated employer tax-related benefits. The act is broad in application, creating complexity. It generally applies to employers with fewer than 500 employees. We have attempted to dissect the act into bite-sized, easily understandable chunks, removing the complexities whenever possible.

Alert: The U.S. Department of Labor is authorized to exempt small businesses with fewer than 50 employees if the act's requirements would "jeopardize the viability of the business as a going concern." We expect this exception to be outlined in regulations shortly.

The act borrows from the Family Medical Leave Act (FMLA) and Fair Labor Standards Act for many of its definitions and guidelines;

however, it modifies a number of existing definitions. Employers with questions about employee coverage requirements should consult with an employment law specialist.

Types of Paid Leave

Fundamentally, the act provides two types of employee paid leave, namely: (i) public health emergency leave (sometimes called family leave), and (ii) paid sick leave.

Paid Family Leave

In general, employers with fewer than 500 employees and public agencies of any size must provide up to 12 weeks of partially paid family leave under the FMLA. Employees are eligible if they have been employed for at least 30 calendar days.

Eligible employees can take up to 12 weeks of FMLA leave to care for a child under 18 if her school or child care provider has been closed by a federal, state, or local authority because of a COVID-19 health emergency and the employee is unable to work or telework. This provision is an expansion of existing FMLA leave laws.

The act requires employers to provide family leave as follows:

- **Ten Days Unpaid:** The first 10 days of family leave may be unpaid, but employees can elect to use any accrued vacation or other paid leave during the 10-day period.
- **Subsequent Paid Leave at Two-Thirds Pay:** After 10 days, employers must pay the employee at least two-thirds of his normal rate of pay, based on the employee's regularly scheduled hours, capped at \$200 per day and \$10,000 in the aggregate.
- **Note:** There are special rules for employees with varying schedules and specific nuances to the calculations.

Employers should consult with an employment law attorney if they have questions.

- Employers cannot require employees to use their other paid leave (for example, paid time off) instead of paid family leave under the act.

Paid Sick Leave

In general, employers with less than 500 employees and public agencies of any size must provide every employee (both full- and part-time, and regardless of how long the employee has been employed) with two weeks of paid sick leave if they are unable to work or telework for the following reasons:

1. the employee is subject to a federal, state, or local quarantine or isolation order related to COVID-19;
2. the employee has been advised by a healthcare provider to self-quarantine because of concerns related to COVID-19;
3. the employee is experiencing symptoms of COVID-19 and seeking a medical diagnosis;
4. the employee is caring for an individual who: (a) is subject to an order described in number 1 above, or (b) has been advised to self-quarantine, as described in number 2 above;
5. the employee is caring for her child if the school or child care provider has been closed (or the child care provider is unavailable), because of COVID-19 precautions; or
6. the employee is experiencing any other substantially similar condition specified in rules from the U.S. Department of Health and Human Services.

Full-time employees are entitled to 80 hours of paid sick leave. Part-time employees are entitled to the number of hours of paid sick leave equal to the number of hours they would work on average over a two-week period:

- For leave under reasons 1, 2, and 3 above, paid leave is determined at the employee's

regular rate of pay, capped at \$511 per day and \$5,110 aggregate.

- For leave under reasons 4, 5, and 6 above, paid leave is determined at two-thirds of the employee's regular rate of pay, capped at \$200 per day, and \$2,000 aggregate.

Alert: Employers cannot require employees to use their other paid leave (for example, paid time off) instead of paid sick leave granted under the act.

There are also special rules for employees with varying schedules and specific nuances to the calculations. The U.S. Department of Labor will issue guidelines in April to assist employers, including a model notice that employers will be obligated to post. Employers should consult with an employment law attorney if they have questions.

Tax Credits

To fund the provision of paid family leave and paid sick leave, the act grants employers refundable employment tax credits equal to 100 percent of the qualified paid leave actually paid by employers. Corresponding paid family leave and paid sick leave credits are also granted to self-employed individuals.

Paid Family Leave Credit

Under the act, employers are allowed a credit against the *employer's* (but not the employee's) share of Social Security and Medicare taxes imposed on employee wages. Employers and employees each pay an equal share of both Social Security taxes (6.2 percent each) and Medicare taxes (1.45 percent each). The credit amount is equal to 100 percent of the qualified family leave wages paid by the employer during the calendar quarter and is applied against the employer's total 7.65 percent share of Social Security and Medicare taxes. Thus, the credit takes into account the above-described caps for paid family leave — that is, \$200 per day and \$10,000 total per employee.

The allowed credit is also increased by so much of the employer's qualified health plan expenses properly allocable to the qualified family leave wages for which the credit is allowed. "Qualified health plan expenses" are defined as amounts paid or incurred by the

employer to maintain a group health plan, but only to the extent those amounts are excluded from the employee's income for coverage. For example, an employer can claim a \$2,700 credit during a calendar quarter: \$2,500 for qualified family leave wages and \$200 for qualified health plan expenses.

