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EMPLOYEE BENEFITS LAW ALERT

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How to claim COVID-19 tax credits via payroll

Employers may claim the Employee Retention Tax Credit and the tax credits available under the ***Families First Coronavirus Response Act*** (FFCRA) for relief during the COVID-19 pandemic. They may choose to do this first, by reducing the employer portion of Social Security taxes, and then, by reducing the employer's payroll deposits in an amount equal to the refundable portion of the accrued credits, instead of depositing said amount with the IRS. The payroll taxes an employer may retain include both the employer and employee share of Social Security and Medicare taxes (i.e., FICA) and withheld federal income taxes with respect to all employees. If the employer's share of Social Security payroll taxes is not reduced to $0, the payment of any remaining employer Social Security payroll tax liability may be deferred until 2021 and 2022, provided the employer has not received Payroll Protection Program loan forgiveness.

Additionally, an employer may, but is not required to, request an advance credit payment of its FFCRA tax credits or Employee Retention Tax Credits from the IRS using Form 7200: Advance Payment of Employer Credits Due to COVID-19, if:

- The payroll taxes retained by the employer are not enough to cover the employer retention credit and the costs of the qualified sick and family leave wages; or
- The employer is due an additional refund of the tax credits because the employer's accrued credits exceed the amount it was required to deposit.

See here for more information.

Step-by-Step

1. Calculate the total amount of accrued tax credits for the payroll

deposit period.

2. Using the accrued tax credits, reduce the employer portion of Social Security payroll taxes for the payroll deposit period, but not below $0.

3. Calculate the remaining amount of accrued tax credits, if any.

4. Retain from the payroll deposit an amount equal to the remaining amount of accrued tax credits.

5. If the remaining accrued tax credits exceed the employer's entire payroll deposit, claim an advance refund or claim a refund on the next payroll tax return.

Examples

The following examples illustrate how an employer will claim the tax credits via payroll in the following situations:

1. The accrued tax credits exceed the employer's entire payroll deposit amount

2. The accrued tax credits exceed the employer's share of Social Security payroll taxes, but do not exceed the employer's entire payroll deposit amount

3. The accrued tax credits do not exceed the employer's share of Social Security payroll taxes

The current tax rate for Social Security is 6.2 percent for the employer and 6.2 percent for the employee. Employers are exempt from paying the employer's 6.2 percent portion of Social Security taxes on the qualified FFCRA wages they pay. We take this into account when calculating the employer's portion of Social Security taxes in the examples below. The current Medicare tax rate is 1.45 percent for the employer and 1.45 percent for the employee. The Social Security tax and the Medicare tax together make up FICA tax, for a combined tax rate of 7.65 percent for the employer and 7.65 percent for the employee. The employees' 25 percent income tax bracket is hypothetical and is used for illustrative purposes only.

Example 1: Accrued tax credits exceed the employer's entire payroll deposit amount

Assume an employer has one employee. The employee is paid $1,000/week and is in the 25 percent tax bracket. The employer withholds from the employee's pay $326/week (the employee portion of FICA, $76.50, plus 25 percent income withholding, $250), resulting in weekly take-home pay of $673.50. Assume, the employer does not qualify for the Employee Retention Tax Credit. If the employee takes two weeks of FFCRA paid sick leave, the following will occur.

- The employer will accrue $2,029 in FFCRA tax credits ($2,000 of qualifying wages, plus $29 of employer paid Medicare taxes).

- The employer's portion of Social Security taxes is $0 (because employers are exempt from paying the employer's portion of Social Security taxes for qualified FFCRA wages), resulting in a refundable credit of $2,029.
- To claim the refundable portion of its FFCRA tax credits, the employer first must reduce payroll deposits by retaining both the employer and employee portions of FICA and any income taxes withheld from their payroll deposit. This will require the employer to retain $682 (2 weeks of employer Medicare, $29; plus, 2 weeks of employee FICA, $153; plus, 2 weeks of income withholding, $500).
- The employer will retain $682 to immediately claim its FFCRA tax credits; and the remaining portion of its refundable credit will be $1,347 (refundable portion of credits of $2,029, minus retained payroll deposit of $682).
- The employer may either request an advanced payment of the employer's refundable credit of $1,347 using Form 7200 or request a refund of its FFCRA tax credits when it files its next payroll tax return.

Example 2 – Accrued tax credits exceed the employer's share of Social Security payroll taxes, but do not exceed the employer's entire payroll deposit amount

Assume the same facts as Example 1, but the employer has an additional 14 employees. These additional 14 employees receive the same pay and are in the same tax bracket as the employee in Example 1. However, these 14 employees are working and are not on leave. Assume, the employer does not qualify for the Employee Retention Tax Credit.

- The employer will accrue $2,029 in FFCRA tax credits ($2,000 of qualifying wages, plus $29 of employer paid Medicare taxes).
- The employer's portion of Social Security taxes for the 15 employees will be $1,736 ($124 of Social Security taxes per employee, times 14 employees). The employer's Social Security taxes will be reduced to $0, resulting in a refundable credit of $293 ($2,029 in credits, minus $1,736 of Social Security taxes owed by the employer).
- The employer's payroll deposit, for each of the 14 additional employees, would be $806 (2 weeks of employer FICA, $153; plus, 2 weeks of employee FICA, $153; plus, 2 weeks of income withholding, $500), resulting in a total payroll deposit of $11,966 (the product of $806 per employee, times 14 employees; plus the $682 deposit for the employee on leave).
- The employer will reduce its payroll deposit by retaining $293 to immediately claim the remainder of the refundable portion of its FFCRA tax credits and must deposit to the IRS the remaining $11,673 (total payroll deposit of $11,966, minus retained payroll deposit of $293).

Example 3 – Accrued tax credits do not exceed the employer's share of Social Security payroll taxes

Assume the same facts as Example 2, except, instead of 14 additional employees, the employer has 19 additional employees. As in Example 2, these 19 employees are working and are not on leave. The employer has not received any Paycheck Protection Program loan forgiveness.

- The employer will accrue $2,029 in FFCRA tax credits ($2,000 of qualifying wages, plus $29 of employer paid Medicare taxes).
- The employer's Social Security taxes for the 20 employees will be $2,356 ($124 of Social Security taxes per employee, times 19 employees). The employer's portion of Social Security taxes will be reduced by the $2,029 of FFCRA tax credits, resulting in a remaining tax liability of employer Social Security taxes of $327 (tax liability of $2,356, minus $2,029 of tax credits).
- The employer may defer the $327 payment of the employer's Social Security tax liability until 2021 and 2022 and deposit the remaining $15,669 (the product of $806 per employee, times 19 employees, plus the $682 deposit for the employee on leave; then minus the deferred payment of $327).
- Please note that if the employer had received Paycheck Protection Program loan forgiveness, they would not be eligible to defer the payment of the employer's portion of Social Security taxes until 2021 and 2022. Rather, the employer would have to deposit to the IRS $15,966 (the product of $806 per employee, times 19 employees, plus the $682 deposit for the employee on leave).

The interactions between Paycheck Protection Program loans, Employee Retention Tax Credits, and FFCRA tax credits are complicated and will depend of the facts and circumstances of each employer. While the information presented here is intended to be current as of April 20, 2020, we expect future guidance from the IRS, which may alter the analysis above.

For more information contact Victoria Hanohano-hong, Gary Schulte, Mark Snider, Dave Tumen or any member of Porter Wright's Employee Benefits group.