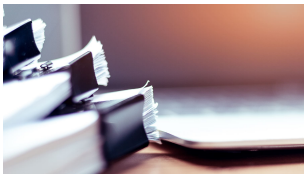

Don’t Leave Eligible FFCRA Tax Credits on the Table

Proper Calculation of Qualified Health Plan Expenses Eligible for Sick and Family Medical Leave Tax Credits Under FFCRA

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Categories:

Coronavirus Response Team
Tax Law Defined™ Blog

On April 1, 2020, H.R. 6201, commonly known as the Families First Coronavirus Response Act (“FFCRA”) went into effect. The FFCRA provides for paid sick leave and emergency paid family and medical leave for those dealing with the effects of COVID-19 and imposes additional paid leave obligations under the Family Medical Leave Act (“FMLA”) for employers with fewer than 500 employees. To offset the burden on employers, the FFCRA provides refundable tax credits for employers that are required to provide the paid leave, which may be claimed for leaves taken beginning April 1, 2020 through December 31, 2020 (the “Credit”).

The Credits can offset quarterly payroll taxes by 100% of up to 10 days of qualified paid sick leave and up to 10 weeks of qualified paid family leave actually paid to employees plus the employer’s share of Medicare tax imposed on the leave wages and any “qualified health plan expenses” that may be allocated to those wages.

The Credits are discussed in detail in Frost Brown Todd’s article, “Your Business, Taxes and the Families First Coronavirus Response Act.” This update addresses the qualified health plan expenses that employers may include in calculating the Credits.

Determination of qualified health plan expenses

Under the FFRCA, any Credit should reflect the amount of qualified health plan expenses properly allocable to an employee’s qualified leave wages. Qualified health plan expenses are defined as amounts paid or incurred by the employer to provide and maintain a group health plan, as defined in section 5000(b)(1) of the Internal Revenue Code (the “Code”), but only to the extent they are excluded from an employee’s gross income under Code section 106(a). The section 5000(b)(1) definition of group health plan broadly includes any plan, whether fully insured or self-insured, that is sponsored by an

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employer, employee organization or a self-employed person and provides health care to current employees, former employees, their families or the employer. These plans would include medical plans (including high deductible plans), dental and vision plans, health flexible spending accounts ("FSA"), and health reimbursement accounts ("HRA"). Other programs, such as employee assistance programs, onsite medical clinics and wellness programs can also be considered group health plans if they provide certain medical benefits.

Fortunately, the IRS has released FAQs that describe how health plan expenses should be determined and allocated. Generally, the FAQs provide that both employer and employee contributions that are made from pre-tax salary reductions count as qualified health plan expenses for purposes of the Credit. Alternatively, the FAQs make clear that the gross amount of employee leave wages can be counted toward the Credit before any pre-tax reductions for employee-elected contributions to health plans are applied. An employer would want to consider this approach if the gross wages paid to an employee on qualified leave exceed the wage limitations imposed by the FFCRA, as amended by the Coronavirus Aid, Relief, and Economic Security ("CARES") Act . Under the CARES Act, employers are not required to pay more than $511 per day and $5,110 in the aggregate for an employee taking leave due to their own COVID-19 related illness, isolation order or self-imposed quarantine and no more than $200 per day and $10,000 in the aggregate for employees taking leave to care for someone else who is subject to an isolation order or self-imposed quarantine or to care for a child whose school or place of care is closed due to COVID-19. Employers can choose to pay employees on qualified leave more than the CARES Act provides, but the Credit cannot exceed those amounts.

Employers that choose to pay more should consider whether it is more advantageous to count an employee's pre-tax salary reductions for health benefits as wages or as health plan expenses. For example, if an employee is paid $7,000 for 10 days of sick leave, and $300 of the $7,000 is attributable to pre-tax salary reduction, it could be more advantageous for the employer to not count the $300 as wages for purposes of the Credit and instead include the

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$300 in the calculation of health plan expenses, since only $5,110 of the $7,000 can be claimed as wages for each employee for purposes of the Credit and any health plan expenses can be claimed in addition to wages. Employers should be careful not to double-count health plan expenses in taking the Credit. If the Credit is claimed for the gross wages paid to the employee before deducting the employee's payments toward health coverage, the employer should not count the employee's payments toward coverage again in calculating the qualified health plan expenses because those payments have already been counted in the employee's wages for which the employer has claimed the Credit. Moreover, the employer is not incurring those amounts as additional costs on top of the wages paid to the employee, and the Credit is only for amounts incurred by the employer. Some employers are paying the full cost of health coverage for employees on FFCRA leaves, particularly if the leaves are paid at less than full wages. In that case, both the employer and the employee-share of the health plan expenses would be counted for purposes of the Credit since the employee's wages are not being reduced for any portion of the cost.

