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IRS FAQs Allow Taxes Withheld from Employees' Wages to Fund Leave and Wage Payments

The Internal Revenue Service (IRS) recently provided guidance, in the form of frequently asked questions (FAQs) related to the refundable payroll tax credits [for the paid family and sick leave](#) required to be provided by certain employers under the Families First Coronavirus Response Act (FFCRA) and [for the employee retention credit](#) available to eligible employers under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The FAQs provide guidance on a myriad of topics, including a listing of the documentation that must be maintained in relation to taking the payroll tax credits, calculate the amount of the payroll tax credits and how procedurally the payroll tax credits can be taken, including requesting advance payment of the refundable credits, and the IRS has indicated that the FAQs will be updated as necessary. Discussed below are two notable points addressed in the FAQs that are helpful to employers. This client alert does not address all of the applicable requirement and limitations related to the credits discussed below. Please contact your regular Brownstein attorney for assistance with the FFCRA or the CARES Act, including questions about the payroll tax credits discussed below.

Employers May Use Payroll and Federal Income Taxes Withheld from Employees' Wages to Fund Emergency Sick and Family Leave and Related Amounts

Under Section 3102 (which amended the Family and Medical Leave Act of 1993) and Division E (the Emergence Paid Sick Leave Act) of FFCRA, employers with fewer than 500 employees are required to provide certain paid sick and family leave for specified reasons related to COVID-19 (qualified leave wages). Sections 7001 and 7003 of FFCRA provide employers with a payroll tax credit against the employer's share of the old-age, survivors, and disability insurance (OASDI) portion of Federal Insurance Contributions Act (FICA) taxes¹. The credit applies for required paid sick and family leave taken during the period beginning on April 1, 2020, and ending on Dec. 31, 2020.

The IRS indicated in FAQ 38 of the IRS guidance on the credit for required paid sick and family leave, that an employer can use payroll taxes that the employer otherwise would be required to deposit during a calendar quarter, *including* payroll taxes and federal income taxes withheld from employees' wages, to fund that same quarter's payment of (1) the qualified leave wages, (2) the allocable amount of qualified health plan expenses and (3) the employer's share of the Medicare tax portion of FICA on the qualified leave wages. The payroll taxes that can be

retained in a calendar quarter by an employer for these purposes are limited to the amount of the employer's anticipated tax credits for the qualified leave wages, including the increased in the credit for the allocable qualified health plan expenses and the employer's share of the Medicare portion of the FICA tax on the qualified leave wages for the same calendar quarter. The use of these funds and the corresponding reduction of the required deposits for a calendar quarter will be accounted for on the Form 941, Employer's Quarterly Federal Tax Return, for the calendar quarter. The IRS provided the following 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.

The IRS also indicated that the penalty for failing to timely deposit payroll taxes will not apply *if*:

1. the employer paid qualified leave wages to its employees in the calendar quarter before the required deposit,
2. the amount of federal employment taxes that the employer does not timely deposit is less than or equal to the amount of the employer's anticipated tax credits for these qualified leave wages (increased by the allocable qualified health plan expenses² and the employer's share of Medicare portion of the FICA tax on the qualified leave wages) for the calendar quarter, as of the time of the required deposit, and
3. the 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.

See FAQ 17 and [IRS Notice 2020-22](#).

The second requirement above is important because it limits the amount of federal employment taxes that are not required to be deposited for an applicable calendar quarter to the amount of the anticipated payroll tax credit for the qualified leave wages for the calendar quarter. We note that the refundable payroll tax credit for any calendar quarter cannot exceed the employer's share of the OASDI portion of FICA taxes for the calendar quarter, after taking into account credits allowed for the employments of qualified veterans and for research expenditures of qualified small businesses.³ This latter limitation could be relevant and limit the refundable payroll tax credit where an employer either has laid off a significant portion of its workforce or has a significant portion of its workforce on unpaid furlough, especially since the qualified leave wages are not subject to the employer's share of the OASDI portion of FICA taxes.

The third requirement above is important because it prevents an employer from getting a double benefit by not depositing payroll taxes *and* requesting an advanced payment of the payroll tax credit equal to the payroll taxes that were not deposited by the employer.

