

Employee Retention Credit

February 17, 2021

Presenter



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Agenda

- What's new with the ERC?
- Who can claim it?
- What are the limitations?
- How do we claim it?
- How does the ERC interact with other credits and PPP loan forgiveness?

ERC Generally

- What is it?

- ERC is a fully refundable credit for certain wages paid to employees during specified periods of economic hardship
 - Full or partial shutdown related to the pandemic
 - More than 50% decline in gross receipts, regardless of the reason

- When was it enacted?

- March 27, 2020, as part of CARES Act

- Did it change recently?

- Yes. It was extended and expanded on December 27, 2020 as part of the Consolidated Appropriations Act, 2021
 - Eliminated ban on ERC if taxpayer also obtained a PPP loan – created retroactive 2020 refund opportunity
 - Extended ERC into first two calendar quarters of 2021, and made it more generous than the 2020 ERC
 - Expanded access to 2020 ERC – raised cap from 100 to 500 employees, *etc.*

Overview of ERC

	2020	2021
Eligibility	<p>Either full or partial suspension of operations (see FAQ #30-38)</p> <p>OR</p> <p>Quarterly drop in 2020 gross receipts by more than 50% compared to the same quarter in 2019, and continuing through quarter where gross receipts are at least 80% of the same quarter in 2019 (see FAQ #39-46)</p>	<p>Either full or partial suspension of operations</p> <p>OR</p> <p>Quarterly drop in 2021 gross receipts by more than 20% Q1 2021 v. Q1 2019 Q2 2021 v. Q2 2019 (or elect to use previous quarter, e.g., Q4 2020 v. Q4 2019)</p>
Wage Period	3/13/20 – 12/31/20 (see FAQ #1)	1/1/2021 – 6/30/2021
Qualified Wages	<p>\$10K of wages + cost of qualified health plan expenses, per employee, for all of 2020 (see FAQs #48-61)</p> <p>(includes healthcare wages even if cash wages are not paid)</p>	<p>\$10K of wages, including rate increases and hazard pay + cost of qualified health plan expenses, per employee, in each of Q1 and Q2 2021</p> <p>(includes healthcare wages even if cash wages are not paid)</p>

Overview of ERC (cont'd)

Credit Amount	50% of Qualified Wages (<i>see FAQ #47</i>) (max \$5K per employee per year)	70% of Qualified Wages (max \$7K per employee per quarter; total of \$14K per year)
Advance Payments	Employers can request an advance payment after reducing employment tax deposits	Employers with 500 or fewer FTEs in 2019 can request an advance payment after reducing employment tax deposits

Overview of ERC (cont'd)

Covered Employees	If the average number of FTEs in 2019 was 100 or less, then the wages of all employees; if > 100, then only the wages of employees not providing services (see FAQ #6)	If the average number of FTEs in 2019 was 500 or less, then the wages of all employees; if > 500, then only the wages of employees not providing services
PPP	Available even if obtained a PPP loan, and can be claimed retroactively The wages used for PPP loan forgiveness cannot also be used to claim the ERC	Available even if obtained a PPP loan, obtained by reducing employment tax deposits or advance credit on Form 7200 The wages used for PPP loan forgiveness cannot also be used to claim the ERC

2020 ERC

2020 ERC

- Eligibility (2-part test) –
 - Full or partial suspension of operations ([FAQs #30-38](#)), or
 - Quarterly drop in 2020 gross receipts by more than 50% compared to the same quarter in 2019 ([FAQs #39-46](#))
- Other eligibility issues
 - Must carry on a trade or business in 2020
 - No size limit – applies to large and small employers (though credit amount differs)
 - Includes tax-exempt organizations

Test #1 – Full or Partial Suspension

- 3-part test ([FAQs #30-38](#))
 - (i) government order restricts operations,
 - (ii) the order limits commerce, travel, or group meetings, and
 - (iii) the order affects the typical operations of the business in a non-trivial manner
(aggregation rules apply – see next slide)
- Common examples
 - Reduction in seating capacity (*e.g.*, restaurants, movie theaters)
 - Reduction in hours of operation
 - Order prohibits suppliers from making delivery of critical goods to an essential business
 - Partial closure of operations (*e.g.*, no elective surgeries)
- Examples that do not meet the test
 - Partial closure if business can run comparably through telework
 - Business able to operate but sales were down b/c of loss of business or customers (but consider 50% declines in gross receipts test)

