Managing Your Business Through the COVID-19 Crisis

Everything You Need to Know About Employee Retention Tax Credits

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Welcome

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Agenda

- Who is eligible for an Employee Retention Tax Credit?
- How can you apply?
- What if my PPP loan has been forgiven?
- What documentation do I need to provide?
- When is the credit issued? Can I take it as an advance?
- How should you balance a PPP loan and ERTC?

Today's Presenters

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Employee Retention Credit ("ERC")

- Who qualifies
- Computational rules (difference between 2020 and 2021)
- Significance of FTEs
- Interplay with PPP loans
- How to claim the credit
- Impact on taxable income

The CARES Act *(March 2020)*…

created two mutually exclusive incentives designed to provide funds to business owners to allow them to keep employees on staff throughout the pandemic:

1. Paycheck Protection Program ("PPP")
   a) Forgivable loans to businesses with fewer than 500 employees
   b) If a business took advantage of the program, they were barred from taking advantage of the second incentive, the Employee Retention Credit ("ERC")
2. ERC
   a) Not limited by the number of employees
   b) Refundable payroll tax credit that was only available to taxpayers who EITHER
      i. had their business fully or partially suspended during at least one quarter in 2020, OR
      ii. had a precipitous drop in gross receipts for quarters in 2020 relative to the same quarters in 2019

The Consolidated Appropriations Act, 2021 (“CAA”)

Taxpayer Certainty and Disaster Tax Relief Act ***(December 2020)***

- ERC retroactively available to businesses who took out a PPP loan during 2020
- Extended the ERC, which was originally slated to expire at the end of 2020, until June 30, 2021
- Dramatically changed the computational rules for credits related to 2021 *(as a result, the credit for 2020 is very different than the credit for 2021)*

American Rescue Plan Act of 2021 *(March 2021)*

- Extended the ERC from June 20, 2021, until the end of 2021
- Credit may only be claimed against Medicare (1.45%, Hospital Insurance) for the 3rd and 4th quarters of 2021 *(for prior quarters, under the CARES Act and CAA, the credit could be claimed against Social Security [6.2%, OASDI] taxes)*
- Added rules for a "recovery start up business"
- Definitively excludes for purposes of calculating the ERC, wages for PPP loans (including second draw PPP loans); shuttered venues operators grants, and restaurant revitalization grants

Computational Aspects (2020)

A for-profit business or tax-exempt organization (but not governmental entities) can claim a refundable payroll tax credit of up to $5,000 per employee for wages paid between March 12 and December 31, 2020, but only for wages paid (including certain qualified health plan expenses) during a calendar quarter in which the business is either:

- Scenario 1: Shut down by government order, OR
- Scenario 2: Experiencing a large drop in year-over-year gross receipts

Scenario 1 – Shut Down

- For any quarter in 2020, the operation of the employer's trade or business must have been "fully or partially suspended" during the quarter 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"
- Once this occurs, the quarter is an "eligible quarter," but a business **will only get a credit on wages paid during the part of the quarter the business was shut down**
- Assume your business was closed from March 15th through April 15th. You will have an eligible quarter for both Q1 and Q2
  - For Q1, eligible wages can only be paid from March 15th – March 31st
  - For Q2, eligible wages can only be paid from April 1st – April 15th

Scenario 1 – Shut Down (Continued)

Some businesses, based on IRS guidance, generally do not meet this test, and would not qualify:

- Those considered essential, unless they have supply of critical material/goods disrupted in a manner that affects their ability to continue to operate
- Businesses shuttered but able to continue their operations largely intact through telework

Examples of Governmental Orders

- **Example 1:**
  - Governor of State Y issues an order that all non-essential businesses must close from March 20, 2020 until April 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 Employee Retention Credit for qualified wages.
- **Example 2:**
  - Mayor of City Y holds a press conference in which she encourages residents to practice social distancing to prevent the spread of COVID-19. The statement during the press conference is not an order limiting commerce, travel, or group meetings. Accordingly, the mayor's statement would not be a governmental order for purposes of the Employee Retention Credit.

