

The top portion of the slide features a grayscale photograph of the United States flag waving on the left, with the dome of the United States Capitol building visible in the background on the right. Below the photograph is a solid green horizontal bar, which transitions into a solid blue background for the text area.

Tax Credit Spotlight: Extension and Expansion of the Employee Retention Credit

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Presenters



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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



- What is the ERC?
- Eligible Employer
- Decline in Gross Receipts
- Aggregation Rules
- Qualified Wages
- Interaction with Other Credits
- Claiming the Credit
- What's Next?



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Employee Retention Credit

Employee Retention Credit

What is the ERC?

- 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).
- If the credit for the quarter exceeds the employer's overall social security tax liability, the excess is refunded.
- 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.
- For 2020, 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.

Employee Retention Credit

What is the ERC?

- The Consolidated Appropriations Act, 2021 (CAA) made a number of changes to the ERC.
- The CAA was signed by President Trump on December 27, 2020.
- The updated ERC provisions expanded and extended the ERC.
- The expanded ERC provisions should allow more companies to take advantage of the credit, especially those that received a Paycheck Protection Program (PPP) loan. Under the original guidelines, for many, meeting the credit requirements to qualify was often difficult.
- The CAA extended the credit until June 30, 2021, so there are two additional quarters of potential eligibility.

Employee Retention Credit

What is the ERC?

- For the 2020 tax year, the CAA, ***retroactive to the effective date of the CARES Act***, does the following:
 - **Provides that employers who receive PPP loans may still qualify for the ERC with respect to wages that are not paid with forgiven PPP proceeds;**
 - Clarifies the determination of gross receipts for certain tax-exempt organizations; and
 - Clarifies that group health plan expenses can be considered qualified wages even when no other wages are paid to the employee, consistent with IRS guidance.

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What is the ERC?

- For **January 1, 2021 through June 30, 2021**, the modifications to the credit include:
 - An increase in the credit rate from 50% to 70% of qualified wages;
 - An increase in the limit on per-employee creditable wages from \$10,000 for the year to \$10,000 for each quarter;
 - A reduction in the required year-over-year gross receipts decline from 50% to 20%;
 - A safe harbor allowing employers to use prior-quarter gross receipts to determine eligibility;
 - A provision to allow certain governmental employers to claim the credit;
 - An increase from 100 to 500 in the number of employees counted when determining the relevant qualified wage base; and
 - Rules allowing new employers who were not in existence for all or part of 2019 to be able to claim the credit.
- For 2020, the CAA did *not* revise the calculation of the ERC.

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Who is eligible for the ERC?

- Eligible Employers that are entitled to claim the ERC are private-sector businesses and tax-exempt organizations that carry on a trade or business and either:
 - Have operations that were **fully or partially suspended** 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;
- OR**
- Experienced a significant decline in gross receipts during the calendar quarter compared to the same quarter in 2019.

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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

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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.

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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.

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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.

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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.

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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.

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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 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 decline more than 50% compared to the same quarter in 2019. **UPDATE: For 2021, the decline was reduced to 20%.**
- The significant decline in gross receipts ends with the first calendar quarter that **follows** the calendar quarter for which the employer's gross receipts are greater than 80% of its gross receipts for the same calendar quarter during 2019.

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Significant Decline in Gross Receipts

Eligible Employer For	Quarter Comparison	% Decline
Q1 2020	Q1 2020 to Q1 2019	>50%
Q2 2020	Q2 2020 to Q2 2019	>50%
Q3 2020	Q3 2020 to Q3 2019	>50%
Q4 2020	Q4 2020 to Q4 2019	>50%
Q1 2021	Q1 2021 to Q1 2019* OR Q4 2020 to Q4 2019	>20%
Q2 2021	Q2 2021 to Q2 2019* OR Q1 2021 to Q1 2019*	>20%

* Employers that did not exist at the beginning of Q1 or Q2 2019 should use Q1 or Q2 2020, respectively.

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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.

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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. **UPDATE: No longer applicable.**

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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.

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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.
- ***UPDATE: For 2021, the 100 employee threshold was increased to 500.***

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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).

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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 7/1/2021.
- Qualified wages include the Eligible Employer's qualified health plan expenses that are properly allocable to the wages.
- IRS FAQ #58 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.
- In addition, the CAA includes guidance stating that any wages taken into account in determining the ERC may not be claimed again for purposes of:
 - § 41 – R&D Credit
 - § 45A – Indian Employment Credit
 - § 45P – Employer Wage Credit for Active Duty Members
 - § 51 – Work Opportunity Tax Credit
 - § 1396 – Empowerment Zone Employment Credit

