

Reporting COVID-19 federal tax benefits on Form 941

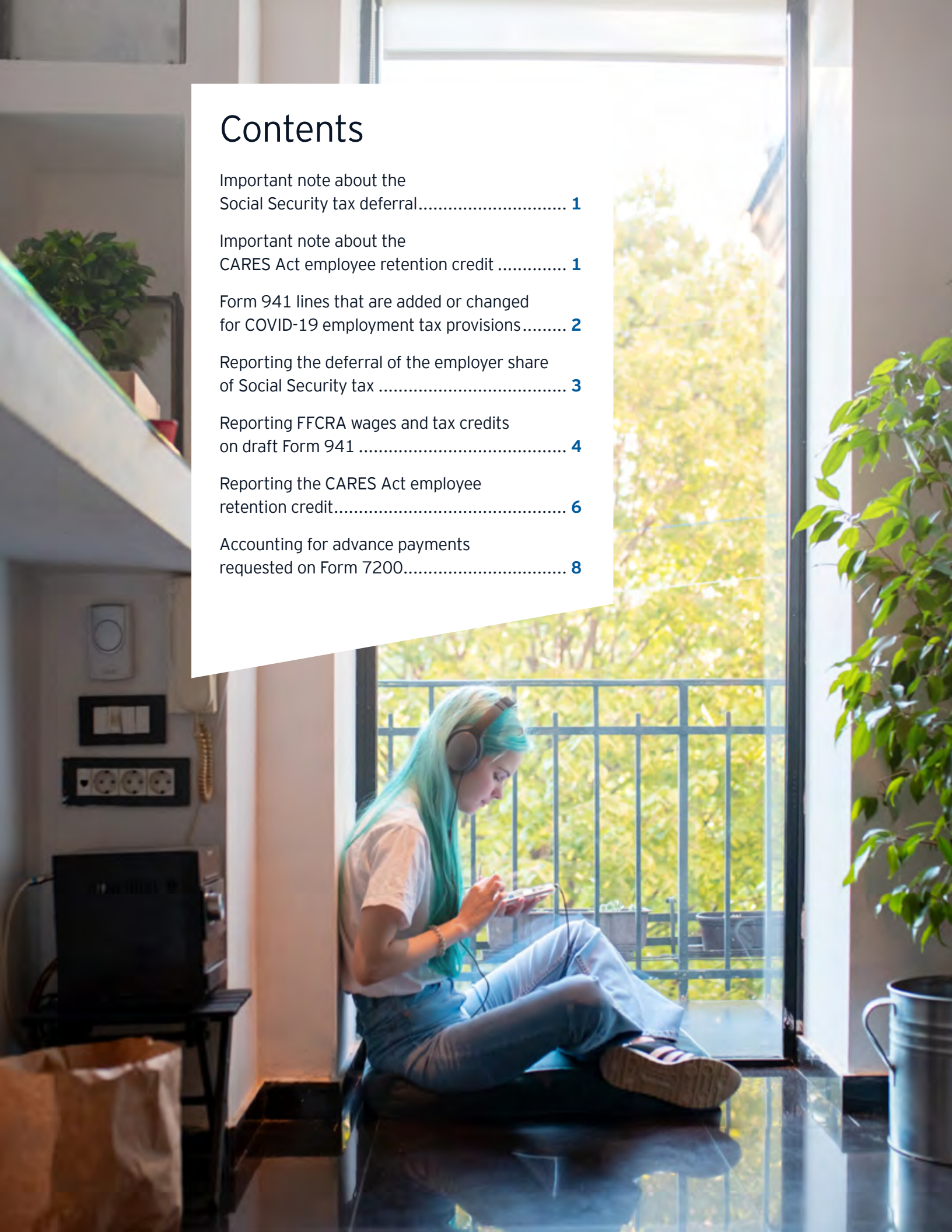


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Reporting COVID-19 federal tax benefits on Form 941

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The IRS issued the final [Form 941, Employer's QUARTERLY Federal Tax Return](#), that went into effect starting with the 2020 second quarter. The Form 941 includes fields for reporting the COVID-19 federal employment tax provisions including the Social Security tax deferral, the employee retention credit under the *Coronavirus Aid, Relief, and Economic Security (CARES) Act* and the paid leave credits under the *Families First Coronavirus Response Act (FFCRA)*.