Test #2 – Decline in Gross Receipts

- Quarterly drop in 2020 gross receipts by more than 50% compared to the same quarter in 2019 ([FAQs #39-46](#))
 - Can be any single quarter in 2020, and does not need to be related to COVID-19
 - Period continues through and including the first quarter when gross receipts are more than 80% of the same quarter in 2019
 - Gross receipts for employers other than tax-exempts –
 - FAQ #40 refers to IRC §448(c)
 - Includes total sales (net of returns and allowances), all amounts received for services, any income from investments, and from incidental or outside sources
 - Includes interest, dividends, rents, royalties, and annuities, regardless of whether such amounts are derived in the ordinary course of the taxpayer's trade or business
 - Not reduced by COGS, but reduced by the taxpayer's adjusted basis in capital assets sold
 - 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
 - Gross receipts for tax exempts – no guidance, but see Reg. §1.6033-1(a)(2)(ii) (broad definition includes gross amount of grants and contributions, gross amount of dues and assessments, gross receipts from unrelated business activity, gross receipts from sales of assets, and gross investment income)
 - Employers should retain proof of the decline in gross receipts for at least 4 years
 - Aggregation rules apply to treat multiple entities as a single employer (see [FAQ #43](#) & [FAQ #25](#))
 - Consider parent/sub, brother/sister, partnerships, *etc.*
 - Generally, 50% vote or value test for parent/sub aggregation
 - Common control test for partnerships, trusts, estates, and sole proprietorships
 - ERC must be apportioned among group members based on proportionate share of qualified wages giving rise to the credit ([FAQ #27](#))

Qualified Wages

- Paid from March 13, 2020 through December 31, 2020 ([FAQ #1](#))
- Includes up to \$10,000 per employee in cash wages and qualified health plan expenses
- No dollar limit or cap on qualified wages like there is with the PPP
- Excludes wages paid to certain related persons (children, siblings, parents, step-parents, nieces/nephews, aunts/uncles, child/parent/sibling in-laws) ([FAQ #59](#))
- Excludes severance paid to former employees after they are terminated ([FAQ #57](#))
- Excludes wages that are exempt from Social Security/Medicare taxes (*e.g.*, independent contractors, church employees, *etc.*) ([FAQ #58](#))
- Full or partial suspension test –
 - Qualified wages include only the wages paid during the period of the suspension (and not the whole quarter)
- Decline in gross receipts test –
 - Qualified wages include all the wages paid during the relevant quarters

Qualified Wages (cont'd)

- Includes qualified group health plan expenses ([FAQs #62-71](#))
 - Includes a proportionate share of healthcare wages even if cash wages are not paid
 - Includes amounts paid by employer and amounts paid by employees with pre-tax dollars, but not amounts paid by employees with after-tax dollars ([FAQ #63](#))
 - Includes allocable costs to maintain a group health plan (but only to extent the amount is excluded from employees' wages)
 - Example: use the average premium for all employees covered by a policy and then pro-rate among the covered employees
 - Includes health plan expenses of furloughed employees who are not receiving cash wages
- Cannot double dip
 - Must exclude wages if reimbursed under PPP, FFCRA qualified sick/family leave reimbursement provisions, WOTC under IRC §51, PATH Act R&D payroll tax credits, and paid family medical leave credits under IRC §45S

Limitation on Qualified Wages

- More than 100 average FTEs in 2019 –
 - Include only the wages of employees NOT providing services (*i.e.*, for paid time off)
 - Includes hourly wages and wages of salaried employees ([FAQs #54-55](#))
 - Cannot increase wages to claim additional credit – lookback rule to 30 days immediately preceding the period of economic hardship ([FAQ #53](#))
 - Do not include wages for vacation, holidays, sick days, or other days off (because accrued during previous periods) ([FAQ #56](#))
- 100 or fewer average FTEs in 2019 –
 - Include wages of ALL employees (*i.e.*, for time worked and for paid time off) ([FAQ #6](#))
 - Includes wages for pre-existing vacation, holidays, sick days, or other days off (because accrued during previous periods) ([FAQ #56](#))
- If self employed, qualified wages do not include self-employment earnings ([FAQ #2](#))

