

DELIVERED VIA EMAIL

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Ms. Carol Weiser
Benefits Tax Counsel
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Ms. Victoria Judson
Associate Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Form 941, Schedule R (Form 941), and Instructions

On behalf of the National Association of Professional Employer Organizations (NAPEO), this letter addresses certain questions and concerns regarding the recently revised Form 941 (April 2020) and Schedule R (June 2020), and the recently released instructions for each form. NAPEO continues to appreciate the tremendous efforts of the Treasury Department and Internal Revenue Service (IRS) in providing expedited guidance regarding the implementation of the FFCRA paid leave tax credits and the CARES Act employee retention credit and employment tax deferral, particularly with respect to professional employer organizations (PEOs) (including both certified PEOs (CPEOs) and non-certified PEOs)¹ and their client employers.

REQUEST FOR AUTOMATIC DELAY OF JULY 31 DEADLINE FOR Q2 2020 REPORTING

In this letter, we focus on a number of more technical questions and challenges that NAPEO's members have identified with respect to the recently revised Form 941 and Schedule R (Form 941), and the interaction of new Form 7200 with Form 941 and Schedule R. But we also reiterate NAPEO's previous requests for a delay in the July 31 filing deadline with respect to the Form 941 and Schedule R for the second quarter of 2020 (at a minimum). Although we believe that many of the issues addressed in this letter can be addressed through further guidance, the complexity of these issues and the myriad new requirements also serve to provide further support and evidence that NAPEO's previously requested delay of the July 31 filing deadline for Form 941 (and accompanying schedules) will be necessary.

Issue: Since the enactment of the FFCRA and CARES Act, NAPEO members have anticipated the likely need for a delay in their federal employment tax reporting requirements with respect to the second quarter of 2020. The need for a delay has only become more apparent as additional complexities related to the new tax credits and tax deferral option have been identified, and new processes affecting PEOs' reporting requirements, such as the Form 7200 process to request an advance credit, have been introduced. In addition, it has understandably taken time for the IRS to design and develop a revised Form 941 and Schedule R, but that has only further reduced the time that PEOs have had to prepare for the fast-approaching July 31 deadline.

As noted previously by NAPEO, PEOs were forced to quickly make decisions regarding how to program their systems to administer the newly enacted tax relief for eligible employers without the benefit of

¹ Unless specified otherwise, use of the term "PEO" in this letter generally refers to both CPEOs and non-certified PEOs.

any immediate guidance from the IRS. As the IRS eventually released revised draft forms, many PEOs realized that they would need to alter initial decisions and adjust their systems to accommodate the reporting approach taken by the IRS. And each time additional guidance is provided or instructions are updated, such as the recent clarification regarding the “reclassification” of prior deposits with respect to the deferral of Social Security taxes, PEOs need more time to determine whether further changes are necessary (and even more time to make those changes, if applicable). The issues discussed within this letter represent only a sampling of the challenges and questions that PEOs have encountered in their efforts with respect to Q2 reporting.

PEOs are working diligently to understand the new reporting requirements and prepare for the new and expanded filing requirements. But NAEPO continues to hear repeatedly from its members that the complexity and difficulty of programming their software and systems to account for the FFCRA and CARES Act provisions is extreme. The fast pace at which procedural and systems changes are being made has also made the auditing process much more critical – and time consuming – and these internal audits often reveal the need for further changes or refinements.

Guidance Requested: In light of the above, we continue to urge the IRS to issue guidance providing the following:

- An automatic extension of the July 31 filing deadline for Form 941 (and accompanying schedules) with respect to the second quarter of 2020. *As noted below, this is also important with respect to addressing the challenges of a July 31 deadline for clients to file Form 7200.*
- That the IRS will liberally grant extension requests with respect to Q3 2020 filings for those taxpayers that show cause due to systems and programming challenges. *As noted below, this may also be necessary for any quarter with respect to which clients are permitted to file Forms 7200 up until the regular filing deadline for Form 941.*

In addition, we urge the IRS to work with PEOs that make a good faith effort to satisfy the new Form 941 filing requirements; be flexible in permitting reasonable interpretations of the reporting requirements to the extent possible; and allow PEOs sufficient time to make corrections as necessary and without penalty.

We believe that the sheer volume of changes affecting federal employment taxes in recent months in connection with COVID-19 relief legislation supports the provision of a blanket extension of the July 31 deadline, especially for taxpayers required to file Schedule R (Form 941). Providing an extension will assuredly reduce the need for subsequent Form 941 corrections and give employers much-needed time to continue working toward the goal of being able to submit complete and accurate employment tax returns.

