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EDITORS' PICK

Six Myths Surrounding The 2021 Employee Retention Tax Credit

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I cover changes and new developments in the federal tax law.

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Businesses around the country have been slow to evaluate, or quick to assume they are ineligible for, the 2021 Employee Retention Credit (“ERC”). The result: a significant amount of cash is still being paid to the Federal government when it could remain with companies that need it.

In 2021 the maximum amount of ERC is \$7,000 per employee, per quarter. Therefore, if a company can identify \$10,000 of qualified wages from each employee in the first and second quarter in 2021, they are looking at a maximum ERC of \$14,000 per employee. This means that a 10-person business could get a maximum ERC of \$140,000 and a 300-person company could generate a \$4,200,000 ERC. You get the idea. Big dollars are available for this credit and businesses are missing the opportunity due to lack of understanding, or possibly just COVID burn out.

It is time to bust the myths surrounding the 2021 ERC and highlight the most common misunderstandings.



U.S. one-hundred dollar, ten-dollar, five-dollar and one-dollar bills in Hong Kong, China. ...

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Myth 1: If my business is eligible for the second draw Paycheck Protection Program (“PPP”), I cannot also benefit from the ERC

While it is true that same \$1 of payroll cannot be utilized towards both PPP debt forgiveness and the ERC (along with other stimulus funding), it is still possible to have sufficient payroll to allow an employer to receive both the 2021 ERC and Second Draw PPP debt forgiveness. While some might question whether a business can utilize payroll paid during the Second Draw PPP covered period, the *Consolidated Appropriations Act, 2021* (“CCA 2021”) clearly states that the amendment to the PPP program is that payroll costs for PPP debt forgiveness do not include qualified wages taken into account in determining the ERC. This language allows for payroll being used during the Second Draw PPP covered period to be used for the ERC.

“Such payroll costs shall not include qualified wages taken into account in determining the credit allowed under section 2301 of the CARES Act or qualified wages taken into account in determining the credit allowed under subsection (a) or (d) of section 303 of the Taxpayer Certainty and Disaster Relief Act of 2020.” Sec. 206(c)(1)

Let's assume that Company A received a second draw PPP loan on January 10th for \$300,000 which is 2.5 times their 2019 average monthly payroll costs. Company A's covered period will start on January 10th and end on June 26th, a maximum covered period of 24 weeks. Company A employs 10 persons. Company A has a decrease in 2021 average monthly salaries, and it will take them 14 weeks to incur payroll expenses of \$300,000. This is approximately \$21,400 per week or \$2,400 per employee. Company A also qualifies as an eligible employer for 2021 Q1 ERC.

Company A can utilize the first five weeks of 2021 payroll to reach the maximum qualified wage amount for the ERC. In other words, each employee will generate \$12,000 (2,400 x5) and be capped at the \$10,000 per employee maximum amount by the end of the 5th week. The \$10,000 qualified wage amount will generate a credit of \$7,000 (or 70%) and the ERC for 2021 Q1 will be \$70,000. This leaves the payroll starting February 8th open to use towards the PPP debt forgiveness. The 14 weeks needed to incur the \$300,000 of

payroll for the second draw PPP debt forgiveness will be met by May 17th, which is ample time prior to the covered period end date of June 26th. Proper planning allowing for the maximization of the federal stimulus programs is reflected in this example, and as a result \$370,000 to be received by Company A.

This example also assumes that all PPP debt forgiveness will be incurred through payroll. However, only 60% of the PPP Second Draw principal balance is required to be utilized toward payroll. Other expenses, such as covered mortgage and rent obligation payments, covered utility payments, covered operation expenditures, damage costs, supplies costs and worker protection expenditures can be utilized toward debt forgiveness. These non-payroll expenses cannot exceed 40% of the Second Draw principal balance. It has become increasingly important to identify these non-payroll expenses in order to ensure that the maximum amount of payroll can be applied to the ERC.

The complexity of these rules can lead to a lot of confusion! There are many variations to this simplistic example. However, the takeaway should be that through proper planning businesses may receive benefit from the Second Draw PPP, the 2021 1st quarter ERC, and even the 2021 2nd Quarter ERC.