Employers May Use Payroll and Federal Income Taxes Withheld from Employees' Wages to Pay "Qualified Wages" to Employees Who Are Not Providing Services to the Extent of the Retention Credit Allowed under the CARES Act

Under Section 2301 of the CARES Act, eligible employers are entitled to a refundable credit against the employer-share of the OASDI portion of FICA taxes⁴ in an amount equal to 50% of the qualified wages paid to each employee (limited

to \$10,000 for all calendar quarters) after March 12, 2020 through Dec. 31, 2020 (the Retention Credit). The Retention Credit is available to an employer who carries on a trade or business during 2020, including a tax-exempt organization, for calendar quarters when the employer either (i) has either fully or partially suspended operations during any calendar quarter in 2020 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, or (ii) experiences a significant decline in gross receipts during the calendar quarter⁵. In general terms, qualified wages are wages paid to an employee for *not* providing services, including allocable qualified health plan expenses⁶, but does *not* include the paid sick and family leave required under the FFCRA. The Retention Credit is *not* available to employers who receive a Small Business Administration (SBA) loan under the Paycheck Protection Program.

Consistent with the discussion above, an employer can use payroll taxes that the employer otherwise would be required to deposit during a calendar quarter, *including* payroll taxes and federal income taxes withheld from employees' wages, to fund the payment of qualified wages during the same calendar quarter.⁷ The use of these funds and the corresponding reduction of the required deposits for a calendar quarter will also be accounted for on the Form 941, Employer's Quarterly Federal Tax Return, for the calendar quarter. The following example is provided (emphasis added to the relevant difference from the example in the preceding discussion):

An Eligible Employer paid \$10,000 in qualified wages (including qualified health plan expenses) and is therefore entitled to a \$5,000 credit, 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 \$10,000 in qualified wages. *The Eligible Employer has no paid sick or family leave credits under the FFCRA.* 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 required to deposit only 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.

The italicized language in the example above is relevant because the refundable Retention Credit for any calendar quarter is limited to the employer's share of the OASDI portion of FICA taxes for the calendar quarter, after taking into account any credits allowed for the employments of qualified veterans and for research expenditures of qualified small businesses *and* the credits discussed above for the required paid sick or family leave.

The IRS also indicated that the penalty for failing to timely deposit payroll taxes will not apply *if* (note the italicized difference from the conditions above related to paid sick and family leave credits):

1. the employer paid qualified wages to its employees in the calendar quarter before the required deposit,
2. the amount of federal employment taxes that the eligible employer does not timely deposit, *reduced by any amount of federal employment taxes not deposited in anticipation of the paid sick or family leave credits claimed under the FFCRA*, is less than or equal to the amount of the employer's anticipated Retention Credit for the qualified wages for the calendar quarter as of the time of the required deposit, and
3. the 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.

See FAQ entitled "May an Eligible Employer reduce its federal employment tax deposit by the qualified wages that it has paid without incurring a failure to deposit penalty?" and IRS Notice 2020-22.

Consistent with the discussion above, the second requirement is important because it limits the amount of federal

employment taxes that are not required to be deposited *after* taking into account the credit discussed above for required paid sick and family leave, which could be relevant where an employer either has laid off a significant portion of its workforce or has a significant portion of its workforce on an unpaid furlough. The last requirement again prevents an employer from getting a double benefit by not depositing payroll taxes *and* requesting an advanced payment of the Retention Credit equal to the payroll taxes that were not deposit by the employer.

We note that an employer can receive tax credits for qualified leave wages under the FFCRA and the Retention Credit but not for the same wages because, as mentioned above, qualified wages for the Retention Credit do not include required qualified sick and family leave wages for which the tax credits are available under the FFCRA.

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¹ For employers subject to the Railroad Retirement Tax Act, the credit is against the employer share of the employer's share of the OASDI and Medicare portions of FICA taxes.

² In very general terms, allocable qualified health plan expenses are amount paid or incurred by an employer to provide or maintain a group health plan to the extent such amount are excludible from the employee's taxable compensation, as allocated to the employee under the IRS guidance.

³ See footnote 2.

⁴ See footnote 2.

⁵ See FAQ entitled "What is a 'significant decline in gross receipts'?" for specific guidance on what constitutes a sufficient decline in gross receipts to qualify for the Retention Credit.

⁶ See footnote 3.

⁷ See the FAQ entitled "How does an Eligible Employer claim the refundable tax credit for qualified wages?" and the FAQ entitled "Can an Eligible Employer paying qualified wages fund its payments of qualified wages before receiving the credits by reducing its federal employment tax deposits?" of the Retention Credit guidance.

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