Tax Credit Spotlight: Employee Retention Credit and Work Opportunity Tax Credit

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Note

1. This presentation is intended to make participants aware of tax issues that may apply to this audience.

2. Information presented herein is not intended to be tax advice.

3. Please consult with a qualified practitioner for tax advice related to specific transactions.

Agenda

- Employee Retention Credit
- Work Opportunity Tax Credit

Employee Retention Credit

Employee Retention Credit

CARES Act

- Section 2301 of the CARES Act encourages employers to retain employees and maintain salary, despite the economic hardship that may be experienced due to COVID-19, with the Employee Retention Credit (ERC).

- The CARES Act also addresses the Expanded Family Medical Leave and Emergency Paid Sick Leave provisions of the Families First Coronavirus Response Act (FFCRA) that require certain employers to pay sick or family leave wages to employees who are unable to work or telework due to certain circumstances related to COVID-19.

- Today, we will focus on the Employee Retention Credit.

- The IRS has published some guidance on the ERC in the form of FAQs on the IRS website. As of June 29, 2020, there were 94 FAQs regarding the ERC, some of which were updated on June 19, 2020.

Employee Retention Credit

What is the ERC?

- The ERC is a refundable tax credit against certain employment or payroll taxes equal to 50% of the qualified wages an eligible employer pays to employees after March 12, 2020, and before January 1, 2021.

- The ERC is available to employers of any size. The number of employees an employer has does not affect whether it is an Eligible Employer that may claim the credit. It will, however, determine the amount of eligible wages.

- The credit amounts are equal to 50% of qualified wages paid by an Eligible Employer to an employee. The maximum amount of wages eligible for the credit is $10,000 per employee. In other words, the maximum credit amount is $5,000 per employee.

- If the credit for the quarter exceeds the employer's overall social security tax liability, the excess is refunded.

Employee Retention Credit

Eligible Employer

- Eligible Employers that are entitled to claim the ERC are private-sector businesses and tax-exempt organizations that carry on a trade or business during calendar year 2020 and either:
    - Have operations that were **fully or partially suspended** during any calendar quarter in 2020 due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19 (in Ohio this is the stay-at-home order); or
    - Experienced a significant decline in gross receipts during the calendar quarter. This is measured as a 50% decline in gross receipts in a quarter compared to the same quarter in 2019.
- If an employer receives a Small Business Interruption Loan under the Paycheck Protection Program, authorized under the CARES Act, then the employer is ***not*** eligible for the ERC.
- Governmental employers are not Eligible Employers for the ERC.
- Self-employed individuals are not eligible for the ERC for their own self-employment earnings.

Employee Retention Credit

Eligible Employer

- The operation of a trade or business is **partially suspended** if:
    1. An appropriate governmental authority imposes restrictions on the employer's operations;
    2. The orders limit commerce, travel, or group meetings (for commercial, social, religious or other purposes) due to COVID-19; and
    3. The employer can continue some, but not all of its typical operations.

- All three of the above tests must be met.

Employee Retention Credit

Eligible Employer

- Example: Governor of State A issues an order that all non-essential businesses must close from 3/20/2020 until 4/30/2020.

- The order provides a list of non-essential businesses, including gyms, spas, nightclubs, barber shops, hair salons, tattoo parlors, physical therapy offices, waxing salons, fitness centers, bowling alleys, arcades, racetracks, indoor children's play areas, theaters, chiropractors, planetariums, museums, and performing arts centers.

- Employers that provide essential services may remain open.

- The governor's order is a governmental order limiting the operations of non-essential businesses, entitling employers with non-essential businesses to claim the ERC for qualified wages.

Employee Retention Credit

Eligible Employer

- IRS FAQ #30 clarifies that an employer who operates an **essential business** may experience a partial suspension if more than a nominal portion of its operations are suspended by a governmental order. For example, a business that conducts both essential and non-essential operations may be considered to have a partial suspension of operations if an order restricts the non-essential portion of the business, even if the essential portion of the business remains unaffected. Also, an essential business may be considered under a partial suspension if an order requires the business to close for a period of time during normal working hours.