FORM 941 AND SCHEDULE R

1. FFCRA Credits and Employer Liability for OASDI when Wage Base Exceeded

Background: The FFCRA provides that wages required to be paid for qualified sick and family leave are not considered wages for purposes of determining the employer’s share of Social Security taxes. To reflect this provision, the revised Form 941 includes new lines 5a(i) and 5a(ii) for qualified sick leave wages and qualified family leave wages, respectively, which are multiplied by 6.2% (rather than 12.4%), to reflect the fact that such wages are only subject to the employee’s share of Social Security taxes.

The Instructions for Form 941 (dated June 3, 2020) indicate that any amounts entered in lines 5a(i) or 5a(ii) should be factored into determining when the Social Security wage base limit has been met. For example, the instructions for line 5a state, “Stop paying social security tax on and entering an employee’s taxable wages on line 5a when the employee’s taxable wages, including qualified sick leave wages, qualified family leave wages, and tips, reach \$137,700 for the year.”

Issue: Under the approach described above, it appears to us that an employer’s annual Social Security tax liability with respect to a particular employee could vary depending on the timing of when the wage base is exceeded relative to when any qualified sick or family leave wages are paid. For example, it appears that an employer would have a greater Social Security tax liability if wages paid to that employee met or exceeded the wage base in a calendar quarter prior to a quarter in which the employer paid qualified sick or family leave wages ($\$137,700 \times 6.2\% \text{ employer share} = \$8,537.40$), as compared to an employee who was paid \$10,000 in qualified leave wages in a quarter prior to that in which the wage base was met ($(\$137,700 - \$10,000) \times 6.2\% = \$7,917.40$).

Question: If the revised Form 941 could indeed result in disparate employer Social Security tax liability for employers with respect to employees who both receive wages that exceed the wage base and receive qualified sick or family leave wages, was this result intended by the IRS? If not intended, will the IRS provide additional guidance to address this result? Although this question is not specific to PEOs, as with many of the issues discussed in this letter, if the IRS makes any further revisions to the Form 941 or its instructions that will require additional changes to processes and/or systems, PEOs will need time to implement such changes.

Related PEO Concern: In addition to the questions noted above, NAEPO members have emphasized that the administrative challenges stemming from the FFCRA’s exemption of qualified sick and family leave wages from the employer share of Social Security tax have been extraordinary. Not only did many PEOs determine that the FFCRA newly necessitated the tracking of separate wage bases for the employer and employee shares of Social Security tax on wages, but the draft Form 941 instructions unveiled a new method of tracking wage accumulation toward the wage base, as described above. This difference in the treatment of qualified sick and family leave wages as compared to other wages subject to Social Security tax has required systems to be reprogrammed and accruals to be reallocated in order to accommodate this new method of treating an exemption. Although these challenges are not unique to PEOs, the degree of complexity and opportunity for error are heightened, and this serves as just one example of why NAEPO members are very concerned about meeting the July 31 filing deadline.

2. Schedule R Filing Requirement for Non-Certified PEOs

Background: The Instructions for Form 941 (dated June 3, 2020) state, “Other third-party payers that file aggregate Forms 941, such as non-certified PEOs, must complete and file Schedule R (Form 941) if they have clients that are claiming the qualified small business payroll tax credit for increasing research activities, the credit for qualified sick and family leave wages, or the employee retention credit, or clients deferring the employer share of social security tax.” The instructions for Schedule R include a similar statement.

The IRS webpage that describes the small business payroll tax credit for increasing research activities specifies that a non-certified PEO must, in order to claim the credit on behalf of a client, complete and attach Schedule R “listing *those clients* electing to claim the [credit]...” [emphasis added]. Similarly, the IRS FAQs on the CARES Act employee retention credit state with respect to non-certified PEOs, “The PEO does not have to complete Schedule R with respect to employers for which it is not claiming an

Employee Retention Credit.” The IRS FAQs on the FFCRA qualified sick and family leave credits also include a similar statement.

Issue: The instructions for Form 941 and Schedule R are not as clear as the guidance provided on IRS.gov that a non-certified PEO is only required to file Schedule R with respect to those clients for which the PEO is claiming an employee retention credit and/or qualified sick and family leave credits.

Guidance Requested: Final instructions for Form 941 and Schedule R should include a statement that, with respect to the small business payroll tax credit for increasing research activities, employee retention credit, and qualified sick and family leave credits, non-certified PEOs must complete Schedule R only with respect to those clients for which the PEO is claiming such credit(s).

