What Companies Can Qualify?

New IRS Guidance Update for the Employee Retention Credit (ERC)

Of all the CARES act provisions, the Employee Retention Credit (ERC) is one of the least understood. The credit, intended to repay employers who continued to pay employees during the pandemic, has changed over time. The latest IRS update issued in May 2021 clarifies several provisions and broadens the qualifications, making it possible for more U.S. businesses to qualify.

Types of Organizations that Qualify for the ERC

Eligible employers are any trade or business in the U.S. if they qualify under the Gross Receipts or Operations Impact tests outlined below. Nonprofits are eligible. Governmental entities that are colleges or universities, or whose principal function is providing medical or hospital care are eligible for credit. Additionally, Recovery startup businesses, which is any employer that began trade or business after February 15, 2020, with gross receipts of less than $1 million, is eligible. Originally PPP loan recipients could not receive credit. This was changed retroactively by TCDTRA.

Ways to Qualify for the ERC: Operations Impact OR Decline in Gross Receipts

1. Gross Receipts Test:

Employers are eligible for the ERC if they experience a significant decline in gross receipts.

2021

2021
20 percent decrease in gross receipts

2021 Gross Receipts

For the first and second quarters of 2021, to use the Gross Receipts Test, **employers must demonstrate at least a 20% reduction in gross receipts to qualify for the credit.** An employer meets this test if their gross receipts for the quarter they are claiming the credit for are less than 80% of their gross receipts for the same calendar quarter of 2019.

Businesses formed after 2019

If the employer was not in existence as of the beginning of the same calendar quarter in 2019, then the same 2020 calendar quarter must be used Instead of comparing gross receipts for the current quarter with gross receipts from the same quarter in 2019, employers can elect to use an alternative quarter to calculate gross receipts. Under this election, an employer compares the calendar quarter prior to the quarter they are claiming the credit for to the same calendar quarter in 2019 to determine if there is a significant decline in gross receipts.

Example of using 2020 gross receipts: Promotion Solutions opened for business on January 15, 2019. In order to determine if its first quarter 2021 gross receipts are eligible for the ERC, it ordinarily must determine whether the first quarter 2021 gross receipts are less than 80% of its first quarter 2019 gross receipts. Because Promotion Solutions was not in existence at the beginning of the first quarter of 2019 (January 1, 2019), it must use its first quarter 2020 gross receipts as its comparison quarter. There is no specific election statement or form required to make this election, and the election can be made on a quarter-by-quarter basis.

Example of alternate gross receipt selection:

Boost, Inc. has the following gross receipts for 2019 through 2021

Quarter	2019	2020	2021
Q1	**$115,000**	**$95,000**	**$95,000**
Q2	**$120,000**	**$90,000**	**$85,000**
Q3	$115,000	$90,000	$85,000
Q4	$125,000	$82,000	N/A

Boost wants to claim the ERC for wages paid in the first quarter of 2021. Boost's 2021 Q1 gross receipts are 82% of 2019 Q1 gross receipts ($95,000 ÷ $115,000 = 82%), so Boost doesn't qualify for the ERC under the general comparison rule.

However, Boost can elect to compare its previous quarter (2020 Q4) gross receipts to its 2019 Q4 gross receipts. Using this election, Boost's 2020 Q4 gross receipts are 65% of its 2019 Q4 gross receipts ($82,000 ÷ $125,000 = 65%); therefore, it qualifies for the ERC for the first quarter of 2021.

Note: If Boost was not in existence as of the beginning of the fourth quarter of 2019, then the alternative election is not available.

2. Operations Impact Test:

Employers are eligible for the ERC if they experienced a partial suspension in operations

According to IRS Notice 2021-20:

"A governmental order that results in a reduction in an employer's ability to provide goods or services in the normal course of the employer's business of not less than 10 percent will be deemed to have more than a nominal effect on the employer's business operations."

Even if a business does not qualify based on gross receipts reduction, almost every business in the U.S. will qualify based on this test because most businesses were shut down in the weeks and months following the breakout of Covid-19. In order to qualify, a company has to show a more than nominal (greater than 10%) effect on operations due to COVID-19. Qualifying companies only are required to demonstrate that sales and hours were affected by a government order related to COVID-19.

The key to qualifying is to determine what government orders related to COVID-19 were in effect in the city, county and state where the business operates. The company will need to document the effects of COVID-19 regulations on their operations.

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