Proskauer

Covid-19: Tax Considerations for REITs

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This blog post summarizes some of the tax considerations for REITs that have arisen in light of COVID-19, the resulting economic downturn, the Coronavirus Aid, Relief, and Economic Securities ("CARES") Act, and the Families First Coronavirus Response Act (the "FFCRA").

Modifications of Leases

A REIT may need to modify leases or defer rent payments for a third-party tenant that is unable to meet its rent obligations. Generally, as long as a lease is not treated as a debt instrument for U.S. federal income tax purposes, modifications of the lease should not give rise to a taxable event. However, if the legal rights and obligations that are altered under the lease and the degree to which they are altered are "economically substantial," the lease will need to be re-tested to determine whether it is a section 467 lease.[1] A section 467 lease generally is a lease (i) with respect to which the total amount of payments that the lessor receives for use of the leased property is greater than $250,000, and (ii) that has increasing, decreasing, prepaid, or deferred rents. If a modification to the lease does result in a REIT holding a section 467 lease, it could affect the character and timing of the REIT's income recognition, which could in turn impact a REIT's ability to meet its required income and distribution requirements.

A REIT may also be limited from certain lease modifications or solutions to insolvent tenants that may be available to other landlords. A REIT is prohibited from taking a 10% or greater ownership interest in the tenant or from entering into a lease where the rent is partially or wholly based on net income or profits of the tenant.

Costs incurred by a REIT in modifying a lease generally must be capitalized and added to any unrecovered amount due under the initial lease and amortized over the resulting term of the modified lease.[2] If a REIT receives a payment by a tenant in exchange for modifying or cancelling a lease, that payment generally will be treated as a payment for rent, and should qualify for purposes of the REIT's 75% and 95% income tests.[3]

A REIT that allows a tenant to defer paying rent will continue to accrue and recognize that rental income, and therefore will have to take that income into account for the 90% dividend distribution requirement, even though the REIT has not received a corresponding cash payment. There are several options available to REITs to address this mismatch, discussed below.

Consent Dividends for Private REITs

In order for a REIT to maintain its favorable U.S. federal income tax treatment, it must distribute at least 90% of its REIT taxable income on an annual basis in the form of qualifying dividends.

A private REIT wishing to minimize cash outlays may seek shareholder consent to pay "consent dividends," which qualify for purposes of the 90% dividend distribution requirement. A REIT that makes consent dividends retains the cash it would have paid to stockholders, but the stockholders are treated (and subject to tax, including withholding) as if the dividend were paid. In order to qualify for the 90% dividend distribution requirement, the "dividend" generally must meet the requirements that otherwise apply to dividends, including that the "dividend" be treated as paid pro-rata with respect to all shares of the same class of stock and treated as paid in accordance with the preferences between different classes of stock.

In order to make a consent dividend, the REIT must obtain shareholder approval from all common stock shareholders that hold "consent stock"[4] on the last day of the taxable year of the REIT on IRS Form 972 *Consent of Shareholder to Include Specific Amount in Gross Income*, and must file all IRS Forms 972 collected from the shareholders together with an IRS Form 973, *Corporation Claim for Deduction for Consent Dividends*, with its IRS Form 1120- REIT for the taxable year the deduction for the consent dividends is claimed.

Distributions of Stock for Publicly-Offered REITs

As mentioned above, in order for a REIT to maintain its favorable U.S. federal income tax treatment, it must distribute at least 90% of its REIT taxable income on an annual basis in the form of qualifying dividends.

Generally, a publicly-offered REIT may pay up to 80% of a required dividend in stock and still have the entire distribution qualify for purposes of the 90% dividend distribution requirement.[5] On May 4, 2020, the IRS issued Revenue Procedure 2020-19, which increases the amount of the distribution that may be paid in stock to 90% for distributions declared by a publicly-offered REIT on or after April 1, 2020, and on or before December 31, 2020.[6]

Year-End and Subsequent Year Dividends 90% for distributions declared by a publicly-offered REIT on or after April 1, 2020, and on or before December 31, 2020

To ease short-term cash flow issues, a REIT may choose to make a "spill-over" dividend, pursuant to which the REIT would postpone a dividend to shareholders on record in the fourth quarter of the taxable year to as late as January 31 of the following taxable year, and the dividend will be treated as having been paid in the prior taxable year.[7] No excise tax is imposed on a REIT that makes a spill-over dividend.

