Compensation and employee benefit provisions under CARES Act

March 26, 2020

In brief

On March 25, the Senate voted to pass the Coronavirus Aid, Relief, and Economic Security Act (CARES Act or Act). In addition to providing for loans to small business and industries hard hit by the COVID-19 pandemic, the CARES Act has specific provisions impacting compensation arrangements and employee benefits, including a tax credit for employers that retain employees during the pandemic, a delay in contributions to single-employer pension plans, and a delay in payment of employer social security taxes. The Act also gives employees expanded access to retirement funds through plan loans and distributions as well as several health-care and health expense related provisions.

In detail

Tax credits for employers that retain employees
The Act provides eligible employers a refundable tax credit for up to 50% of the qualified wages paid to each employee during the calendar quarter. The credit is applied against the employer’s share of social security taxes for each quarter, and any excess credit is refundable to the employer. The maximum credit is 50% of qualified wages up to a maximum of $10,000 of such wages per employee for all quarters. The employee retention credit is reduced if the employer is already claiming the payroll Work Opportunity Tax Credit, the payroll research credit, the employer credit for paid family and medical leave, or the payroll tax credits under the Families First Coronavirus Response Act for required paid family and sick leave for these wages. The credit is not available for any employees for whom the employer is claiming the Work Opportunity Tax Credit. An employer can elect not to receive the credit. The credit may not be available to employers that receive certain business interruption loans from the Small Business Administration.

In order to claim the credit, the employer must carry on a trade or business during calendar 2020, and must meet either the business closure or significant decline in gross receipts test for the quarter in which the credit is claimed. The credit applies to qualified wages paid after March 12, 2020 through December 31, 2020.
### Business closures

An employer is eligible to claim the credit if the business operation is fully or partially suspended during that quarter due to orders from an appropriate government authority (e.g., the governor of the state) limiting commerce, travel, or group meetings due to COVID-19. Tax-exempt entities are eligible to claim the credit under this provision.

### Businesses experiencing a significant decline in gross receipts

Even if the business has not been forced to close, an employer is eligible to claim the credit if the employer has a significant decline in gross receipts during the calendar quarter. A significant decline occurs when gross receipts for quarters beginning January 1, 2020 are less than 50% of gross receipts for the same calendar quarter in 2019. The employer can continue to claim the credit due to a significant decline in gross receipts until the first quarter after a quarter in which gross receipts are greater than 80% of the gross receipts received in the corresponding quarter in 2019.

### Qualified wages eligible for the credit

For employers with an average of more than 100 full-time equivalent employees in 2019 (based on rules under Section 4980H related to the employer mandate under the Affordable Care Act), the credit can be taken on wages paid by the employer to an employee who is not providing services because the business is fully or partially suspended or the business is experiencing a significant decline in gross receipts. For employers with an average of 100 or fewer full-time equivalent employees, the credit can be taken on all wages during the quarters the business is closed or limited or during the period of the significant decline in gross receipts. For these purposes, all entities treated as a single employer under Sections 52(a) or (b) or 414(m) or (o) are treated as the same employer.

Qualified wages cannot exceed $10,000 per employee in total for all quarters and cannot exceed the amount the employee would have been paid for working for the equivalent time for the 30 days before the closure/decline in gross receipts period. Wages include amounts spent on certain health plan expenses for those employees.

The IRS is instructed to provide rules for advance payment of the credit.

### Delay in payment of employer social security taxes

The Act allows a delay in payment for the employer’s portion of social security taxes and 50% of a self-employed individual’s social security taxes for the period beginning on the date of enactment through December 31, 2020. Under the Act, 50% of those taxes are due on December 31, 2021 and 50% are due on December 31, 2022. This provision does not apply to any taxpayer that has debt forgiven for certain Small Business Administration loans. Special rules apply to employers that contract with certain agents or certified professional employer organizations.

### Delay in filing income tax returns and paying income taxes due on April 15, 2020

Notice 2020-18 provides that the due date for filing certain federal income tax returns and making income tax payments normally due on April 15, 2020 has been extended to July 15, 2020. Taxpayers do not have to file Forms 4868 or 7004 to request this extension. The extension applies to income taxes due on April 15, 2020 for 2019 and estimated taxes for 2020 due on April 15, 2020. No interest will apply to the late payment and there is no limit to the amount of taxes that can be delayed until July 15, 2020. The extension does not apply to any return or tax payment that otherwise would be due during the period from April 16 to July 14, 2020.

This extension was issued by the IRS in Notice 2020-18. It is not part of the Act but is a key component of cash management for businesses and employees.

### Additional time to make minimum required contributions to pension plans

The Act provides that minimum required contributions due during 2020, including both final contributions for the 2019 plan year as well as 2020 quarterly contributions, can be deferred until January 1, 2021. The contribution must be increased for interest from the original due date for the contribution until the actual payment date at the plan’s effective interest rate for the year the payment is made.
In addition, a plan sponsor may elect to treat the plan’s adjusted funding target attainment percentage (AFTAP) for 2019 as the AFTAP for 2020, which would minimize the impact that unpaid 2020 contributions would have on benefit restrictions in 2020.