3. Reporting the Funding of Qualified Wages Using a PEO’s Aggregate Employment Tax Liability

Background: As a general matter, each eligible employer may claim the FFCRA paid leave and CARES Act employee retention credits against the applicable employment taxes it pays. To expedite the financial relief provided by the credits to eligible employers, the IRS has provided guidance stating that an eligible employer may reduce its deposit of federal employment taxes to the extent of its anticipated credits. If the anticipated credit amount is not able to be fully funded by accessing such deposits, then the employer may request an advance of the remaining credit amount by filing Form 7200. If necessary, an employer is permitted to file multiple Forms 7200 throughout the quarter.

In comments submitted to the IRS on March 31, 2020, NAEPO noted that, because PEOs are aggregating employment taxes for multiple business clients, PEOs are in a position to quickly and efficiently provide needed relief to clients that are eligible for the credits by funding such credit amounts using the PEO’s aggregate payroll liability. We noted that PEOs choosing to use this approach would also reduce the immediate administrative burden on both the client and IRS that would result from requesting advance payments from the IRS (using the subsequently developed Form 7200).

Issue: Consistent with the intent of the statute, as PEOs began to assist their clients with the new credits immediately following passage of the FFCRA and CARES Act, PEOs were forced to quickly make business, administrative, and programming decisions without the benefit of any guidance from the IRS, including guidance related to how such credits would eventually be reported. These decisions included whether and how a PEO would utilize its aggregate federal employment tax liability to expedite relief to clients that are eligible for the FFCRA and/or CARES Act credits.

Since the IRS released a draft revised Form 941 and Schedule R, PEOs have been working diligently to determine how to correctly report the various approaches that PEOs have taken with respect to the credits. NAEPO members have questioned whether, in the case of a PEO that is providing advance funding of the FFCRA and CARES Act credits to eligible clients using the PEO’s aggregate employment tax liability, IRS systems have been programmed in anticipation of receiving returns that may reflect this approach taken by a PEO. For example, in order to ensure that the PEO’s aggregate tax liability, deposits, and credits (including credit advances) are correctly reflected on Form 941, it may be necessary to enter a “negative” deposit amount with respect to certain clients on Schedule R. In such case, the negative number would represent the amount of advance funding provided by the PEO (using the PEO’s aggregate employment tax liability) instead of the client having to use Form 7200 to obtain an advance payment.

Guidance Requested: The revised Form 941 and Schedule R should be processed in a manner that accepts reasonable reporting methods used by any PEOs that provided advance funding of the FFCRA paid leave and CARES Act employee retention credits to eligible client employers using the PEO's aggregate applicable employment tax liability. If the IRS provides specific instructions regarding how such an approach should be reported by PEOs on the Form 941 and Schedule R, then PEOs should be provided with sufficient time to adjust their systems and/or make any corrections, as necessary, without the imposition of any reporting penalties.

INTERPLAY OF FORM 7200 WITH FORM 941 AND SCHEDULE R

NAPEO members have identified the following issues and questions with respect to Form 7200 and its impact on PEOs, including especially the impact on PEO reporting requirements with respect to Form 941 and Schedule R. NAPEO raised a number of these concerns with the IRS in an email provided on May 29, 2020. Those and several additional issues that NAPEO's members have since identified are described below.

1. Appropriate Use of Form 7200 in Various PEO-Client Employer Scenarios

Issue: We appreciate that the Form 7200 process for eligible employers to obtain an advance payment of COVID-19-related credits was likely initially developed with a focus on employers that are not involved in a PEO relationship. Although PEO clients are nevertheless permitted to file Form 7200, there are a number of scenarios in which a client employer's use of Form 7200 is expected to be especially problematic (or unclear) for PEO reporting purposes. For example, these situations include the following:

- ***Workers not covered by PEO contract:*** A client employer files Form 7200 to request an advance payment of credits that the client anticipates qualifying for based on wages that the client paid to certain workers not covered by the contract with its PEO.
- ***PEO relationship begins mid-quarter:***
 - A client employer enters into a PEO relationship mid-quarter, and the client filed Form 7200 earlier in the quarter based on wages the client employer paid prior to contracting with the PEO.
 - A client employer enters into a PEO relationship mid-quarter and anticipates being eligible for an amount of FFCRA or CARES Act credits with respect to wages paid earlier in the quarter, but the client employer did not fully fund the credit amount through reduced deposits and has not (yet) filed a Form 7200.

The instructions for Form 7200 (March 2020) simply instruct clients of CPEOs and non-certified PEOs to provide their PEO with a copy of the Form(s) 7200 that the client files. The instructions do not appear to consider the variety of more complex situations that exist, such as the three situations described above. For example, a PEO should not be required to report information regarding a Form 7200 that was filed by a client employer if the Form 7200 concerns credits based on wages paid to workers that are not covered by the PEO relationship. It is not clear from the instructions, however, that it may be more appropriate in that situation for the client employer to submit Form 7200 under its own EIN, leaving the third-party payer information blank, and *not* providing a copy to the PEO.