A REIT may also make an election to credit to the current taxable year a dividend paid in a future taxable year to the extent of the REIT's earnings and profits in the current taxable year. Thus, a REIT with earnings and profits in 2019, but that failed to pay a dividend in 2019 would normally have until April 15 (for a calendar year REIT), but now has until July 15, to pay the 2019 dividend. Likewise, a calendar-year REIT that will have insufficient cash flow in 2020 to pay a dividend could avoid paying a dividend until April 15, 2021, and so long as the REIT actually pays the dividend within 12 months from the end of the REIT's taxable year (December 31 for a calendar year REIT), the REIT would retain its REIT status. REIT shareholders will not include the dividend in income until it is actually received. However, these distributions generally do not qualify as current year distributions for purposes of computing the 4% REIT excise tax, and a REIT that defers paying dividends in 2020 may have an excise tax liability in 2020.

Raising Additional Funds through Debt

A REIT that needs additional cash for operational expenses or in order to make dividends to meet its 90% dividend distribution requirement may consider borrowing those funds. Several options are discussed below.

Amending existing credit facilities; forbearance

A REIT may amend its existing credit facilities to defer payments. However, if the amendment constitutes a "significant modification," the REIT may recognize "cancellation of indebtedness" income. A significant modification is an alternation that either, based on all facts and circumstances, alters the legal rights or obligations of a debt instrument to a degree that is economically significant, or that falls into other specified categories of changes under Treasury Regulation section 1.1001-3.[8] The Treasury Regulation also outlines certain safe harbors for alterations that will not be treated as significant modifications. This includes a safe harbor for forbearance of debt collection for a period of two years (or less), as well as any additional period during which the parties conduct good faith negotiations or during which the issuer is in a title 11 bankruptcy or similar case.[9]

A REIT that holds multifamily properties with a federally backed mortgage loan may be able to take advantage of provisions under the CARES Act that require servicers of those loans to grant forbearance on collection. An eligible borrower must have been current with its payment through February 1, 2020 and must request relief affirming that the borrower is experiencing a hardship as a result of the COVID-19 situation.

The CARES Act includes a loan forgiveness program under the PPP. Any cancellation of debt income under the PPP is tax-free (i.e., excluded from income), and does not result in a loss of tax attributes. However, the IRS has held that a borrower whose loan is forgiven may not deduct the expenses that relate to the forgiven amount (i.e., the eight weeks of wages, employee benefits, interest, rent, and utilities that determined the forgiven amount).[10] Senator Chuck Grassley (R., Iowa), the Chair of the Senate Finance Committee, has said that the IRS misconstrued Congressional intent, and Representative Richard Neal (D., Mass), the Chair of the House Ways and Means Committee, has indicated that he intends to reverse the IRS guidance and allow the deductions. An employer that receives a PPP loan is not eligible for the social security tax deferral once it receives notice from a lender that the loan is forgiven. However, the employer may continue to defer any payroll tax that it deferred prior to the loan forgiveness in accordance with the CARES act rules.

New NOL Carrybacks are not Available to REITs

The CARES Act allows a corporation's losses from 2018, 2019, and 2020 to be carried back for five years, and allows corporate NOLs to fully reduce taxable income (rather than only 80% of taxable income under current law). A REIT is not permitted to carry back losses (but a TRS can). These provisions temporarily reverse certain changes made by the TCJA. However, the CARES Act effectively prevents the use of NOL carrybacks to offset income includible under section 965 (the deemed repatriation provision enacted in the TCJA). The CARES Act allows corporate taxpayers that may be able to carryback losses a 120-day period to make certain important elections, including the election to forego the carryback.

Interest Deduction Limitation and Property Depreciation

Section 163(j), as originally enacted, limits the interest deduction for certain business interest expenses to 30% of adjusted taxable income. The CARES Act increased the deduction limitation from 30% of adjusted taxable income to 50% for years 2019 and 2020. Under the relevant Treasury Regulation, a REIT generally was able to make a (previously irrevocable) election out of section 163(j). Most REITs chose to make such an election, under which they are not subject to the business interest expense limit. However, taxpayers making this election must use the "alternative depreciation system" to depreciate any non-residential real property, residential real property, and qualified improvement property rather than the "general modified accelerated cost recovery system".[11] If a REIT has elected out of section 163(j), its TRS may still be eligible for these benefits.