The IRS has also issued the final [Form 941, instructions](#) that include new Worksheet 1 for figuring the tax credits for the CARES Act employee retention credit and/or the FFCRA paid leave credits. It is necessary to complete Worksheet 1 before preparing the Form 941. Worksheet 1 is retained in the employer's records and is not filed with the IRS; however, the IRS is likely to require it in the case of an audit. (See *Form 941 instructions, pg. 12.*)

The Form 941 contains the details necessary for employers and the IRS to confirm that the special employment tax provisions available for COVID-19 are properly applied and accurate compared with the total Social Security wages, number of employees and the COVID-19 tax provision details that are reported on Forms 941.

Important note about the Social Security tax deferral

Although the CARES Act allows employers to defer payment of the employer portion of Social Security tax effective March 27, 2020, the instructions on line 13b of the Form 941 instructions state that the employer cannot defer Social Security tax that it already paid. In [FAQ 6](#), the IRS also states that if employers claimed the Social Security tax deferral in the 2020 first quarter for the period March 27, 2020, to March 31, 2020, they will receive a notice concerning a deposit deficiency and they will need to explain the shortage as due to the Social Security tax deferral. The IRS is likely using this procedure because there is no way to correct liabilities reported on Form 941 and comparable employment tax returns.

The updated FAQs do not provide further information on if or how employers can claim the deferral for the 2020 first quarter as allowed under the CARES Act.

Important note about the CARES Act employee retention credit

The Form 941 instructions indicate that the CARES Act employee retention credit cannot be claimed in the 2020 first quarter; accordingly, if employers claimed this credit for the 2020 first quarter, a Form 941-X is necessary for the 2020 second quarter.

Any CARES Act employee retention credit applicable to the period March 13 through March 31, 2020, can only be claimed on the 2020 second-quarter Form 941, and no amount can be entered for this period on the 2020 third- or fourth-quarter Form 941. Employers that missed reporting the employee retention credit for this period on the 2020 second-quarter Form 941 will need to file a Form 941-X.

Form 941 lines that are added or changed for COVID-19 employment tax provisions

The Form 941 shows that the following lines will be added or changed for purposes of the new COVID-19 federal employment tax provisions:

- ▶ **Line 5a(i):** Qualified sick leave wages
- ▶ **Line 5a(ii):** Qualified family leave wages
- ▶ **Line 11b:** Nonrefundable portion of credit for qualified sick and family leave wages from Worksheet 1
- ▶ **Line 11c:** Nonrefundable portion of employee retention credit from Worksheet 1
- ▶ **Line 11d:** Total nonrefundable credits
- ▶ **Line 13a:** Total deposits for this quarter, including overpayment applied from a prior quarter and overpayments applied from Form 941-X, 941-X (PR), 944-X, or 944-X (SP) filed in the current quarter
- ▶ **Line 13b:** Deferred amount of the employer share of Social Security tax
- ▶ **Line 13c:** Refundable portion of credit for qualified sick and family leave wages from Worksheet 1
- ▶ **Line 13d:** Refundable portion of the employee retention credit from Worksheet 1
- ▶ **Line 13e:** Total deposits, deferrals, and refundable credits. (Add lines 13a, 13b, 13c, and 13d)
- ▶ **Line 13f:** Total advances received from filing Form(s) [7200](#) for the quarter
- ▶ **Line 13g:** Total deposits, deferrals, and refundable credits less advances. (Subtract line 13f from line 13e)
- ▶ **Line 19:** Qualified health plan expenses allocable to qualified sick leave wages
- ▶ **Line 20:** Qualified health plan expenses allocable to qualified family leave wages
- ▶ **Line 21:** Qualified wages for the employee retention credit
- ▶ **Line 22:** Qualified health plan expenses allocable to wages reported on line 21
- ▶ **Line 23:** Credit from [Form 5884-C](#), line 11, for this quarter
- ▶ **Line 24:** Qualified wages paid March 13 through March 31, 2020, for the employee retention credit (use this line only for the second quarter filing of Form 941)
- ▶ **Line 25:** Qualified health plan expenses allocable to wages reported on line 24 (use this line only for the second quarter filing of Form 941)



Reporting the deferral of the employer share of Social Security tax

The CARES Act allows employers to defer the deposit and payment of the employer share of Social Security tax for deposits due on or after March 27, 2020, and before January 1, 2021, with 50% of the deferral required to be repaid by December 31, 2021, and the remainder by December 31, 2022.