FTE Calculation

- Calculation of average number of FTEs in 2019 is based on IRC §4980H ([FAQ #49](#))
 - Take the sum of the monthly averages of FTEs during 2019 and divide by 12
 - Can use 2020 averages if not in business in 2019
 - FTE means an employee who worked on average at least 30 hours a week or 130 hours a month
 - For PTEs, monthly average is determined using an aggregate number of hours for all part-timers divided by 120
 - Example: 4 part-timers each work 40 hours in a given month; number of FTEs that month is 1.3 ($4 \times 40 / 120$)
 - Must take into account the aggregation rules discussed earlier

How is the 2020 ERC Calculated?

- Credit Amount
 - 50% of qualified wages, up to \$5,000 per employee for the year ([FAQ #47](#))
- Interaction with PPP, Qualified Sick/Family Leave Credits, and Work Opportunity Tax Credits (WOTCs) under IRC §51
 - Can claim ERC even if obtained a PPP loan
 - No double dipping with PPP – wages used for PPP loan forgiveness cannot be used for ERC
 - No double dipping with FFCRA – qualified sick/family leave wages reimbursed with credits cannot be used for ERC ([FAQ #14](#))
 - Also cannot double dip with paid family medical leave credits under IRC §45S
 - No double dipping with WOTCs (§51), PATH Act R&D payroll tax credits, and paid family medical leave credits (§45S)

How to Claim the 2020 ERC

- Employers may reduce their employment tax and income tax deposits for the amount of anticipated credits without penalty ([Notice 2020-22](#))
 - [Form 941](#), starting in Q2 2020 (see [Instructions to Form 941](#))
- [Form 7200](#) for advance payments (see [Instructions to Form 7200](#))
- Can be claimed retroactively on [Form 941-X](#) (see [Instructions to Form 941-X](#))

Part 3: Enter the corrections for this quarter. If any line doesn't apply, leave it blank. (continued)				
	Column 1 Total corrected amount (for ALL employees)	Column 2 Amount originally reported or as previously corrected (for ALL employees)	Column 3 Difference (If this amount is a negative number, use a minus sign.)	Column 4 Tax correction
26. Refundable portion of employee retention credit (Form 941 or 941-SS, line 13d)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Suggested Approach

- Determine the minimum payroll amount listed on the PPP loan forgiveness application that is required to obtain the amount of forgiveness requested – may be 7 weeks or more depending on amount of nonpayroll costs used
- Map those wages to the PPP and any excess wages can be used to claim the ERC
 - Recall PPP wages were limited to \$100,000; no such limitation for the ERC
 - Recall there were owner wage limitations for the PPP, *i.e.*, C or S corp shareholders of 5% or more, general partners, and owner compensation replacement amount for Sch. C filers
 - Consider allocating PPP wages to highly-paid employees first to preserve the wages of lower-paid employees for the ERC so they have a greater chance of reaching \$10,000

Mergers & Acquisitions

■ What if I acquired a business in 2020?

- Including the gross receipts in 2020, but not in 2019, makes it harder to meet the decline in gross receipts test
- Businesses must include the target's gross receipts for each quarter owned (regardless if acquired in a stock or asset acquisition)
- IRS safe harbor for 2020 calendar-year acquisitions ([FAQ #45](#))
 - Business may, to the extent information is available, include the gross receipts of the acquired business in its gross receipts for the relevant 2019 calendar quarter, even though not owned at that time
 - If business acquired mid-quarter, must estimate the 2020 quarterly gross receipts for the quarter acquired based on actual gross receipts of portion of the quarter that taxpayer owned the business
 - Not necessary to do if the safe harbor approach is not used

■ What about an acquisition in Q4 2019?

