



Coronavirus Update

Updated May 11, 2020

Claiming tax benefits for health coverage costs under the Employee Retention Credit: Updated agency guidance

Recent legislation has provided various forms of industry, employer and individual relief from the economic downturn caused by the coronavirus pandemic. Congress has offered employers three different ways to recapture some or all their health insurance expenditures made on behalf of employees during these unprecedented times, through tax credits and small business loan forgiveness.

Over the past few weeks, we've issued several alerts about the new federal programs that provide tax benefits for employers who continue to pay wages and health insurance costs for their workers. These programs include:

- [The Families First Coronavirus Response Act \(FFCRA\)](#): requires employers with fewer than 500 employees to provide paid sick leave and FMLA+ leave to their workers for reasons related to the COVID-19 virus, beginning on April 1, 2020, through Dec. 31, 2020.
- [The Employee Retention Credit \(ERC\)](#): provides a tax credit for paying employees during periods where, due to the COVID-19 pandemic, the employer's business operations are suspended in whole or in part due to a government order, or the employer has experienced significant decline in revenue.
- [Paycheck Protection Program \(PPP\)](#): offers forgivable loans to small businesses to keep them afloat during the economic downturn.

All three programs – FFCRA, ERC and PPP – allow an eligible employer to claim tax benefits for certain wages, and health insurance that is provided with those wages, to affected employees. Note the same wages and healthcare expenses cannot be claimed under more than one program (no double dip).

Qualified health plan expenses under the FFCRA

We explored earlier, in our [April 7 alert](#), the rules for claiming tax credits for health plan expenses incurred when providing employees paid leave mandated under the FFCRA.

Qualified health plan expenses under the ERC

We earlier explained the mechanics of the of the ERC, in an [alert](#) also published on April 7. That alert supplies important details on which employers are eligible to claim the credit, and for which kinds of expenses.

Lockton comment: The IRS recently issued [FAQ guidance](#) regarding the health insurance employers can claim as “qualified health expenses” under the ERC. Because the statutory definition of qualified health expenses under the ERC matches the definition under FFCRA, the new [IRS guidance](#) largely mirrors the IRS guidance on “qualified health plan expenses” under FFCRA that we discussed in our [April 7 alert](#). Similar to the FFCRA credits, employers claim ERC credits on their quarterly payroll tax returns.

Employers who provide wages that qualify for tax credits under the ERC can also include qualified health expenses in the calculation of the ERC. These costs include the employer cost for health insurance plus any employee pretax contributions under Section 125 (but not employee after-tax payments). Qualified health plan expenses also include employer contributions to health flexible spending accounts (FSAs) and health reimbursement arrangements (HRAs), but not to small employer HRAs (known as QSEHRAs) or employer contributions to health savings accounts (HSAs).

Lockton comment: These rules are the same as those governing FFCRA’s calculation of qualifying health expenses. Qualifying health expenses include not only major medical coverage, but also dental and vision coverage and any other benefit to which the COBRA continuation rules would apply.

Employers may apply the ERC to health insurance expenses that are allocated to wages on a pro rata basis among covered employees (for example, the average premium for all employees covered by a plan) and over periods of coverage (relative to the periods to which such wages relate). If there are separate plans, the health plan expenses are determined separately for each plan. Similar rules apply to insured and self-funded plans.

Lockton comment: The methodology and examples used in the guidance mirror the same for FFCRA. Our [April 7 alert](#) contains an example (ABC Company) on how these expenses are allocable to wages that would also apply to the ERC.

Under the initial ERC rules, employers with more than 100 employees were not permitted to claim the credit for qualifying health plan expenses it paid unless the employer was also continuing wages. However, the IRS reconsidered the issue after receiving pressure from the Senate Finance Committee. Thus, during any unpaid leave or furlough, qualifying health expenses paid by the employer in that period can be claimed as a credit (subject to the \$10,000 maximum). However, such a larger employer may never claim the tax credit for health plan expenses allocable to the time for which the employees are receiving wages for providing services; only the portion of health plan expenses allocable to the time the employees are not providing services are treated as qualified wages.

Example: Employer B is subject to a government order that partially suspends the operations of its trade or business. In response to the government order, Employer B reduces its employees’ hours by 50%, but it reduces its employees’ wages by only 40%, so the employees receive 60% of their wages for 50% of their normal hours. Employer B continues to cover 100% of the employees’ health plan expenses.

In this case, Employer B may treat as qualified wages: (i) the 10% of the wages it pays employees for time the employees are not providing services, plus (ii) 50% of the health plan expenses, because the health plan expenses are allocable to the time that employees were not providing services.

Group healthcare benefits under PPP

Under the PPP, the calculation of the maximum loan amount (and the portion of that loan that might be forgivable, depending on how the loan amount is spent), requires the employer determine its “payroll costs” for certain periods. Payroll costs, in turn, are comprised of wages and, among other items, “payment required for the provision of group healthcare benefits, including insurance premiums.”

The term “wages” includes employee pretax contributions for health insurance and other Section 125 pretax benefits (HSA contributions, dependent care FSA, etc.), which makes sense because but for the employee’s decision to have their salary reduced to pay for those benefits, those amounts would have been cash compensation to the employee. The cost for “group healthcare benefits” include only pure employer contributions for health coverage, ignoring any employee pretax contributions that were considered under wages, as well as any employer HSA contributions.

Lockton comment: For fully insured plans, the determination of health insurance costs will include the employer’s share of the premium paid to the insurer. For self-insured plans, the cost appears to be the claims paid and related costs, such as stop-loss insurance. The Council of Insurance Agents and Brokers (CIAB) has asked regulators to allow self-insured plans to use COBRA rates, to protect employers from significant disruptions in claims activity on account of the COVID-19 virus.

Conclusion

Employers will need to carefully study the new rules and discuss the mechanics of the claiming the tax benefits with their payroll advisor. The FFCRA and ERC benefits can be claimed on the next quarterly payroll tax return, Form 941, that is due July 31.

Details by program

	FFCRA QUALIFYING HEALTH PLAN EXPENSES	ERC QUALIFYING HEALTH PLAN EXPENSES	PPP GROUP HEALTHCARE BENEFITS
Employer premium payments for insured health coverage*	Included	Included	Included
Employer claim payments for self-insured coverage*	Included (can also use COBRA rates)	Included (can also use COBRA rates)	Included (no express rule that allows COBRA rates)
Employee pretax payments for health coverage (insured or self-funded)	Included	Included	Not included (included in wages, though)
Employee after-tax contributions for health coverage (this is rare except for COBRA coverage)	Not included**	Not included**	Not included
HRA contributions (other than QSEHRA)	Included	Included	Included if used to pay HRA claims

HSA contributions	Not included	Not included	Not included (but employee pretax HSA contributions included in wages)
Employee pretax health FSA contributions	Included	Included	Not included (included in wages, though)

*For FFCRA and ERC, includes any coverage meeting the definition of group health plan, including dental and vision coverage. Presumably, same result applies to PPP.

**Would appear to be included in costs if employer uses COBRA rate (or a similar method) to allocate health plan costs.

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