All employers and self-employed individuals may avail themselves of this CARES Act provision, except that this option is no longer available once a lender notifies an employer that a loan provided under the [Paycheck Protection Program](#) (PPP) is forgiven.

Line 13b: Deferred amount of the employer share of Social Security tax

Enter on line 13b the amount of the employer share of Social Security tax that is being deferred for the quarter. The employer share of Social Security tax is 50% of Column 2 of line 5a plus 50% of Column 2 of line 5b.

Don't include the employee Social Security taxes reported on lines 5a(i) and 5a(ii), and don't reduce the amount reported on line 13b by any credits claimed on line 11a, 11b or 11c.

The employer cannot defer Social Security tax that it already paid; accordingly, the maximum amount that can be deferred each quarter is the employer share of Social Security tax less any excess of total deposits (line 13a) over the difference between total taxes after adjustments (line 10) and the employer share of Social Security tax (50% of Column 2, line 5a and line 5b).



The IRS clarifies that the deferred amount of the employer share of Social Security tax is a deferral of deposits and payments, not a deferral of liability. Employers won't receive a refund or credit of any amount of the employer share of Social Security tax already deposited or paid for the quarter. However, in determining whether any amount of the employer share of Social Security tax was already deposited for this purpose, employers can consider prior deposits during the quarter as first being deposited for employment taxes other than the employer share of Social Security tax. Although employers depositing taxes using the Electronic Federal Tax Payment System® identify the subcategory of separate deposits for the different employment taxes (e.g., Social Security tax and Medicare tax), those entries are for informational purposes only. The IRS doesn't use that information in comparing liabilities reported on the employment tax return and the total deposits made.

- ▶ **Note for third-party payers of sick pay that are not agents.** On June 3, 2020, it was added that if you are a third-party payer of sick pay that is not an agent (e.g., an insurance company) and you're claiming the employee retention credit for amounts paid to your own employees, the amount of the employer share of Social Security tax reported on line 5a must be reduced by any adjustment you make on line 8 for the employer share of Social Security tax transferred to your client. If you received a Section 3121(q) *Notice and Demand* for tax due on unreported tips (Letter 3263 or Letter 4520) during the quarter, you report the amount for the employer share of Social Security tax and Medicare tax on Form 941, line 5f. Letter 3263 or Letter 4520 includes an attachment that shows the employer share of Social Security tax. This amount of the employer share of Social Security tax can also be reduced by the nonrefundable portion of the credit. See Worksheet 1 (line 1e) to figure your credit.

Reporting FFCRA wages and tax credits on draft Form 941

Line 5a: Taxable Social Security wages

Do not include on line 5a wages that are reported on line 5a(i) or line 5a(ii). The total reported on lines 5a, 5a(i), 5a(ii) and 5(b) should not exceed the 2020 Social Security wage limit of \$137,700.

Line 5c: Taxable Medicare wages & tips

FFRCA-qualified sick and family leave wages are subject to Medicare tax. The refundable credit available for the Medicare tax allocable to qualified FFCRA wages is reported on line 13c.

Line 5a(i): Qualified sick leave wages

In Column 1, show the total qualified sick wages paid under the FFCRA. These wages are not subject to the employer portion of Social Security tax. Accordingly, in Column 2, show only 6.2% of the amount in Column 1.

The refundable credit for qualified sick wages is reported on line 13c, and qualified health plan expenses for these employees are reported on line 19.