Employee Retention Credit

How to Claim the Credit

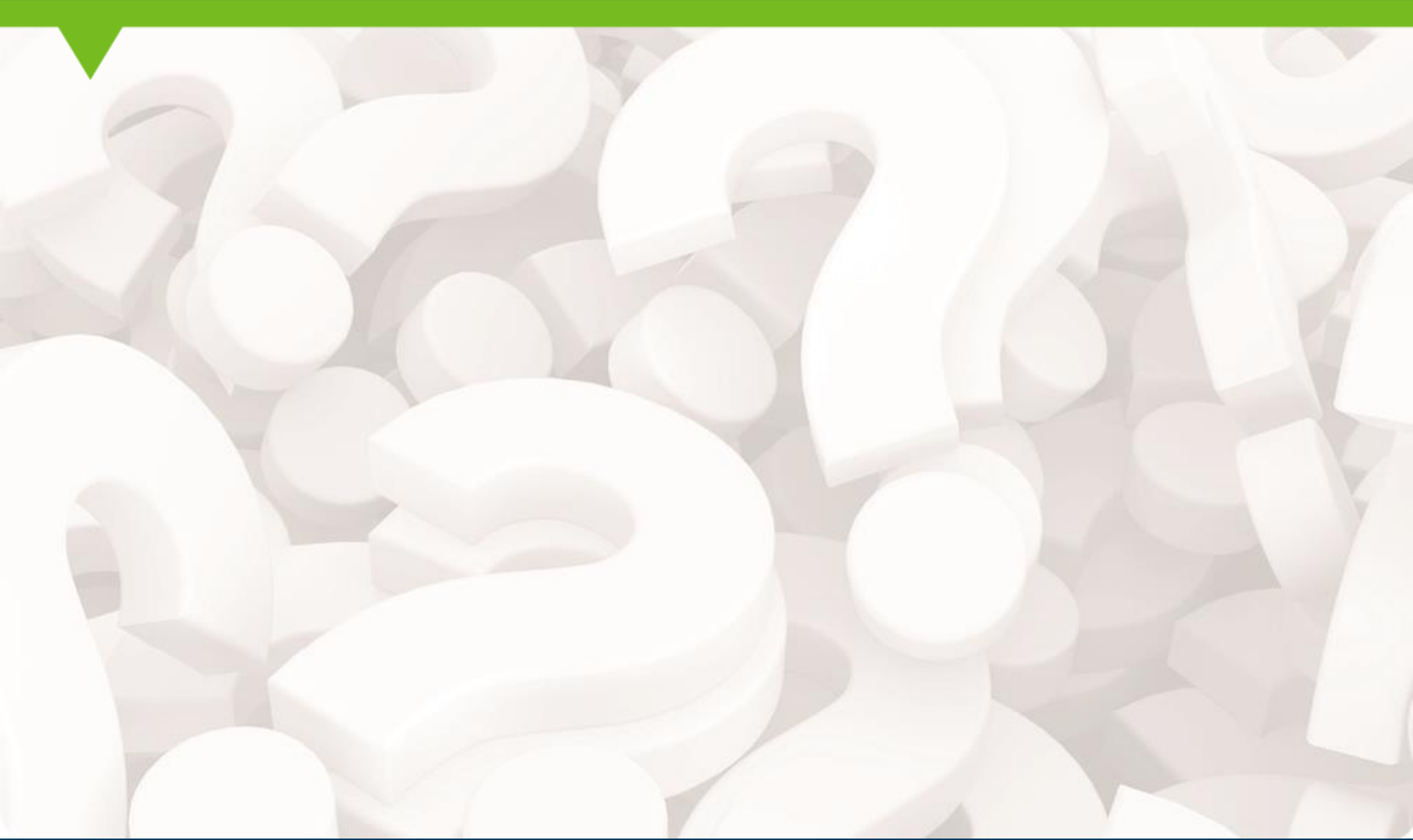
- The CAA allows employers to treat any applicable wages paid prior to the enactment of the ACT as being paid in the calendar quarter in which the Act was enacted (Q4 2020).
- This provision appears to allow employers to claim any retroactive credits on the Q4 Form 941.
- A taxpayer should also be able to file amended payroll returns to claim 2020 credits.
- The CAA also allows for an advanced payment of the ERC to small employers.
- The advanced payment option is available in 2021 to small employers with 500 or fewer employees during 2019.
- The advance cannot exceed 70% of the average quarterly wages paid by the employer in calendar year 2019.
- We are anticipating more guidance on both of these processes.

Employee Retention Credit

What's next?

- Businesses should review the ERC eligibility requirements for both 2020 and 2021.
- Businesses that received a PPP loan must review their 2020 payroll costs to determine if there are wages remaining – not paid with PPP loan funds – that can be used to claim the ERC retroactively.
- If a business that received a PPP loan has not yet completed its loan forgiveness application, there may be strategic decisions as to what to submit for forgiveness expenses.
- Businesses will need to consider these same rules as they apply for a second round of PPP in 2021.
- Businesses must be cognizant of all PPP and payroll tax filing deadlines.
- If a taxpayer is already claiming other tax credits, such as WOTC, it will need to consider the interaction with the ERC.
- Some businesses may consider whether an advance payment of the ERC is a beneficial option.

Thank you!



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