Employee Retention Credit

Eligible Employer

- An employer with an essential business may also be considered to have a full or partial suspension of operations if the business' suppliers are unable to make deliveries of critical goods or materials due to a governmental order that causes the supplier to suspend its operations.

- If the facts and circumstances indicate that the essential business' operations are fully or partially suspended as a result of the inability to obtain critical goods or materials from its suppliers that were required to suspend operations, then the essential business would be considered an Eligible Employer and may be eligible to receive the ERC.

- Alternatively, the employer may be an Eligible Employer if it experiences a significant decline in gross receipts.

Employee Retention Credit

Eligible Employer

- Example: Employer E operates a manufacturing business that is considered an essential trade or business in the jurisdiction where it operates.

- Employer E's supplier of raw materials is required to shut down its operations due to a governmental order.

- Employer E is unable to obtain these raw materials from an alternate supplier.

- Due to the suspension of Employer E's supplier, Employer E is not able to perform its operations.

- Under these facts and circumstances, Employer E would be considered an Eligible Employer because its operations have been suspended as a result of the governmental order that suspended the operations of its supplier.

Employee Retention Credit

Significant Decline in Gross Receipts

- "Gross receipts" for purposes of the ERC for an employer other than a tax-exempt organization has the same meaning as when used under Section 448(c) of the Code. Under the Section 448(c) regulations, receipts include total sales (less returns and allowances) and income from services provided.

- Receipts also include interest, dividends, rents, royalties and sales of assets (reduced by the adjusted basis of such assets).

- Gross receipts are ***not*** reduced by cost of goods sold.

- Gross receipts do not include the repayment of a loan or amounts received with respect to sales tax if the tax is legally imposed on the purchaser of the good or service, and the taxpayer merely collects and remits the sales tax to the taxing authority.

Employee Retention Credit

Significant Decline in Gross Receipts

- The CARES Act does not require that the significant decline in gross receipts be related to COVID-19, but employers should keep records for the relevant calendar quarters in 2019 and 2020 to document the significant decline in gross receipts.

- The records should be available for IRS review for at least four years.

- A significant decline in gross receipts begins with the first quarter in which an employer’s gross receipts for a calendar quarter in 2020 are less than 50% of its gross receipts for the same calendar quarter in 2019.

- The significant decline in gross receipts ends with the first calendar quarter that **follows** the calendar quarter for which the employer’s 2020 gross receipts are greater than 80% of its gross receipts for the same calendar quarter during 2019.

Employee Retention Credit

Significant Decline in Gross Receipts

- Example: Employer Y's gross receipts were $150,000, $285,000, and $345,000 in the first, second, and third calendar quarters of 2020, respectively. Its gross receipts were $315,000, $345,000, and $375,000 in the first, second, and third calendar quarters of 2019, respectively.

- Employer Y's 2020 first, second, and third quarter gross receipts were approximately 48%, 83%, and 92% of its 2019 first, second, and third quarter gross receipts, respectively. Accordingly, Employer Y had a significant decline in gross receipts commencing on the first day of the first calendar quarter of 2020 (the calendar quarter in which gross receipts were less than 50% of the same quarter in 2019) and ending on the first day of the third calendar quarter of 2020 (the quarter following the quarter for which the gross receipts were more than 80% of the same quarter in 2019).

- Employer Y is entitled to an ERC with respect to the first and second calendar quarters.

Employee Retention Credit

Significant Decline in Gross Receipts

- If an Eligible Employer does not determine that it had a significant decline in gross receipts in 2020 until after 1/1/2021, it may still be eligible for the ERC on qualified wages paid in 2020.

- The employer may claim the ERC on qualified wages paid in 2020 if it determines that a significant decline in gross receipts occurred in 2020, even if it does not make the determination until after 1/1/2021.