The FAQ also provides that employee after-tax contributions for health plan expenses are not counted as qualified health plan expenses, although it is unusual for employee health plan contributions to be made on an after-tax basis. In addition, the FAQs make clear that employer contributions to Health Savings Accounts (HSAs), Archer Medical Saving Accounts and Qualified Small Employer Health Reimbursement Arrangements are not counted as qualified health plan expenses for purposes of the Credit. But employer contributions to standard health reimbursement arrangements (HRAs) and health flexible spending accounts (FSAs) are counted. Again, employee wages are counted for purposes of the Credit, which has the effect of counting employee contributions to health FSAs and HSAs even though they are not counted as qualified health plan expenses.

According to the FAQs, employers should determine qualified health plan expenses separately for each health plan. The Credit is available based on the plans in which an employee receiving

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qualified paid sick or emergency family and medical leave participates. The FAQs also provide specific guidance for determining qualified health plan expenses for fully insured health plans, self-insured health plans, and contributions to an HRA or FSA, as described below.

Fully insured group health plan expenses

Qualified health plan expenses must be allocated on a pro rata basis during the period health care coverage is provided while an employee is on a qualified leave. According to the FAQs, an employer that sponsors a fully insured group health plan may use any reasonable method to determine and allocate the plan's expenses, and the following three methods are deemed reasonable:

- The COBRA applicable premium for the employee, which is the actual premium charged by the insurer (note that the FAQs do not address whether the 2% administrative fee included in COBRA premiums should be included, but we recommend that employers not include it because the fee is not an actual expense to the employer),
- One average premium rate for all employees, without regard to whether the coverage is self-only, family, employee plus one, etc., or
- An average premium rate determination that reflects the employee's type of coverage (e.g. a separate rate for employees with self-only coverage, a separate rate for employees with family coverage, etc.).

If an employer uses an average premium rate for all employees, the FAQ provides the following example of how the daily allocable costs can be calculated:

An employer sponsors an insured group health plan that covers 400 employees, some with self-only coverage and some with family coverage. Each employee is expected to have 260 workdays a year (five days a week for 52 weeks). The employees contribute a portion of their premium by pre-tax salary reduction, with different amounts for self-only and family. The total annual premium for the 400 employees is $5.2 million. (This includes both the amount paid

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by the employer and the amounts paid by employees through salary reduction.)

Employers can follow a three-step process to determine an employee's daily health plan expense under the plan:

- Divide the employer's overall annual premium by the number of employees covered by the policy to determine the average annual employee premium.

  Example: $5.2 million divided by 400 employees equals $13,000 per employee.

- Divide the average annual employee premium by the average number of workdays during the year by all covered employees (treating days of paid leave as a workday and a workday as including any day on which work is performed) to determine the average daily premium per employee.

  Example: Each employee is expected to have 260 workdays a year; therefore, the average annual employee premium ($13,000) is divided by 260, which equals or $50 per day.

- Finally, the average daily premium is allocated to each day of qualified sick or family leave wages.

  Example: If a full time employee takes 10 days of paid sick leave, the amount of qualified health expenses allocated to the leave would be $50 multiplied by 10, equaling $500 of qualified health plan expense credit, plus any additional health plan expenses that may be attributed to that employee from other group health plans.

If this amount is based on the total employer and employee cost, the employee's wages for purposes of determining the Credit should be wages reduced by the employee's contributions toward the coverage. Most employers will probably calculate just the employer's cost of coverage and count the employee's full wages.

The FAQs say health plan expenses are to be determined separately for each plan and refer to health FSAs as a separate plan from major medical. Typically, all major medical options are documented by the

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employer as a single plan for ERISA purposes, and health FSAs, dental benefits, and vision benefits are also part of that single plan. But the FAQs treat the expenses associated with health FSAs, dental, vision and major medical options as separate. The FAQs do not address whether separate calculations should be done for each major medical benefit option provided under a plan, such as a high and a low option, or high deductible (HDHP) options and non-HDHP options, which many employers have.