- No impact on 2020 ERC b/c gross receipts included in both Q4 2020 and 2019
- What about 2021 ERC?
 - Recall the comparison is Q1 2021 to Q1 2019
 - Including gross receipts in Q1 2021, but not Q1 2019 makes it harder to meet the gross receipts test
 - Can reasoning similar to the safe harbor in FAQ #45 be employed to include the gross receipts in Q1 2019?
 - Can elect to use the previous quarter (Q4 2020 v. Q4 2019), but this won't help if business acquired in Q3 2019 or earlier

Taxation of the ERC

- Is the amount of the ERC includible in taxable income?
 - No, the ERC is not included in gross income ([FAQ #86](#)), **BUT . . .**
- Does expense disallowance apply?
 - Yes – the employer’s aggregate deductions are reduced by the amount of the ERC ([FAQ #85](#))
 - This means the ERC is taxable, and this applies both to the 2020 ERC and the 2021 ERC

2021 ERC

Eligibility

- Test similar but different –
 - Full or partial suspension of operations, or
 - Quarterly drop in 2021 gross receipts by more than **20%** compared to the same quarter in 2019
 - Q1 2021 v. Q1 2019
 - Q2 2021 v. Q2 2019
 - If not in business in the same quarter in 2019, then can use the same quarter in 2020
 - Election to use prior quarter
 - For Q1 2021, taxpayers can use Q4 2020 v. Q4 2019
 - For Q2 2021, taxpayers can use Q1 2021 v. Q1 2019
 - If elected, not clear if required to use previous quarter for both Q1 and Q2 of 2021
 - Example: if business meets the test in Q1 2021, but not Q2, then the Q1 drop in gross receipts can justify 2 quarters of the ERC if the election is made for Q2
- No size limit – applies to large and small employers (though credit amount differs)

Eligibility Differences

2020 ERC

- Full or partial suspension
- 50% reduction in gross receipts

2021 ERC

- Full or partial suspension
- 20% reduction in gross receipts
- Includes certain public instrumentalities, such as public universities, hospitals, and medical-care providers
- Included employers not in existence in 2019

Qualified Wages

- Paid from January 1, 2021 through June 30, 2021
- No dollar limit or cap on qualified wages like there is for the PPP
 - Includes bonuses paid during the quarter; thus, does not limit wages to comparable wages during previous 30 days (like the 2020 ERC)
 - **Tip:** if not scheduled to pay \$10K in Q1 or Q2, consider bunching wages to maximize the ERC
- Up to \$10,000 per quarter, including allocable qualified health plan expenses
 - Includes a proportionate share of healthcare wages even if cash wages are not paid
- Full or partial suspension test –
 - Qualified wages include only the wages paid during the period of the suspension (and not the whole quarter)
- Decline in gross receipts test –
 - Qualified wages include all the wages paid during the quarter

Relaxed Limitation on Qualified Wages

- The FTE limitation was increased from 100 FTEs to 500 FTEs, substantially broadening the 2021 ERC
 - Same calculation of average number of FTEs based on IRC §4980H
- More than 500 average FTEs in 2019 –
 - Include only the wages of employees NOT providing services (*i.e.*, for paid time off)
- 500 or fewer average FTEs in 2019 –
 - Include wages of ALL employees (*i.e.*, for time worked and for paid time off)

How is the 2021 ERC Calculated?

- Credit Amount

- 70% of qualified wages, up to \$7,000 per employee per quarter (\$14,000 max per employee for 2021)

- Interaction with PPP and Qualified Sick/Family Leave Credits

- Can claim ERC even if obtained a PPP loan
- No double dipping with PPP – wages used for PPP loan forgiveness cannot be used for ERC
 - Can claim the ERC on ANY qualified wages that are not counted as payroll costs in obtaining PPP loan forgiveness
 - **Tip:** maximize nonpayroll costs on the PPP loan forgiveness application, and then map the payroll costs between these two programs to prevent double dipping
- No double dipping with FFCRA – qualified sick/family leave wages reimbursed with credits cannot be used for ERC
- No double dipping with WOTCs (§51), PATH Act R&D payroll tax credits, and paid family medical leave credits (§45S)