- In this case, the employer may claim the credit by filing the appropriate form to report adjustments to its employment taxes, typically Form 941-X.

Employee Retention Credit

Eligible Employer

KEY POINT: To be eligible for the ERC, during a calendar quarter in 2020, an employer must satisfy one of the two following scenarios:

- *Scenario 1:* The employer was required to fully or partially suspend operations during any calendar quarter in 2020 due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19; or

- *Scenario 2:* The employer experienced a significant decline in gross receipts during the calendar quarter when compared to the same quarter in 2019.

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Employee Retention Credit

Aggregation Rules

- All members of an aggregated group are treated as a single employer for purposes of the ERC.
- All entities that are treated as a single employer under section 52(a) or (b) of the Internal Revenue Code (the "Code") or section 414(m) or (o) of the Code are considered one employer for purposes of the ERC.
- As a result, these employers must be aggregated for purposes of the following rules applicable to the ERC:
    - Determining whether the employer has a trade or business operation that was fully or partially suspended due to orders related to COVID-19 from an appropriate governmental authority.
    - Determining whether the employer has a significant decline in gross receipts.
    - Determining whether the employer has more than 100 full-time employees.
    - The application of the rules that preclude an employer from claiming the Employee Retention Credit if any member of the aggregated group received a Paycheck Protection Program (PPP) loan under the Small Business Act.

Employee Retention Credit

Aggregation Rules

- Example from IRS FAQ #37: Employer Group G is a restaurant chain that operates a single trade or business through multiple subsidiary corporations located in various jurisdictions.

- Certain members of Employer Group G's operations are closed by a governmental order, while other members of Employer Group G's operations remain open.

- As a result of a governmental order causing the suspension of operations of certain of Employer Group G members, the operations of all members of Employer Group G's controlled group of corporations are treated as partially suspended due to the governmental order.

Employee Retention Credit

Qualified Wages

- The definition of qualified wages depends on how many employees an eligible employer has.

- If an employer averaged more than 100 full-time employees during 2019, qualified wages are generally those wages, including certain health care costs, (up to $10,000 per employee) paid to employees that are **not** providing services (or face reduced hours) because operations were suspended or due to the decline in gross receipts.

- If an employer averaged 100 or fewer full-time employees during 2019, qualified wages are those wages, including health care costs, (up to $10,000 per employee) paid to any employee during the period operations were suspended or the period of the decline in gross receipts, regardless of whether or not its employees are providing services.

Employee Retention Credit

Qualified Wages

X Co. was an Eligible Employer in Q2, Q3 and Q4 of 2020. X Co. has fewer than 100 FTEs, and during those quarters, X Co. paid salaries to employees in the following sums:

Employees	Q2	Q3	Q4
A	$8,000	$7,000	$10,000
B	$12,000	$10,000	$11,000
C	$4,000	$4,000	$4,000
D	$2,000	$2,000	$2,000

- In Q2, X Co. has $24,000 in qualified wages ($8,000 + $10,000 + $4,000 + $2,000). B is topped out and disqualified for the rest of 2020.
- In Q3, X Co. has $8,000 in qualified wages ($2,000 + $0 + $4,000 + $2,000). A is now topped out and disqualified for the rest of 2020.
- In Q4, X Co. has $4,000 in qualified wages ($0 + $0 + $2,000 + $2,000).

Employee Retention Credit

Qualified Wages

- Example: Employer T, a manufacturing business, that averaged more than 100 full-time employees in 2019, has several locations that are closed during the second quarter of 2020 due to a governmental order.
- Employer T continues to pay hourly employees who are not providing services at the closed locations 50% of their normal hourly wage rates.
- Employer T also reduced headquarters' administrative staff hours by 40%, but continues to pay them at 100% of their normal hourly wage rates.
- For employees who are not providing services due to the closure of their location, but are receiving 50% of their normal hourly wage rates, Employer T may treat the wages paid as qualified wages for purposes of the ERC.
- For the administrative staff whose hours were reduced by 40%, but who are paid for 100% of the normal wage rate, Employer T may treat the 40% of wages paid for time that these employees are not providing services as qualified wages for purposes of the ERC.