Guidance Requested: The IRS should provide additional guidance addressing the implications of and appropriate use of Form 7200 by PEO clients in situations such as those listed above. For example, such guidance should include:

- Clarification that any requirements of a PEO to report or otherwise address Forms 7200 filed by a client employer do not result in the PEO having any additional or new responsibilities (for example, with respect to wages paid outside of or prior to the PEO relationship).
- Specific instructions for client employers to file separate Forms 7200 in different situations as appropriate. For example, if a client seeks advance payment of credits that are based partly on wages paid by a PEO and partly on wages paid directly by the client, then the client should submit separate Forms 7200. The client should only provide the PEO with a copy of the Form 7200 that relates to wages paid by the PEO, and the PEO is only required to incorporate the information on that form as part of the PEO's Form 941/Schedule R.

2. Interaction of Form 7200 and the Form 941/Schedule R Filing Deadlines

Issue: As addressed in our comments submitted May 29, NAPEO members are very concerned with the virtual impossibility of filing complete, accurate, and timely Forms 941 with respect to any quarter in which client employers are permitted to file Form 7200. The near impossibility arises because the instructions for Form 7200 provide that employers may file Form 7200 “at any time before the end of the month following the quarter in which you paid the qualified wages.” Thus, with respect to the second quarter of 2020, the deadline to file *both* Form 941 and Form 7200 is July 31, 2020. Although this may not be problematic for an employer that files its own Form 941, it is very problematic for a PEO. For example, if a client files Form 7200 on July 31, a PEO has essentially no time to include information regarding that Form 7200 on the PEO's Form 941 and Schedule R.

In a related concern, the Instructions for Form 941 (dated June 3, 2020) state in a “Tip” that Forms 7200 filed after the end of the quarter may not be processed prior to the processing of the filed Form 941. In that case, the IRS will “correct the amount reported on line 13f to match the amount of advance payments issued or contact you to reconcile the difference before we finish processing Form 941.” It is unclear how the process outlined in the instructions would operate in the PEO context, and we are concerned that any such reconciliation process will be inordinately complex and burdensome for PEOs. The complexity will only be exacerbated by the fact that some Forms 7200 filed by clients will not be accounted for in the PEO's reporting because a client failed to provide a copy of the Form 7200 to its PEO, or the Form 7200 might relate to wages paid outside the PEO relationship, yet the client entered the PEO's information on Form 7200.

Guidance Requested: We urge the IRS to issue guidance aimed at reducing the instances where the Form 7200 affects the PEO's ability to file correct, accurate, and timely Forms 941/Schedule R. One way to help accomplish this is to separate the filing deadlines for Form 7200 and Form 941 for PEOs. For example, if the Form 7200 deadline for qualified wages paid during the second quarter remains July 31, then the deadline for PEOs to file Form 941 (and accompanying schedules) should be extended to August 31 (at a minimum). Alternatively, client employers could be required to file Form(s) 7200 and provide a copy to their PEO by July 15. (However, as discussed above, NAPEO members continue to overwhelmingly believe that a filing extension for the second quarter is necessary and warranted, even if this particular issue with Form 7200 is ameliorated.)

3. Specific Form Questions

NAPEO members have raised the following questions related to Form 941/Schedule R and Form 7200:

- Part I, line C of Form 7200 requires the employer to enter the amount reported on line 2 of the employer's most recently filed Form 941 or information from a Schedule R filed by a third-party payer. What should a client of a non-certified PEO enter in Part I, line C if the PEO filed an aggregate Form 941 (including wages paid on behalf of the client) but the non-certified PEO was not required to file a Schedule R with respect to the client in the most recent (or any preceding) quarter?
- If an employer that is a client of a PEO files Form 7200, will the Form 7200 appear on the transcript under the client's EIN or the PEO's EIN? We believe that it would appear under the client's EIN but would appreciate confirmation.

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Thank you for your consideration of our comments on the recently revised Form 941 and Schedule R and the instructions thereto, and our related request for a temporary delay in PEOs' quarterly federal employment tax reporting deadlines. Should you have any questions regarding our comments, please contact Thom Stohler, Vice President, Federal Government Affairs at TStohler@napeo.org or (703) 344-4988. As always, we would welcome the opportunity for NAPEO's members with expertise on these reporting issues to discuss our concerns further with you.

Sincerely,



Pat Cleary
President & CEO

Cc:

Helen Morrison (Treasury)
Janine Cook (IRS)
Kathy Stroub (IRS)