Paid Sick Leave Credit

Under the act, employers are allowed a credit against the employer's 7.65 percent share of Social Security and Medicare taxes imposed on employee wages, equal to 100 percent of the qualified paid sick leave wages paid by the employer during the calendar quarter. Thus, the credit takes into account the above-described caps for paid sick leave. The allowed credit is also increased by so much of the employer's qualified health plan expenses properly allocable to the qualified family leave wages for which the credit is allowed.

Credits for Self-Employed Individuals

Under the act, an eligible self-employed individual is allowed a refundable tax credit in circumstances in which they would have received qualified family leave or qualified paid sick leave under the act if they had been an employee of an employer. For self-employed individuals:

- The qualified family leave equivalent amount is equal to the number of days (up to 50) during the tax year that the self-employed individual cannot perform services for which she would have been entitled to paid family leave if she was an employee, multiplied by the lesser of: (a) \$200 or (b) 67 percent of her average daily self-employment income for the year.
- The qualified paid sick leave equivalent amount is equal to the number of days (up to 10) during the tax year that the self-employed individual cannot perform services for which she would have been entitled to paid sick leave if she was an employee, multiplied by the *lesser of* two amounts:
 - in the case of paid sick leave described under reasons 1, 2, and 3 above, \$511 or 100 percent of the average daily self-employment income for the tax year; or

- in the case of paid sick leave described under reasons 4, 5, and 6 above, \$200 or 67 percent of the average daily self-employment income for the tax year.
- For these purposes, average daily self-employment income is equal to the individual's net earnings from self-employment for the year divided by 260.

Other Aspects – No Double Dipping

- Any paid family leave or paid sick leave required by the act are considered "wages" for purposes of determining employee FICA and income tax withholding. That is, such amounts are considered wage income to the employee for income and payroll tax and reporting purposes (that is, amounts reportable in boxes 1, 3, and 5 on Form W-2). However, paid leave amounts are not considered "wages" for purposes of calculating the employer's 6.2 percent share of Social Security taxes. The act is silent as to whether paid leave amounts are "wages" for purposes of calculating the employer's 1.45 percent share of Medicare taxes. This may be an oversight, as Congress added the provision to expand the tax credits to also include the employer's share Medicare taxes at the last minute.
- The act prevents double dipping by employers: Employers are required to include in income the amount of tax credit received and are allowed an offsetting wage deduction in the amount of the paid family leave or paid sick leave paid to their employees. Thus, the amounts "net out" for income tax purposes. (The act also prevents employers from receiving credit if they are already allowed a credit under IRC section 45S for paid family and medical leave.)
- If a self-employed person is also employed as an employee, there are rules that coordinate and limit the maximum tax credit with any qualified family leave and paid sick leave received as an employee.
- Of note, to make up for the lost revenue, the act provides that the amount of all those tax credits given will be transferred to the Social Security trust fund. Thus, the ultimate impact of these credits is to the Treasury's

general revenues, and not to the Social Security trust fund.

Alert: The tax credits are not available to federal, state, or local government agencies.

Stay Tuned for More

The act automatically sunsets on December 31, 2020. In the meantime, there are many questions. Ideally, the various agencies, including the U.S. Department of the Treasury, will issue future guidance quickly.

There are many details left for future guidance, including whether (and how) Treasury will lend or advance employers the amount of the credit as a means of actually providing them with the necessary cash flow to fund the paid sick leave and paid family leave, as had been discussed during passage of the act. On that point, the IRS has released a statement that eligible employers will be able to retain an amount of all payroll taxes (including both the employer and employee share of Social Security and Medicare taxes and employee federal income tax withholding) equal to the amount of qualifying paid family leave and paid sick leave that they paid, rather than deposit them with the IRS. This statement clearly goes beyond the scope of the statute. The IRS has also indicated that if there are not sufficient payroll taxes to cover the cost of family leave and paid sick leave, employers will be able to file a request for an accelerated payment from the IRS. The IRS expects to announce further details in the near future.

Employers should consult with qualified tax and employment law professionals if they have further questions. The law was drafted and passed with lightning speed. It is likely that several complexities were not envisioned by the drafters.

We are living in precarious times. Keeping our workforce intact is vital to our communities and the country's future economy. The new leave laws are aimed at that objective. The tax credit component of these laws serves as fuel to facilitate attaining this monumental goal. We suspect Congress will continue looking for additional methods to support our communities and the U.S. economy in the near future. Our tax laws will undoubtedly be a part of these efforts. More than

ever before, lawmakers need to come together and act in a unified manner in order to tackle the rough roads ahead. ■