Employee Retention Credit

Qualified Wages

- Qualified wages are wages and compensation, both determined without regard to the contribution and benefit base, paid by an Eligible Employer to some or all of its employees after 3/12/2020, and before 1/1/2021.
- Qualified wages include the Eligible Employer's qualified health plan expenses that are properly allocable to the wages.
- IRS FAQ #58 now includes a third example that explains that qualified wages may include employee pre-tax contributions to a 401(k) plan and both the employer amounts and employee pre-tax contributions for maintaining a group health plan. However, employer matching contributions to a 401(k) plan, pre-tax contributions to a dependent care assistance program or qualified transportation benefits are not considered qualified wages for the purposes of the ERC because they do not constitute wages under Code Sec. 3121(a).
- Generally, the qualified health plan expense is the amount that is allocable to the hours for which the employees receive other qualified wages.

Employee Retention Credit

Qualified Wages

- Qualified health plan expenses are properly treated as qualified wages if the allocation is made on a pro rata basis among covered employees (for example, the average premium for all employees covered by a policy) and pro rata on the basis of periods of coverage (relative to the time periods for which such wages relate).
- The amount of qualified health plan expenses taken into account in determining the amount of qualified wages generally includes both the portion of the cost paid by the Eligible Employer and the portion of the cost paid by the employee with pre-tax salary reduction contributions.
- However, the qualified health plan expenses should not include amounts that the employee paid for with after-tax contributions.
- An eligible employer that averaged more than 100 FTEs in 2019 that pays wages to its employees for hours that the employees are not providing services may treat the portion of the health plan expenses allocated to the time that the employees are being paid, but not providing services, as qualified wages.
- Eligible Employers may treat health plan expenses allocable to the applicable periods as qualified wages even if the employees are not working and the Eligible Employer does not pay the employees any wages for the time they are not working.

Employee Retention Credit

No Double Dipping

- Wages for this credit do not include wages for which the employer received a tax credit for paid sick and family leave under the Families First Coronavirus Response Act.

- Wages counted for this credit cannot be counted for the credit for paid family and medical leave under section 45S of the Internal Revenue Code.

- An Eligible Employer may not claim the ERC and the Work Opportunity Tax Credit (WOTC) for the same employee for the same period of time.

Employee Retention Credit

How to Claim the Credit

- There are three ways to claim the ERC:

    1. Filing Form 941, Employer's Quarterly Federal Tax Return. Note the credit will be added in time for filing the second quarter 2020 form. Qualified wages paid between March 12 and March 31 should be reported on the 2nd Quarterly Tax Return due July 31st.

    2. Reducing the next required federal tax deposit, which includes taxes withheld from employees, by the anticipated credit.

    3. Filing Form 7200 to request an advance on the credit. This method should only be used if the anticipated credit is greater than the required federal tax deposit.

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Employee Retention Credit

How to Claim the Credit

- If an Eligible Employer elected not to claim the ERC in one calendar quarter, the Eligible Employer is not prohibited from claiming the credit in a subsequent calendar quarter for qualified wages paid in that subsequent quarter provided it meets the requirements to claim the credit.

- As noted previously, qualified wages paid during the first quarter of 2020 should be reported on the employer's second quarter Form 941. An employer should not file a Form 941-X to make an adjustment for qualified wages paid during the first quarter of 2020.

- Employers may amend Forms 941 for the second, third and fourth quarters of 2020, if applicable, within the appropriate statute of limitations.

Employee Retention Tax Credit

Other Items to Note

- A special rule prohibits application of the credit for wages paid to an employee that exceed the amount the employee would have been paid for working the same amount of time during the prior 30-day period. This may cause issues for employees who work on commissions, and such situations may need to be addressed by future guidance from the IRS.