A taxpayer that previously made an "irrevocable" election out of section 163(j) may be able to withdraw that election by including with its timely filed amended federal tax return a formal election statement stating that it is withdrawing its previously made election with respect to section 163(j).[12] Now that qualified improvement property is eligible for bonus depreciation, including on a retroactive basis as described below under "Immediate Expensing of Costs Associated With Improving Qualified Improvement Property", and the section 163(j) limitation has been increased to 50% of adjusted taxable income for 2019 and 2020, a REIT may want to reconsider the costs and benefits of electing out of section 163(j). Finally, a taxpayer may make a late election under section 163(j)(7) to be treated as an electing real property for taxable years 2018, 2019 and 2020 by filing a formal statement with the taxpayer's amended return in accordance with proposed Treasury Regulation section 1.163(j)-9.

Immediate Expensing of Costs Associated With Improving Qualified Improvement Property

The CARES Act corrects an error in the TCJA that prevented businesses from expensing certain costs for improvements to "qualified improvement property," and required the costs to be depreciated over the 39-year life of the building. Qualified improvement property is any improvement to the interior of a nonresidential building that is placed in service after the building is first placed in service. Qualified improvement property does not include improvements that are attributable to the enlargement of the building, elevators or escalators, or the internal structural framework of the building. The change is retroactive to the date of enactment of the TCJA.

An eligible taxpayer may apply for retroactive bonus depreciation for qualified improvement property placed into service after December 31, 2017.[13] (However, a taxpayer that has elected out of section 163(j), or that has revoked such an election, is ineligible). To obtain retroactive relief, the taxpayer must file for an automatic change in accounting method on IRS Form 3115 with the succeeding year's return, under the automatic method change rules. If a taxpayer has only filed one "incorrect" year, it may instead file an amended return. Alternatively, if a taxpayer placed qualified service property into place in 2019 and has already filed a 2019 calendar-year tax return, the taxpayer has until July 15, 2019 to file a superseded return to claim the bonus depreciation.

A taxpayer that elected out of the 163(j) limitation may claim bonus depreciation on personal property and depreciate its qualified improvement property placed in service after December 31, 2017 over a shortened (20-year) recovery period.

50% Employee Retention Credit for Employers Closed Due to Covid-19

A management company of a REIT, a self-managed REIT, or a TRS may be able to benefit from a refundable payroll tax credit equal to 50% of certain "qualified wages" (including certain health plan expenses) paid to its employees beginning March 13, 2020 through December 31, 2020 if the employer is engaged in a trade or business in 2020 and the wages are paid (i) while operation of that trade or business is fully or partially suspended due to a governmental order related to COVID-19 or (ii) during the period beginning in the first quarter in which gross receipts for that trade or business are less than 50% of gross receipts for the same calendar quarter of 2019 and ending at the end of the first subsequent quarter in which gross receipts are more than 80% for the same calendar quarter of 2019. The employee retention credit can be used to offset all federal payroll taxes, including federal withholding tax, and the employer's and employee's share of Social Security tax and Medicare, but not the federal unemployment tax ("FUTA").

The operation of an employer's trade or business is "partially suspended" due to a governmental order related to COVID-19 if the employer is able to "continue some, but not all of its typical operations" as a result of the governmental order.[14] If an employer's workplace is closed by a governmental order for certain purposes, but the employer's workplace remains open for other purposes or the employer is able to continue certain operations remotely, the employer's operations are considered to be partially suspended.[15] Thus, even a business providing essential services, such as an oil and gas company, is eligible for the credit if it can demonstrate that some portion of its typical operations have been suspended due to a COVID-19-related governmental order.[16] However, an essential business is not considered to be fully or partially suspended if a governmental order causes its customers to stay at home or the government order applies only to non-essential businesses, even though the governmental order may have an effect on the employer's operations.[17] An employer that operates a trade or business in multiple locations and is subject to state and local governmental orders limiting operations in some, but not all, jurisdictions is considered to have a partial suspension of its operations.[18] It is less clear that an employer's operations are partially suspended if it continues to provide all services to all customers, but is unable to generate the same level of new business.