If COBRA premiums are used for major medical, those would reflect the benefit option chosen. It would likely be reasonable to determine the costs by combining or not combining the different high, low and HDHP options into a single premium calculation. The employer could either determine the cost of each major medical benefit option separately or determine the cost on an aggregate basis for all benefit options combined. In either case, the employer would have the additional choice of performing separate calculations for the level of coverage elected (e.g. employee only, family, etc.).

Allocating qualified health care expenses for self-insured group health plans

Employers that sponsor a self-insured group health plan may also use any reasonable method to determine and allocate the plan's expenses, including (1) the COBRA applicable premium for the employee, which is typically calculated by the vendor that processes claims based on an actuarial estimate of expected cost for the plan year, or (2) based on a reasonable actuarial method, which would include determining one premium rate for all employees or determining a separate premium for employees based on their coverage level (e.g. employee only, family, etc.). As noted above, the COBRA premium would reflect the employee's current level of coverage as well as the benefit option chosen (high, low, HDHP, etc.). The approach should be similar to the approach for fully insured plans, as described in detail above.

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Allocating qualified health plan expenses for part-time employees

Calculations for part-time and seasonal employees who participate in the plan are adjusted as appropriate. The FAQ again provides that employers may use any reasonable method for calculating the expense attributable to part-time employee workdays.

Although employees who work at least 30 hours per week are considered full-time for purposes of health plan eligibility to comply with the Affordable Care Act, regulations under the FFCRA define a full-time employee as a person normally scheduled to work at least 40 hours per workweek. The preamble indicates that a part-time employee is anyone normally scheduled to work less than 40 hours per work week. Thus, the calculation above will need to be adjusted for part-time employees. For example:

An employer sponsors a group health plan that covers 100 employees consisting of 80 full-time employees (those who work 40 hours) and 20 part-time employees (those who work 30 hours) that has a total annual premium of $1 million.

The 20 part-time employees each work 75% of the full-time employees' hours (30 hours divided by 40 hours equals .75, or 75%), which means the part-time employees are equivalent to 15 full-time employees (75% of 20 employees equals 15).

The total premium, $1 million, is then divided by the number of full-time employees (80) plus the number of full-time equivalents (15), giving an annual per employee premium of $10,526.32. Next, the annual employee premium is divided by the number of working days in a year (260 days), which results in a daily expense of $40.49 for full-time employees. A part-time employee's daily expense would be equal to 75% of full-time employee's daily expense, or $30.37.

If a full-time employee takes two weeks of sick leave under the FFCRA, the qualified health plan expense credit allocated to that employee would be $404.90 ($40.49 x 10 days). If a part-time employee takes two weeks of sick leave under the FFCRA, the qualified health plan expense credit allocated to that employee would be $303.70 ($30.37 x 10).

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Allocating employer contributions to HRA and FSA accounts

The FAQ provides that employers should use the actual amount of employer and employee contributions made to an employee's HRA or FSA account during the leave period. While the FAQs don't give an example of how to calculate this amount, it seems a reasonable method to allocate these expenses would be to divide the total contribution during the period by the number of days in the period. For example, if $100 is contributed to an employee's HRA for the month, and there are 22 workdays in the month, $100 would be divided by 22 days to get a daily expense of $4.55. Under this method, if an employee took 10 days of sick leave under the FFCRA during the month, $45.50 ($4.55 x 10) of the HRA contribution would be available as a qualified health plan expense credit. HRAs are fully employer-paid, so this calculation will be needed for any HRA contributions but would also apply to health FSAs that have employer contributions. FSAs that are fully employee-paid, which is typical, will account for employee contributions in employee wages.

We continue to follow these developments closely and will update accordingly, as both the federal and state governments continue to decipher how best to aid taxpayers during this difficult time. For more information as to how the spread of COVID-19 creates tax implications, contact Kellie Money, Dylan Grafe, or another attorney in Frost Brown Todd's Tax and Employee Benefits & ERISA practices. You can also visit our Tax Law Defined blog or Coronavirus Response Team page to get the latest updates on COVID-19 related tax implications.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a Coronavirus Response Team. Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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