- In order to avoid a double tax benefit, the CARES Act provides that the deduction for wages paid shall be reduced by the amount of the tax credits received.

- The ERC will not be available for wages paid to owners of a business or their relatives.

- If an employer uses a Professional Employer Organization (PEO) to provide staffing, the tax credit belongs to the employer, not to the PEO. The PEO is required to provide information to the employer so that the employer can use the information to claim the credit.

Employee Retention Credit

Other Items to Note

- IRS FAQ #88 notes that the signatory (Principal or Responsible Official) for the payroll reporting agent (RA) must sign, date, and print his or her name in the relevant boxes of Form 7200 (Advance Payment of Employer Credits Due to COVID-19) . The box labeled "Printed Title" must be completed with the RA company name or name of business as it appears on line 9 of Form 8655 (Reporting Agent Authorization) or Form 7200 cannot be processed.
- If you have not yet heard from your payroll provider about the process for claiming the ERC or other COVID-19 tax credits on the Form 941, you might consider reaching out now to obtain this information.
- It is important to keep in mind that most payroll providers will require your COVID-19 tax credit information ahead of the Form 941 filing due date. This means that you may need to begin the process of figuring the 2020 second quarter tax credits by the end of June or the first week in July, depending on your payroll provider. Missing the deadline could mean that your payroll provider will impose added fees for the filing of the Form 941/Form 941-X.

Employee Retention Credit

On the Horizon

- On Friday, May 15, 2020, the United States House of Representatives passed the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act.
- Lawmakers are proposing increasing the value of the ERC per employee per quarter from $5,000 for the remainder of the year to $12,000 per quarter.
- The bill also would remove some limits for how many employees the business must have to qualify and make it easier to demonstrate need for the tax break.
- Employers could be eligible for the ERC, as well as Paycheck Protection Program loans, which currently isn’t allowed.
- GBQ will continue to provide updates on the HEROES Act as they become available.

Work Opportunity Tax Credit

Work Opportunity Tax Credit

WOTC

- The Work Opportunity Tax Credit (WOTC) is a Federal tax credit available to employers for hiring individuals from certain targeted groups who have consistently faced significant barriers to employment.
- Targeted groups include: qualified veterans, SNAP recipients, ex-felons, summer youth employees, designated community residents, long-term unemployment recipients and TANF recipients.
- Eligible employers can claim the WOTC for eligible employees who begin work for the employer before January 1, 2021.
- Qualified tax-exempt organizations described in IRC Section 501(c) and exempt from taxation under IRC Section 501(a), may claim the credit for qualified veterans who begin work before January 1, 2021.
- An eligible employer must file Form 8850 with their respective state workforce agency within 28 days after the eligible worker begins work.
- IRS Notice 2020-23 provides WOTC deadline relief to July 15, 2020 due to COVID-19.

Work Opportunity Tax Credit

WOTC

- The WOTC is a federal tax incentive program that can reduce an employer's costs by up to $9,600 per new hire.
- The amount of tax credit is based on a percentage of the eligible employee's wages.
- There is no limit on the number of eligible employees.
- The WOTC is a General Business Credit. A taxable business may apply the credit against its business income tax liability.
- The credit has a carryback of one year and carryforward of twenty years.
- The employer's wage expense deduction must be reduced by the amount of the WOTC claimed.
- Eligible employees must perform at least 120 hours of service for the employer for credit to be allowed.
- No credit is allowed for wages paid to an individual if before the individual's hiring date the individual had been employed by the employer at any time. In other words, no rehires.

Work Opportunity Tax Credit

WOTC

- For qualified tax-exempt organizations, the WOTC is limited to the amount of employer social security tax owed on wages paid to all employees for the period the credit is claimed.

- Ohio's state workforce agency, the Ohio Department of Jobs and Family Services (ODJFS), is one of the best administrators in the country.

Thank you!

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