Line 5a(ii): Qualified family leave wages

In Column 1, show the total of qualified family leave wages paid under the FFCRA. These wages are not subject to the employer portion of Social Security tax. Accordingly, in Column 2, show only 6.2% of the amount in Column 1.

The refundable credit for qualified family leave wages is reported on line 13c, and qualified health plan expenses for these employees are reported on line 20.

Line 11b: Nonrefundable portion of credit for qualified sick and family leave wages from Worksheet 1

Enter here the portion of the tax credit for the FFCRA qualified sick and family leave wages that is not refundable because the credits taken on [Form 8974](#), *Qualified Small Business Payroll Tax Credit for Increasing Research Activities*, and Form 5884-C, *Work Opportunity Credit for Qualified Tax-Exempt Organizations Hiring Qualified Veterans*, exceed the FFCRA credit available.

This amount is reflected on Worksheet 1, Step 2, line 2j of the Form 941 instructions. Any FFCRA tax credit in excess of those claimed on Form 8974 and Form 5884-C represents the refundable portion that is reported on line 13c.

- ▶ **Note for third-party payers of sick pay that are not agents.** On June 3, 2020, it was added that if you are a third-party payer of sick pay that is not an agent (e.g., an insurance company) and you're claiming the employee retention credit for amounts paid to your own employees, the amount of the employer share of Social Security tax reported on line 5a must be reduced by any adjustment you make on line 8 for the employer share of Social Security tax transferred to your client. If you received a Section 3121(q) *Notice and Demand* for tax due on unreported tips (Letter 3263 or Letter 4520) during the quarter, you report the amount for the employer share of Social Security tax and Medicare tax on Form 941, line 5f. Letter 3263 or Letter 4520 includes an attachment that shows the employer share of Social Security tax. This amount of the employer share of Social Security tax can also be reduced by the nonrefundable portion of the credit. See Worksheet 1 (line 1e) to figure your credit.



Line 13c: Refundable portion of credit for qualified sick and family leave wages from Worksheet 1

Businesses and tax-exempt organizations with fewer than 500 employees that are required to provide paid sick leave and family leave under the FFCRA are eligible to claim the FFCRA tax credit.

The credit for qualified sick and family leave wages consists of the qualified sick leave wages, the qualified family leave wages, the employer share of Medicare tax (at 1.45%) allocable to those wages and the qualified health plan expenses for these qualified employees.

Qualified health plan expenses incurred in connection with FFCRA-qualified wages are required to be reported on line 19 (for qualified sick leave wages) and line 20 (for qualified family leave wages).

Enter the refundable portion of the credit for qualified sick and family leave wages from Worksheet 1, Step 2, line 2k.

The refundable portion of the credit is allowed after the employer share of Social Security tax reported on Form 941, lines 5a and 5b, is reduced to zero by nonrefundable credits.

Line 19: Qualified health expenses allocable to qualified sick leave wages

A qualified health expense is defined as the cost the employer incurred to maintain health insurance coverage for an employee during the period it provided paid sick leave pursuant to the FFCRA.

Report on line 19 the amount shown on Worksheet 1, Step 2, line 2b.

Line 20: Qualified health plan expenses allocable to qualified family leave wages

A qualified health expense is defined as the cost the employer incurred to maintain health insurance coverage for an employee during the period it provided paid family leave pursuant to the FFCRA.

Report on line 20 the amount shown on Worksheet 1, Step 2, line 2f.



Reporting the CARES Act employee retention credit

With the exception of state and local governments, the credit is available to all employers regardless of size, including tax-exempt organizations.

The draft Form 941 instructions initially stated that employer cannot claim the CARES Act employee retention credit if the employer receives a Small Business Interruption Loan under the [Paycheck Protection Program](#) (PPP). Note however that the IRS updated its frequently asked questions (FAQs) to state in [FAQ 79](#) that if an otherwise eligible employer repays its PPP loan by May 18, 2020, it is eligible to claim the employee retention credit. This information is now reflected on line 11c of the draft Form 941.