For employers with more than 100 full-time employees, the CARES Act provides that the credit is available only with respect to wages paid to an employee who is not providing services due to the circumstances described in (i) or (ii) above. Thus, if an employee is being paid wages for a reason unrelated to the circumstances described in (i) or (ii) above (like paternity or maternity leave), the credit is unavailable. However, if an employee is unable to fully work due to one of the circumstances described in (i) or (ii) above, the credit is available for the portion of the employee's time that the employee is not working.[19] Accordingly, if an employee is working 25% of a pay period, wages eligible for the credit include the wages paid to employee for 75% of the period during which the employee is not providing services due to the circumstances described in (i) or (ii) above.

All persons treated as a single employer under section 52(a)[20] or (b) or section 414(m) or (o) are treated as one employer for all purposes of the credit, including for purposes of determining whether they exceed the 100 full-time employee threshold. First, companies related through greater than 50% ownership (by vote or value) are treated as one employer for purposes of the 100 full-time employee threshold. Second, chains of organizations (whether or not incorporated) conducting trades or businesses may be treated as one employer if they are common control. The test for common control depends on the types of organizations in the chain of ownership, but generally requires that corporations be connected through ownership of greater than 50% of the vote or value of each corporation and partnerships be connected through ownership of more than 50% of profits or capital. In *Sun Capital Partners III, LP v. New England Teamsters & Trucking Industry Pension Fund*, 724 F.3d 129 (1st. Cir. 2013), the First District Court of Appeals held that a private equity fund would typically be treated as conducting a trade or business for purposes of a control test under section 414 that is similar to the rule in section 52(b) unless the fund can establish that its investment is truly passive, which is a high bar. Therefore, under the court's holding, two corporations more than 50% of the vote or value of each of which is owned by a private equity fund would be treated as a single employer for purposes of the 100 full-time employee rule. In *Sun Capital*, the court treated parallel funds as one entity for tax purposes where the funds were run by the same sponsor, shared a single general partner, and invested nearly identically.[21] Therefore, under *Sun Capital*, if two parallel funds each own 50% or less of two corporations, but the funds in the aggregate own more than 50% of each corporation, both corporations would be treated as a single employer. However, under a second *Sun Capital* case, where a single sponsor managed two funds that did not invest in parallel, the holdings of the two funds were not aggregated.[22] Finally, section 414(m) contains special rules for "affiliated service groups".

The credit is capped at $5,000 (50% of $10,000 qualified wages) per employee for all calendar quarters. Section 501(c) tax-exempt organizations are eligible for the credit, but governmental entities and companies receiving loans under the CARES Act as part of the Small Business Administration's Paycheck Protection Program (the "PPP") are not. If a company receives a PPP loan, all other persons that are treated as one employer with that company under the rules described above are ineligible for the credit.

Sick and Family Leave Credits

The FFCRA imposes obligations on private employers and nonprofit organizations with fewer than 500 employees to provide paid leave to employees that are unable to work for certain reasons related to COVID-19.

Paid Sick Leave. Under the Emergency Paid Sick Leave Act (the "EPSLA"), an employer must pay an employee who is unable to work due to certain quarantine measures or sickness related to COVID-19[23] his or her full regular wage (up to $511 per day or $5,110 total) for sick leave of up to 10 days (up to 80 hours). The EPSLA also requires an employer to pay an employee who is unable to work due to a COVID-19 circumstance related to care of others[24] two-thirds of his or her regular wage (up to $200 per day or $2,000 total) for sick leave of up to 10 days (up to 80 hours).[25]

Paid Family Leave. In addition to the paid sick leave under the EPSLA, an employer is also required under the Emergency Family and Medical Leave Expansion Act to pay an employee two-thirds of his or her regular wage (up to $200 per day and $10,000 total) for family leave of up to 10 weeks if the employee is unable to work (or telework) because of a need to care for a child whose school or place of care is closed or whose child care provider is unavailable due to COVID-19.[26]

Refundable Credit for Paid Sick and Family Leave. An employer subject to these requirements is entitled to a refundable tax credit equal to (i) the wages ("qualified leave wages") for paid sick and family leave described above that is taken between April 1, 2020 and December 31, 2020 and (ii) the employer's share of Medicare tax imposed on those wages and its allocable cost of maintaining health insurance coverage for the employee during the leave period ("qualified health plan expenses"), even if the payments of the wages are made after this period. The employer is not subject to the employer portion of Social Security tax imposed on those wages.