Myth 2: I don't qualify for the ERC because I don't have a significant decline in gross receipts.

For purposes of the ERC, an eligible employer must be able to reflect that EITHER the business had operations that were fully or partially suspended OR experienced a significant decline in gross receipts. To be an eligible employer for the ERC they must only meet one of these tests. It is an "OR" test.

Myth 3: My business is operating so I cannot qualify as having full or partial shutdown due to governmental authority.

Not so fast. There are a variety of ways where a business is considered subject to a partial shutdown. Two of the most common examples often missed are instances where operational hours are limited or where suppliers of an essential business are suspended due to governmental orders.

Governmental orders include an order from a local official imposing a curfew on residents that impacts the operating hours of a trade or business for a specified period. Any football fan used to watching NFL games at the local establishment, is well aware of this rule. Living in Buffalo Bills country, where the buffalo wing was invented, it was a significant point of contention that fans could not watch the entire football game at a restaurant due to a 10:00 p.m. curfew enacted by New York State as part of COVID containment policies. Even though restaurants were operating from noon to 10:00 p.m., the inability to operate under their normal hours would be considered a partial shutdown. Therefore, the restaurants in this example would be treated as an eligible employer for the ERC. The hours restriction must be due to a Federal, State, or local government mandate. A voluntary change in business hours would not be treated as a partial suspension.

While the general rule surrounding ERC for eligible employers states that essential businesses do not qualify, a significant exception to this rule is if the suppliers of the essential business are unable to make deliveries of critical goods or materials due to a governmental order that requires the supplier to suspend its operations. Therefore, if California production is shut down due to

State restrictions and the Ohio manufacturer (deemed an essential business) is unable to operate normally due to the lack of material, the Ohio manufacturer could be viewed as an eligible employer for the ERC under the partial suspension guidelines as well.

Myth 4: I have to wait for my 2021 First Quarter to be completed in order to certify the company can qualify for ERC.

New for 2021 ERC, the most recent legislation introduces a prior calendar quarter test when trying to assess if a significant decline in gross receipts took place. Therefore, every business can assess whether they qualify for the 2021 Q1 ERC today. If the fourth quarter receipts of 2020 declined more than 20% when compared to the fourth quarter receipts of 2019, the employer automatically qualifies for the ERC in Q1 2021. The employer does NOT have to wait until the end of March to make this determination. The significance? The employer can access the cash related to the ERC by reducing federal employment tax deposits every pay period during the first quarter. (See Myth 7.) This can create a significant cash inflow today, as opposed to 4-6 months from now. The ability to receive part of the ERC by decreasing federal employment tax deposits may be the lifeline some companies require to survive.

Myth 5: Only small companies, with fewer than 500 employees, can qualify for the 2021 ERC.

To be deemed an eligible employer, a business must prove that they have a significant decline in gross receipts OR operations that have been fully or partially suspended. That's it! If either of those tests are met, the employer is eligible for the ERC and the number of employees will determine the amount of qualified wages the employer is able to consider when calculating the credit.

For 2021, an eligible employer that averaged 500 or fewer full-time employees in 2019 can include ANY wages (whether the employee provided a service to the business or not) when trying to determine the maximum amount of qualified wages. However, an employer that averaged greater than 500 full-time employees in 2019 can only evaluate wages paid to employees for not providing services. Sometimes this statement discourages large employers, but this requires a closer look. Remember that qualified wages include the employer's contribution of qualified health plan expenses. Therefore, qualified health plan expenses paid by the employer for furloughed employees would be included as a qualified wage for large employers. In addition, the wages paid to employees who weren't working full time may also be considered. For example, assume you continue to pay someone their full salary even though they are only working 25 hours a week. The compensation for the "non-working" 15 hours a week could be considered a qualified wage for a larger employer. Documentation surrounding these conclusions will be key.

Myth 6: The business is over 500 employees for PPP, so the business is also considered to have over 500 employees for ERC.

Maybe. The rules governing employee headcount for PPP loans falls under the Small Business Administration (“SBA”) guidelines. Under SBA guidelines, an employer must calculate the average number of people employed for each pay period over the business’s latest 12 calendar months. Any person on the payroll must be included as one employee regardless of hours worked or temporary status. Therefore, regardless if an employee worked 5 hours or 40 hours, they would be counted as 1 employee for PPP.

