EMPLOYEE RETENTION CREDIT (ERC) – TURBO-CHARGED

The ERC was one of the provisions included in the CARES Act from last March. When enacted, it provided a refundable employer credit against quarterly employment taxes equal to 50% of the qualified wages and compensation paid to each employee by a qualified employer. Wages paid after March 12, 2020, and before January 1, 2021, qualified for the credit. In its original form, it offered potentially significant benefits, but its use was restricted because it wasn't available to Paycheck Protection Program (PPP) borrowers. The credit has been modified, expanded, extended and greatly enhanced – and more available - under the Taxpayer Certainty and Disaster Tax Relief Act (TCDTRA) passed on 12/27/20. It now potentially offers tremendous benefits because:

1. The credit's life was extended; it's now available through the first two quarters of 2021.
2. Maybe the greatest change is that PPP loan recipients were previously ineligible to claim the credit. TCDTRA retroactively repealed that rule.
3. For 2021:
    1. The wage credit rate for 2021 increased from 50% of qualified wages to 70%.
    2. The wage limitation was increased from $10,000/employee per year to $10,000/employee per quarter.
    3. Reduced the required decline in business revenue qualification test.

For clients that we have access to accounting records for, we are investigating or assisting with analysis regarding eligibility and the related benefit. Utilization requires a team effort between accounting and payroll processing people. It appears that payroll providers have decided to let the dust settle, file the December payroll reports and, as needed, amend them. For some, there is a potentially a large refund at stake.

Problem: The federal quarterly payroll tax form and instructions have not been updated.

Employers eligible for ERC are those that:

1. Carried on a trade or business, including non-profit, during 2020/2021; and
2. For any calendar quarter:
    1. **Fully or partially suspended** operations due to orders from any governmental authority limiting commerce, travel or group meetings due to COVID-19; or
    2. Experienced a *significant decline* in gross receipts.

Here's how it works: For 2020 wages paid, the employer may receive a credit – reduction of taxes paid or refund – of 50% of wages on the federal quarterly payroll tax return, Form 941. The annual wage threshold is $10,000 per employee, or $5,000 credit, per employee. Beginning 1/1/21 through 6/30/21, the credit rate is 70%, or $7,000 credit per employee per *quarter*. Example: If in the second quarter of 2020, an eligible business had qualified wages $10,000 each for 10 employees - $100,000 of paid wages – the employer would receive a credit of $50,000. That credit is applied against the employer's federal payroll tax liability. The amount in excess of the liability can be refunded. For the period 4/1/21 – 6/30/21, the credit would be $70,000.

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The great news:

1. There is no maximum number of employees who may be included in the calculation.
2. The ERC is in addition to payroll tax credits available under the Families First Coronavirus Response Act (FFCRA) for paid sick leave (but see below).
3. The refund can be advanced by filing Form 7200, Advance Payment of Employer Credits Due to COVID-19.
4. It is retroactive to March 12, 2020. To the extent it was available for wages paid in previous quarters, the credit for those prior periods may now be claimed retroactively and cumulatively on the 12/31/20 Form 941.
5. The 2020 decline in revenue test uses a 50% decrease in gross revenue for comparable quarters of 2019 compared to 2020. For 2021, the qualifying revenue decrease is 20%.
6. While the wages used to claim the credit may not also be deducted, it appears that the taxpayer can still include all wages paid in their IRC §199A wage calculation.
7. Employee health care costs are included in the wages paid calculation, even if no other compensation was paid or the employee was furloughed.

Restrictions include:

1. Wages paid with PPP debt that has been forgiven or will be used for forgiveness should not be included in payroll costs when computing the ERC. However, wages paid with PPP loan proceeds that is not forgiven, or wages paid in excess of the forgiven amount, are eligible. No double dipping.
2. It can't be claimed on the same wages available under the FFCRA (no double dipping). However, the employer may claim the ERC for "qualified wages" paid to the same employee in addition to paid sick leave & paid family leave benefits. Example: If ABC is an eligible employer, and it pays $2,500 in new paid sick leave benefits under FFCRA, plus $3,000 in regular wages in one quarter. ABC may claim an ERC of $1,500 ($3,000 x 50%). It may claim an Employer Paid Sick Leave credit for $2,500.
3. Self-employed individuals may not claim the credit for their SE income but may claim the credit on employee payroll.
4. No deduction for the portion of wages paid for which a credit is claimed.
5. The same wages cannot be used for ERC and certain other credits, including Work opportunity, R & D, Empowerment Zone, Indian Employment, etc.
6. Wages paid to related individuals, as defined by IRC §51(i)(1), are not considered:
    1. If the employer is a corporation, then a related individual is any person that bears a relationship with an individual owning, directly or indirectly, more than 50% in value of the corporation's outstanding stock.
    2. If the employer is a noncorporate entity, then a related individual is any person that bears a relationship with an individual owning, directly or indirectly, more than 50% of the entity's capital and profits interests.
7. All entities that are treated as a single employer under IRC §52(a) or IRC §414(m) or (o) are treated as a single employer for purposes of the Employee Retention Credit

Significant decline in gross receipts: Under the CARES Act, it applies to the first calendar quarter in 2020 for which gross receipts are < 50% of gross receipts for the same calendar quarter in 2019. An ERC can be claimed through the end of the first quarter for which its gross receipts are < 80% of the gross receipts for the same quarter in 2019. Here's a 2020 example:

QUARTER END	GROSS RECEIPTS 2019	2020	% DECREASE IN GROSS RECEIPTS	ELIGIBLE QUARTER
3/31	$250,000	$175,000	30%	No
6/30	$300,000	$100,000	67%	Yes
9/30	$250,000	$210,000	16%	Yes
12/31	$225,000	$195,000	13%	No

For calendar quarters beginning after 12/31/20, the definition was modified to apply to any employer if the gross receipts are < 80% of the gross receipts of such employer for the same calendar quarter in 2019; i.e., a 20% decline in gross receipts now qualifies. If the business wasn't in operation at the beginning of a calendar quarter in 2019, the taxpayer may use the 2020 comparable quarter.

While most literature focuses on using an either 50% or 20% decline in revenue test, the "**Fully or partially suspended** operations due to orders from any governmental authority limiting commerce, travel…" limitation, even without the revenue decline, also works. See the link below.

Where employers use a professional employer organization (PEO, third-party payor), the "true", common-law employer claims the ERC, not the PEO.

ERC REFUND ADVANCES

Rather than wait for an IRS refund after filing Form 941, there are two alternative ways employers can access these credits quickly:

1. They can retain, not deposit, the following employment taxes:
    1. Federal income taxes withheld for all employees;
    2. Employees' share of Social Security & Medicare (FICA) for employees who received the paid benefits or qualified wages;
    3. Employer's share of FICA for all employees; or
2. If the tax not deposited are not sufficient to cover the credit, Form 7200, may be filed to expedite a refund of the credit due in excess of previously retained taxes.

Employment taxes against which the ERC are applied is the employer's portion of Social Security taxes (6.2%).

Caution! An incorrect calculation can land the employer a trust fund penalty. Also, advanced refunds are subject to offset for outstanding taxes, child support, etc. This will go into effect beginning with the second quarter, 2020.

Employers with an average of > 100 full-time employees (30 hours/week) face additional limitations.

The IRS has provided a list of FAQ's at www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act. As the name implies, they were written in response to the CARES Act and - as of this writing – have not incorporated changes resulting from TCDTRA.

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