An employer may use the paid sick and family leave credits under the FFCRA to offset all federal employment taxes (including federal withholding tax, and the employer's and the employee's share of Social Security and Medicare taxes), but not federal unemployment (FUTA).[27]

The credits are not available for an employer receiving a credit for paid family and medical leave under the 2017 Tax Cut and Jobs Act (the "TCJA"). An employer may receive both the tax credits for qualified leave wages under the FFCRA and the employee retention credit under the CARES Act, but not for the same wage payments.

Companies receiving loans under the Small Business Administration's Paycheck Protection Program (the "PPP") are eligible for the tax credits under the FFCRA.

More information about the COVID-19-related tax credits available to employers under the FFCRA, including how to obtain the credits, is available here.

Filing and Payment Extensions

First and Second Quarter Estimated Tax Payments; Other Extensions.

The Treasury and the IRS extended the due dates for the first estimated tax payments and the April 15 filing date to July 15, 2020. Notice 2020-23 applies this extension to a variety of taxpayer deadlines and due dates for filings and other time-sensitive actions that fall between April 1, 2020 and July 15, 2020, including IRS Form 1120-REIT. Although Notice 2020-23 extends the due date for self-employed individuals required to make second quarter estimated tax payments, it does not do so for employers required to deposit second quarter estimated tax payments for payroll taxes.

Like-Kind Exchanges.

If the last day of either the 45-day period to identify replacement property for a section 1031 like-kind exchange or the 180-day period to close on replacement property falls on or after April 1, 2020 and before July 15, 2020, then the applicable period is extended to at least July 15, 2020. Although Notice 2020-23 references Revenue Procedure 2018-58, which extends these periods to the later of (i) 120 days or (ii) the last date of the extension period for a federally declared disaster (i.e., July 15, 2020 for the COVID-19 emergency), it is not clear that Notice 2020-23 extends the time period beyond July 15, 2020.

Deferral of Social Security Payments

The CARES Act permits employers and self-employed individuals to delay payment of the 6.2% employer share of the social security tax (but not the employer's share of FUTA or the 1.45% employer share of the Medicare tax) from the date of enactment through the end of 2020. The tax is payable over the following two years with half due by December 31, 2021 and the other half by December 31, 2022. These provisions are available to everyone, regardless of income. An employer that receives a PPP loan is not eligible for the social security tax deferral once it receives notice from a lender that the loan is forgiven. However, the employer may continue to defer any social security tax that it deferred prior to the loan forgiveness in accordance with the rules described above.[28]

[1] Treas. Reg. section 1.467-1.

[2] *See* Treas. Reg. section 1.263(a)-4(d)(6)(vii); Rev. Rul. 73-176.

[3] *See* Treas. Reg. section 1.61-8(b).

[4] Consent stock is a class of stock that is "entitled, after the payment of preferred dividends, to a share in the distribution (other than in complete or partial liquidation) within the taxable year of all the remaining earnings and profits, which share constitutes the same proportion of such distribution regardless of the amount of such distribution." Section 561(f)(1).

[5] Rev. Proc. 2017-45. In order for a dividend paid partially in stock of the REIT to qualify in its entirety for purposes of the 90% dividend distribution requirement, it must be payable at the election of each shareholder in cash or stock (or a combination of the two), but may have a "cash cap" that limits the total amount of cash paid to not less than 20% (10% for distributions declared on or after April 1, 2020, and on or before December 31, 2020) of the entire distribution. If shareholders in the aggregate elect to receive an amount of cash greater than the REIT's cash cap, then each shareholder who elected to receive cash receives a pro rata share of the cash and the rest of their distribution in stock of the REIT. The value of the portion of the distribution made in stock will be equal to the amount of cash for which the stock is substituted. As a matter of practice, a REIT may set the default position for a shareholder that fails to make a timely election. Generally, a REIT relying on Rev. Proc. 2017-45 to limit the amount of cash it distributes would want to set the default distribution to be in 20% cash and 80% common stock (10% cash and 90% common stock for distributions declared on or after April 1, 2020, and on or before December 31, 2020) of the REIT, to minimize its cash outlay. A publicly offered REIT is one that is required to file annual and periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

[6] Rev. Proc. 2020-19.