In addition, for purposes of the CARES Act employee retention credit, an employer may not take into account the following:

- ▶ Wages taken into account under sections 7001 and 7003 of the FFCRA that provides payroll tax credits for paid leave required to be provided by small employers
- ▶ Wages taken into account under IRC §45S (income tax credit for paid family and medical leave)
- ▶ Wages paid to certain related individuals specified in [IRC §51\(i\)\(1\)](#)
- ▶ Wages of an employee for whom a work opportunity tax credit is claimed

For the 2020 second quarter only, the credit includes 50% of the qualified wages paid between March 13, 2020, and March 31, 2020 (see lines 24 and 25). That is because the CARES Act employee retention credit cannot be claimed in the 2020 first quarter.

Any CARES Act employee retention credit applicable to the period March 13 through March 31, 2020, can only be claimed on the 2020 second-quarter Form 941 (lines 24 and 25), and no amount can be entered for this period on the 2020 third- or fourth-quarter Form 941. Employers that missed reporting the employee retention credit for this period on the 2020 second-quarter Form 941 will presumably need to file a Form 941-X.

Line 5a: Taxable Social Security wages

Do not reduce the wages reported on line 5a for any portion of the CARES Act employee retention credit.

Line 5c: Taxable Medicare wages & tips

Do not reduce the wages reported on line 5c for any portion of the CARES Act retention credit. Note also that there is no refundable credit for the Medicare tax allocable to qualified wages paid in connection with the CARES Act employee retention credit.

Line 11c: Nonrefundable portion of employee retention credit from Worksheet 1

Enter here the portion of the tax credit for the CARES Act employee retention credit that is not refundable because the credits taken on Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities, Form 5884-C, Work Opportunity Credit for Qualified Tax-Exempt Organizations Hiring Qualified Veterans and the FFCRA paid leave credits exceed the CARES Act employee retention credit available.

This amount is reflected on Worksheet 1, Step 3, line 3j of the Form 941 instructions.

The nonrefundable portion of the credit is limited to the employer share of Social Security tax reported on Form 941, lines 5a and 5b, after that share is first reduced by any credits claimed on [Form 8974](#), [Form 5884-C](#), and/or for the nonrefundable portion of the credit for FFCRA-qualified sick and family leave wages.

Any credit in excess of the remaining amount of the employer share of Social Security tax is refundable and reported on Form 941, line 13d.

- ▶ **Note for third-party payers of sick pay that are not agents.** On June 3, 2020, it was added that if you are a third-party payer of sick pay that is not an agent (e.g., an insurance company) and you're claiming the employee retention credit for amounts paid to your own employees, the amount of the employer share of Social Security tax reported on line 5a must be reduced by any adjustment you make on line 8 for the employer share of Social Security tax transferred to your client. If you received a Section 3121(q) Notice and Demand for tax due on unreported tips (Letter 3263 or Letter 4520) during the quarter, you report the amount for the employer share of Social Security tax and Medicare tax on Form 941, line 5f. Letter 3263 or Letter 4520 includes an attachment that shows the employer share of Social Security tax. This amount of the employer share of Social Security tax can also be reduced by the nonrefundable portion of the credit. See Worksheet 1 (line 1e) to figure your credit.

Line 21: Qualified wages for the employee retention credit

Enter here the qualified wages on which the CARES Act employee retention credit is being claimed. Do not include the qualified health plan expenses allocable to these wages; instead, report them on Line 22.

Exclude from line 21 qualified wages for the CARES Act employee retention credit incurred for the period March 13 through March 31, 2020. Instead, report the amount for this period on line 24.

Report on line 21 the amount shown on Worksheet 1, Step 3, line 3a.

Line 22: Qualified health plan expenses allocable to wages reported on line 21

A qualified health expense is defined as the cost the employer incurred to maintain health insurance coverage for an employee during the period the qualified wages from line 21 were paid.

Note that qualified health insurance coverage claimed for an employee who is included in the amount reported on line 20 (FFCRA-qualified health expenses) cannot also be reported here.

On May 7, 2020, the IRS updated its [FAQs](#) on the employee retention credit (64 and 65) to reflect that all employers may treat as qualified health plan expenses those incurred for furloughed employees who are not working or providing services due to COVID-19, provided that the expenses are allocable to the time the employee is not providing services.