**Distribution and loans from qualified plans**

The Act allows expanded qualified plan distributions and loans for individuals impacted by the pandemic. Eligible individuals include an individual who is diagnosed or whose spouse or dependent is diagnosed with the coronavirus, or an individual who experiences adverse financial consequences as a result of having been quarantined, furloughed, or laid off, or whose work hours were reduced due to the virus, who was unable to work due to the lack of childcare due to the virus, or who was impacted by the closing or reduced hours of a business owned or operated by the individual due to the virus. A plan administrator may rely upon an employee’s certification in determining whether any distribution is a coronavirus-related distribution.

**Plan distributions**

The Act waives the 10% early distribution penalty for coronavirus-related distributions of up to $100,000 from a qualified plan (such as a 401(k) plan), and also including a 403(a) annuity plan, a 403(b) plan and a 457(b) government-sponsored plan and individual retirement accounts (IRAs). The $100,000 limit is applied in the aggregate to all distributions from all plans maintained by the employer on a controlled group basis. The distribution for coronavirus-related purposes must be made during the period from January 1 to December 30, 2020.

The Act suspends the normal 20% withholding on eligible rollovers. A coronavirus-related distribution can be repaid by the individual at any time during the three-year period beginning on the day after the distribution date. Repayments within the three-year period are treated as a direct trustee-to-trustee transfer made within the required sixty-day period. Income on a coronavirus-related distribution will be included ratably over the three-year period beginning with 2020.

**Observation:** Although a repayment contribution can be made at any time for three years after the distribution, the income inclusion begins in the year of the distribution. It is unclear whether the employee will have to elect in 2020 whether a re contribution will be made in the future, and if so, what happens if the employee does not make some or all of that contribution.

**Loans from qualified plans**

The CARES Act increases the limit on plan loans to the lesser of (i) $100,000 (less the excess of the highest outstanding loan balance during 2019 over the current outstanding loan balance) or (ii) the greater of (a) the present value of the employee’s nonforfeitable accrued benefit, or (b) $10,000. The higher limits apply for loans made during the 180 days after the date of enactment.

**Observation:** The Act raised the limits under both tests: the $50,000 limit is now $100,000, and the normal limit of ½ the present value of the employee’s vested benefit is now the entire present value of the vested benefit.

The Act also extends loan repayment dates. For any loans outstanding on or after the date of enactment that had loan repayment dates through December 31, 2020, the due date is delayed for one year. Subsequent repayments will be adjusted to reflect the extension and any interest accruing during the delay. In applying the 5-year loan term, the period of the permitted extension is ignored.

**Plan amendments**

Plans can be retroactively amended to reflect these rules on or before the last day of the first plan year beginning on or after January 1, 2022. The IRS has the authority to further delay this deadline. Plans must be operated in compliance with these rules until they are formally amended.

**Waiver of required minimum distributions from certain plans**

The Act provides that required 2020 minimum distributions, including distributions for a required beginning date in 2020 and distributions for a required beginning date in 2019 that have not yet been made in 2020, are waived for qualified plans under Section 401(a), 403(a) plans, 403(b) plans of tax-exempt employers, 457(b) governmental plans, and IRAs. Plans and annuity contracts can be retroactively amended to reflect these rules on or before the last day of the first plan year.
beginning on or after January 1, 2022. Plans and annuity contracts must be operated in compliance with these rules until they are formally amended.

Other provisions

Employer repayment of student loans
The Act allows employers to provide a student loan repayment benefit to employees on a tax-free basis. An employer may contribute up to $5,250 annually toward an employee’s student loans. The payment may be made to the employee or the lender and may include principal and interest. The $5,250 cap applies both to student loan repayments and existing educational assistance under Section 127. The provision applies to such student loan payments made after the date of enactment and before January 1, 2021.

Limits on executive compensation for recipients of emergency loans (sec. 4004)
The CARES Act provides for federal loans or loan guarantees to airlines and other businesses. If a business accepts a loan, it must agree that for the period of the loan plus one year, no officer or employee of the business whose total compensation exceeded $425,000 in calendar year 2019 will receive compensation in excess of his or her 2019 compensation during any 12 consecutive months of the two-year period. Further, no such officer or employee can receive severance pay or other benefits upon termination that amount to more than two times the total compensation received by the individual in 2019. Total compensation includes salary, bonuses, stock awards, and other financial benefits. Also, anyone whose total compensation was in excess of $3 million may not receive more than the sum of $3 million plus 50% of the excess over $3 million received in calendar 2019.

Observation: Employees who made between $425,000 and $3,000,000 in 2019 will see their pay capped, while employees making more than $3,000,000 in 2019 will have a pay cut during the loan period.

Health benefits

Coverage of coronavirus vaccines by health plans
Group health plans and health insurance issuers offering group or individual health insurance must cover any qualifying coronavirus preventive service, including vaccines, with no cost-sharing. Coverage must be provided within 15 business days of the date that the vaccine or service is rated either an A or a B by the U.S. Preventive Services Task Force or is recommended for a given individual by the Advisory Committee on Immunization Practices.

Telehealth by HDHPs
Under the Act, a high-deductible health plan can offer telehealth and other remote care services with no deductible from the date of enactment through the end of the plan year beginning on or before December 31, 2021.

Coverage of menstrual care products
Under the Act, menstrual care products can be covered and paid for out of health savings accounts (HSAs), flexible spending arrangements, health reimbursement accounts, and Archer MSAs. This change is for expenses incurred after December 31, 2019.

The takeaway
The CARES Act provides important tax credits and other liquidity to employers and employees. Employers should carefully consider the opportunities provided under the Act.
Let’s talk

For a deeper discussion of how this issue might affect your business, please contact:

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