[7] Section 857(b)(9).

[8] Specific types of changes that will deem an alternation of a debt instrument to be a significant modification includes certain changes in the: yield, timing of payments, obligor or security, nature of the debt instrument, and accounting or financial covenants. *See* Treas. Reg.

[9] Treas. Reg. section 1.1001-3(c)(4)(ii).

[10] Notice 2020-32.

[11] *See* section 168.

[12] Rev. Proc. 2020-22.

[13] Rev. Proc. 2020-25.

[14] "3. When is the operation of a trade or business partially suspended for the purposes of the Employee Retention Credit?", FAQs. The Joint Committee on Taxation (the "JCT") has indicated that a restaurant in a state under a statewide order that restaurants offer only take-out services or a concert venue in a state under a statewide order limiting gatherings to no more than 10 people would meet the governmental order test. An accounting firm that is subject to a countywide directive from public health authorities to cease all activities other than minimum basic operations and that closes its offices and does not require employees who cannot work from home (*e.g.*, custodial employees, mail room employees) to work also meets this test. Joint. Comm. Tax'n, Description of the Tax Provisions of Public Law 116-136, The Coronavirus Aid, Relief, and Economic Security ("CARES") Act at 38 (Apr. 22, 2020), https://www.jct.gov/publications.html?func=startdown&id=5256 (the "JCT Report").

[15] For example, a restaurant business is considered to be partially suspended if it must close its restaurant locations to in-room dining due to a governmental order closing all restaurants for sit-down service, but is allowed to continue food or beverage sales to the public on a carry-out, drive-through, or delivery basis. "34. If a governmental order requires an employer to close its workplace for certain purposes, but the workplace may remain operational for limited purposes, is the employer considered to have a suspension of operations?", FAQs. However, a software company is not considered to be partially suspended if it closes its office in accordance with a citywide order closing all non-essential businesses, but is able to continue operations comparable to its operations prior to the closure by having its employees work remotely. "33. If a governmental order requires an employer to close its workplace, but the employer is able to continue operations comparable to its operations prior to the closure by requiring employees to telework, is the employer considered to have a suspension of operations?", FAQs.

[16] An essential business may be considered to be partially suspended if the business's suppliers are unable to make deliveries of critical goods or materials due to a governmental order that causes the supplier to suspend its operations. "31. If a governmental order causes the suppliers to an essential business to suspend their operations, is the essential business considered to have a suspension of operations?", FAQs.

[17] “30. If a governmental order requires non-essential businesses to suspend operations but allows essential businesses to continue operations, is the essential business considered to have a full or partial suspension of operations?” and “32. If a governmental order causes the customers of an essential business to stay at home is the essential business considered to have a suspension of operations?”, FAQs. The JCT report includes an example of a grocery store in a state that generally imposes limitations on food service, gathering size, and travel outside the home but exempts grocery stores (and travel to and from grocery stores) from any COVID-19 related restrictions because they are “essential businesses” that are excepted from restrictions, and provides that the grocery store would not meet the governmental order test. However, slight variations in the example might lead to different conclusions. For example, if the grocery store in the example also were to normally operate a sit-down restaurant (without delivery service), it appears that the restaurant’s closure as a result of a governmental order would qualify as a partial suspension of the operation of the store’s trade or business, and therefore the store would be eligible for the credit, and if the store had more than 100 employees, would be eligible for the credit only with respect to wages paid to the restaurant employees who were unable to work because of the order.

[18] “33. If a governmental order requires an employer to close its workplace, but the employer is able to continue operations comparable to its operations prior to the closure by requiring employees to telework, is the employer considered to have a suspension of operations?”, FAQs.