Exclude from line 22 qualified health plan expenses incurred for the period March 13 through March 31, 2020. Instead, report the amount for this period on line 25.

Report on line 22 the amount shown on Worksheet 1, Step 3, line 3b.

Line 24: Qualified wages paid March 13 through March 31, 2020, for the employee retention credit (use this line only for the second quarter filing of Form 941)

Line 24 can only be completed in the 2020 second quarter. No entry is allowed on this line for the 2020 third and fourth quarter.

Report on line 24 the amount shown on Worksheet 1, Step 3, line 3c.

Line 25: Qualified health plan expenses allocable to wages reported on line 24 (use this line only for the second quarter filing of Form 941)

Line 25 can only be completed in the 2020 second quarter. No entry is allowed on this line for the 2020 third and fourth quarter.

Report on line 25 the amount shown on Worksheet 1, Step 3, line 3d.



Accounting for advance payments requested on Form 7200

Employers are eligible to file [Form 7200](#) for the quarter if they paid FFCRA-qualified sick and/or family leave wages or qualified wages eligible for the CARES Act employee retention credit, and the amount of employment tax deposits they retained weren't sufficient to cover the cost of these credits.

The employer can file Form 7200 for advance credits anticipated for a quarter at any time before the end of the month following the quarter in which it paid the qualified wages. If necessary, the employer can file Form 7200 several times during each quarter.

Employers are instructed that they should not file Form 7200 after they file Form 941 for the fourth quarter of 2020, or the annual Forms 943, 944, or CT-1 for 2020. Additionally, employers should not file Form 7200 to request advance credits for any anticipated credit for which they already reduced their federal employment tax deposits.

Line 13f: Total advances received from filing Form(s) 7200 for the quarter

Report on line 13f the total advances received from filing Form 7200; however, if the employer filed a Form 7200 before the end of the quarter but did not receive the advance before filing Form 941, that amount is not included on line 13f.

Ernst & Young LLP can assist you throughout the COVID-19 workforce life cycle

Federal and state paid leave requirements	Federal law imposes paid leave for employees impacted by COVID-19 under the Families First Coronavirus Response Act. Some states (e.g., Colorado and New York) have also adopted COVID-19 leave provisions.
Employee work-from-home considerations	Telework arrangements raise numerous tax-related questions, including the income tax withholding and unemployment insurance rules that apply, the nexus implications for businesses taxes, and the tax treatment of tools and equipment provided to work-from-home employees. See our brochure for more information on how we can help you with teleworker arrangements.
Employee disaster relief benefits	Employers are providing their affected employees with disaster assistance payments, additional day care, loans, advances and other disaster-related benefits. The federal, state and local tax treatment can vary depending on the facts.
State unemployment insurance management	State rules governing the charging of COVID-19-related unemployment insurance (UI) vary, and there are various options available to avoid layoffs during a temporary shutdown, such as a workshare program. UI cost-containment measures are vital to decreasing employer costs. See our brochure for more information on how we can help you with workshare programs for unemployment insurance.
Social Security payment deferrals	The employer portion of Social Security tax (6.2% up to \$137,700) can be deferred with 50% of the amount paid by December 31, 2021, and the remainder by December 31, 2022. Form 941 reconciliation issues could occur, resulting in subsequent IRS notices/audits.
Federal tax credits	For employers with fewer than 500 employees, two tax credits are available – the paid sick leave credit and the child care leave credit. For all employers regardless of size, a federal retention tax credit applies for wages paid from March 13, 2020, to December 31, 2020, by employers that are subject to closure or significant economic downturn due to COVID-19.
Tax filing and payment extensions	Whether the issue is staffing shortages to meet deadlines or deferring tax payments to assist with temporary cash flow issues, state provisions for delaying income tax withholding and UI tax returns and payments can be very helpful.
Paycheck Protection Program	Small businesses with fewer than 500 employees are eligible for loans that can be fully forgiven if the borrower keeps its employees on the payroll for 8 weeks and the loan is used for payroll, rent, mortgage interest or utilities.

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