How to Claim the 2021 ERC

- Employers may reduce their employment tax and income tax deposits for the amount of anticipated credits without penalty
 - IRS Form 941, starting in Q1 2021
- Employers with 500 or fewer average FTEs in 2019 can request and advance payment on Form 7200 after reducing their deposits
- Can use same mapping procedure as 2020 ERC to ensure no overlap between ERC and PPP/FFCRA/WOTCs (§51)/PATH Act R&D payroll tax credits/paid family medical leave credits (§45S)

Sample Document Request List

Business information –

- Confirm entity type (S or C corporation, partnership/LLC, sole proprietorship)
- Obtain filed 941s for 2020 and 2021
- Confirm whether there are any greater than 50% owned subsidiaries because they are aggregated for purposes of the ERC
 - Note there is a different rule below to determine FTEs for a limited purpose

Sample Document Request List (cont'd)

ERC eligibility for 2020 and Q1/Q2 2021 –

- **For the tests below (except for the special rule below), include info for all subsidiaries that are greater than 50% owned**
- Confirm partial or full suspension of operations (need exact dates when suspension began and when it ended), or
- Confirm decrease in “gross receipts” in 2020 v. 2019
 - More than 50% for 2020 ERC
 - [Confirm when gross receipts returned to at least 80% of 2019 level](#)
 - More than 20% for 2021 ERC
- Confirm “gross receipts” by quarter (P&L will work)
 - Q2 2020 v. Q2 2019
 - Q3 2020 v. Q3 2019
 - Q4 2020 v. Q4 2019
 - Q1 2021 v. Q1 2019
 - Q2 2021 v. Q2 2019
- Confirm average monthly number of FTEs during 2019
 - FTE means an employee who worked on average at least 30 hours a week
 - For PTEs, it is an aggregate determination – use aggregate number of hours for all part-timers and then divide by 120
 - [Example: 4 part-timers each work 40 hours in a given month; number of FTEs that month is 1.3 \(4*40/120\)](#)
 - Aggregation rules (see §414(b), (c), (m), or (o))
 - [Must aggregate 80%-owned subs; attribution rules apply](#)
 - [Must aggregate brother/sister corps if 5 or fewer persons own more than 50% of each](#)

Sample Document Request List (cont'd)

2020 ERC (if applicable) –

- Schedule of payroll by employee by pay period from 3/13/2020 through 12/31/2020 (preferably in Excel)
- Schedule of group health plan expenses relating to the wages if such amount is NOT included in the employees' gross wages
 - Includes amounts paid by employer and amounts paid by employees with pre-tax dollars, but not amounts paid by employees with after-tax dollars
 - Include health plan expenses of furloughed employees who are not receiving cash wages
 - Example: use the average premium for all employees covered by a policy and then prorate among the covered employees

2021 ERC –

- Schedule of payroll by employee by pay period from 1/1/2021 through 6/30/2021 (preferably in Excel)
- Schedule of group health plan expenses (see above under 2020 ERC)

Sample Document Request List (cont'd)

PPP1 or PPP2 loans –

- Loan amounts and loan agreements (if available)
- Loan disbursement date(s)
- Copy of loan forgiveness application(s)
- Loan forgiveness calculations by employee, even if not attached to the loan forgiveness applications
- Schedule of any owners' compensation that was limited in the loan forgiveness calculations
- SBA forgiveness letters (if available)
- If PPP loan forgiveness application not submitted, then obtain schedule of all nonpayroll costs, *i.e.*, mortgage interest, rent, utilities, covered operations expenditures, covered property damage costs, covered supplier costs, and covered worker protection expenditures

Helpful Links & Resources

- Where can I get more information?
 - IRS [FAQs](#) (updated regularly)
 - CARES Act [JCT Bluebook](#)
 - U.S. Senate Finance Committee [FAQs](#) address nonprofits
 - [IRS Form 941](#) & [Instructions to Form 941](#)
 - [IRS Form 7200](#) & [Instructions to Form 7200](#)
 - IRS press release January 26, 2021 ([IR-2021-21](#))

Questions?

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