[19] *See* "48. What is the definition of 'qualified wages'?" and "52. May an Eligible Employer that averaged more than 100 full-time employees during 2019 treat all wages paid to employees as qualified wages?", FAQs (providing an example in which an employer with more than 100 full-time employees that is forced to suspend its operations at the end of the first calendar quarter of 2020 is eligible for the credit with respect to wages paid to employees who stopped working during the portion of the quarter when the business is suspended); JCT Report, *supra* note 2 at 39-40 (providing two examples that make clear that an employer is entitled to credits for wages paid to employees for the portion of their time that they were unable to work); "CARES Act: Employee Retention Credit FAQ", United States Senate Committee on Finance (Mar. 31, 2020), https://www.finance.senate.gov/chairmans-news/cares-act-employee-retention-credit-faq. ("[i]f an employee is performing services on a reduced schedule, wages paid to the employee are only treated as qualified wages if they exceed what the employee would have otherwise been paid for the services performed. In that case, employers will receive a credit for the difference between the total wages paid to the employee and the amount the employer would have paid for the reduced hours or services actually provided by the employee."). Policy reasons support this interpretation. If the statute imposed a cliff effect, employers would be discouraged from having employees perform any services so as to benefit from tax credits. This interpretation enables an employer to use employees as necessary for its business operations (and relieves the government of providing tax credits with respect to that use), without penalizing the employer by denying credits for qualified wages paid to the employee during the period he or she was not providing services.

[20] All section references are to the U.S. Internal Revenue Code or the Treasury regulations promulgated thereunder, unless otherwise specified.

[21] One of the funds at issue in the *Sun Capital* case was actually comprised of two parallel funds, which the court treated as a single entity. *See* footnote 3 of *Sun Capital Partners III*, 724 F.3d at 133 n.3; *Sun Capital Partners III, LP v. New England Teamsters & Trucking Industry Pension Fund*, 943 F.3d 49, 52 n.1 (1st. Cir. 2019).

[22] *Sun Capital Partners III, LP v. New England Teamsters & Trucking Industry Pension Fund*, 943 F.3d 49 (1st. Cir. 2019).

[23] Those circumstances are: the employee is under a federal, state, or local quarantine or isolation order related to COVID-19; the employee has been advised by a health care provider to self-quarantine due to concerns related to COVID-19; and the employee is experiencing symptoms of COVID-19 and seeking a medical diagnosis.

[24] Those circumstances are: the employee is caring for an individual who is subject to a federal, state, or local quarantine or isolation order related to COVID-19, or has been advised by a health care provider to self-quarantine due to concerns related to COVID-19; the employee is caring for the child of such employee if the school or place of care of the child has been closed, or the child care provider of such child is unavailable, due to COVID–19 precautions; and the employee is experiencing any other substantially similar condition specified by the U.S. Department of Health and Human Services.

[25] Regulations issued by the U.S. Department of Labor provide that, for purposes of the FFCRA, a quarantine or isolation order includes quarantine, isolation, containment, shelter-in-place, or stay-at-home orders issued by any federal, state, or local government authority, such as the stay-at-home order in effect in California or the "On PAUSE" executive order in effect in New York, that cause the employee to be unable to work even though his or her employer has work that the employee could perform but for the order. However, the Regulations provide that an employee subject to one of these orders may not take paid sick leave where the employer does not have work for the employee. This is because the employee would be unable to work even if he or she were not required to comply with the quarantine or isolation order.

[26] An employer is required to provide this paid family leave only after an employee has been unable to work or telework for 80 hours for these reasons. Wages for the first 80 hours may be covered by the requirements under the EPSLA if the employee so elects.

[27] Instructions to IRS Form 7200, *Advance Payment of Employer Credits Due to COVID-19.*

[28] IRS News Release, "Deferral of employment tax deposits and payments through December 31, 2020," (Apr. 16, 2020). The IRS also confirmed that relief from penalties for failure to deposit and pay the employer's share of social security taxes is in addition to penalty relief under Notice 2020-22, which provides relief from penalties for failure to deposit employment taxes, including taxes withheld from employees, in anticipation of paid leave credits under the FFCRA and the employee retention credit under the CARES Act. For more details on these credits, please see our prior posts, here and here.

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