For ERC purposes, the definition of a full-time employee is based on the Internal Revenue Code. The term full-time employee for purposes of the ERC means an employee who for a calendar month in 2019 had an average of at least 30 hours of service week or 130 hours of service in the month, as determined in accordance with IRC §4980H. Any employee who consistently worked 30 hours per week in a month would be counted as one employee. Employees who work part-time can be combined with the other part-time employees for the month and divided by 130 to create a full-time employee equivalent. While it can be confusing, the fact that part-time employee hours can be added together to form a full-time employee equivalent most likely will allow businesses to have fewer employees for the ERC than what they reported for PPP.

Myth 7 (Bonus): I must wait for my quarter payroll Form 941 to be filed in order to request the cash payment related to the ERC

This myth might be the most common assumption I hear from clients. First off, it is important to realize that the ERC is a payroll credit and not an income tax credit. The fact that the ERC is a payroll credit should allow businesses the opportunity to receive the credit, and thereby the refund, more quickly as payroll forms are filed quarterly. For example, the Form 941 for the 2021 first calendar quarter is generally due by April 30, 2021.

Taking it a step further, some businesses may not be evaluating the ERC now because they do not believe the ERC can be claimed until they file the Form 941. While that is one way to claim the ERC, businesses who need or want cash now should instead be adjusting their federal employment tax deposits by the amount of ERC reasonably expected. If businesses wait to claim the credit on their Form 941, the word on the street is that the IRS could take 4-6 months to process the refund. Many businesses can't wait that long and are in need of the cash now.

The IRS has noted that an eligible employer that pays qualified wages in a calendar quarter will not be subject to a penalty under IRC §6656 for failing to deposit federal employment taxes. Which leads us to our final Myth.

Myth 8 (Bonus): The only federal employment deposit a business can offset is the employer portion of Social Security and Medicare.

The IRS has made clear that the federal employment deposit is not required if there is a reasonable expectation that an ERC is expected. The federal employment deposit includes the employee AND the employer portion of Social Security and Medicare, as well as the employee federal withholdings. Take a breath! I know this makes businesses nervous. Employees will still be credited as if the business paid the federal government the Social Security, Medicare, and withholdings to the federal government. This is merely a more efficient and quicker way to allow businesses to keep the cash they are due from the federal government related to ERC. As the famous saying goes, rob Peter to pay Paul.

Going back to our original example, Company A calculated that they would receive a \$70,000 ERC for 2021 quarter 1. They could simply place the \$70,000 on their Form 941 filed in April, and patiently wait for their refund. Alternatively, Company A could stop remitting the employee and the employer portion of Social Security and Medicare, as well as the employee federal withholdings every pay period. Assuming the federal employment deposit is \$4,000 for the business bi-weekly pay periods, the business would not remit \$24,000 (6 bi-weekly periods x 4,000) over the first quarter and instead allow the cash to remain in the business. The remaining \$46,000 (70,000-24,000) can be credited to 2021 Q2 employment taxes or requested to be refunded based on what box is checked on Form 941.

Payroll companies are coming up to speed with these rules and have adjusted their systems accordingly to properly record the qualified wages per employee. That being said, it appears the payroll companies will not assist the business in determining what the qualified wages are per employee. That is where assistance from your accountant or business advisor will be necessary.

It is frustrating for so many, as the rules keep changing surrounding PPP and other governmental incentives during the constant fight for businesses to survive. It is hard to keep track of all the incentives and a month after you feel you have finally understand them, the rules change again. While most of the changes in the *Consolidated Appropriations Act of 2021* were welcomed, it did add a layer of complexity. This layer of complication seems to be causing businesses to delay, if not all together ignore, the new incentives. In reality, business owners are not only trying to keep their doors open, but also trying to prepare for year-end audits, tax return filings, operational decisions, and juggling all the non-work hurdles too. I get it! It is overwhelming. Take a breath and prioritize as you see fit. While prioritizing, take a hard look at the ERC. You might find that this calculation and subsequent cash savings may rise to the top of your list. ...