Examples of Governmental Orders (Continued)

- **Example 3:**
  - Employer C, a software development company maintains an office in a city where the mayor has ordered that only essential businesses may operate. Employer C's business is not essential under the mayor's order which requires Employer C to close its office. Prior to the governmental order, all employees at the company teleworked once or twice per week, and business meetings were held at various locations. Following the governmental order, the company ordered mandatory telework for all employees and limited client meetings to telephone or video conferences. Employer C's business operations are not considered to be fully or partially suspended by the governmental order because its business operations may continue in a comparable manner.

Examples of Governmental Orders (Continued)

- **Example 4:**
  - Employer D operates a physical therapy facility in a city where the mayor has ordered that only essential businesses may operate. Employer D's business is not considered essential under the mayor's order, which requires Employer D to close its workplace. Prior to the governmental order, none of Employer D's employees provided services through telework and all appointments, administration, and other duties were carried out at Employer D's workplace. Following the governmental order, Employer D moves to an online format and is able to serve some clients remotely, but employees cannot access specific equipment or tools that they typically use in therapy and not all clients can be served remotely. Employer D's business operations are considered to be partially suspended by the governmental order because Employer D's workplace, including access to physical therapy equipment, is central to its operations, and the business operations cannot continue in a comparable manner.

Scenario 2 – Drop in Gross Receipts (2020)

- For any quarter in 2020, the "gross receipts" from the "trade or business" of the employer must be less than 50% of what they were for the same quarter in 2019
- A member of controlled or affiliated service groups are considered a single employer, so they must aggregate their gross receipts to determine when and if they qualify
- Once this happens, every quarter is an "eligible quarter" until the END of the quarter in which the business's receipts have returned to at least 80% of what they were for the same quarter in 2019
- If receipts in Q1, Q2, Q3 and Q4 of 2019 were $100,000, $120,000, $100,000 and $150,000, and for the same quarters in 2020 receipts were $40,000, $70,000, $85,000 and $125,000, the "eligible quarters" for 2020 are Q1 (the first quarter in which receipts are less than 50% of 2019), Q2 (still less than 80% of 2019) and Q3 (the end of the first quarter in which receipts have returned to at least 80% of the same quarter of 2019)

The Significance of FTEs (2020)

- If you have MORE than 100 average monthly FTEs for 2019, only wages paid to an employee during an eligible quarter to NOT PROVIDE SERVICES are eligible for the credit *(you MUST be paying an employee to NOT work, either because business has been shut down or receipts have dropped significantly)*
- If you have LESS than or equal to 100 average monthly FTEs for 2019, then ALL wages paid to an employee during an eligible quarter can give rise to a credit, even if the employee is currently at work
- A "severely financially distressed employer" is an employer that experienced a gross receipts reduction of more than 90 percent as compared to the same quarter in 2019. Such employers may treat all wages paid to employees as qualified wages, regardless of the size of the employer and number of employees

Example

- Q is a chain of full-service restaurants with more than 100 average monthly FTEs in 2019. State X forced Q to go to take-out only for Q2 and Q3 of 2020. Q continues to pay its kitchen staff to come in and prepare food every day. Even though Q has had its operations partially suspended, because Q has more than 100 FTEs for 2019, only those wages paid to employees NOT TO WORK are eligible for the credit. Thus, the amount Q pays its kitchen staff to cook are not eligible for the ERC.
- Assume, however, that Q also paid wages to waiters and bartenders who are NOT coming into work. These wages WOULD be eligible for the credit.
- If instead, Q had LESS than 100 average monthly FTEs in 2019, ALL wages paid during Q2 and Q3 to ALL employees would be eligible for the credit; even the wages paid to kitchen staff who were continuing to work.

Definition of FTE for ERC

- A full-time employee is defined as one that in any calendar month in 2019 worked at least 30 hours per week or 130 hours in a month
- Employers who were in business the entire calendar year in 2019 or 2020 would take the sum of the number of full-time employees in each calendar month and divide by 12
- An employer who started a business during 2019 or 2020 determines the number of full-time employees by taking the sum of the number of full-time employees in each full calendar month in 2019 or 2020 in which the business operated and divides by that number of months
- An employer who started a business in 2021 determines the number of full-time employees by taking the sum of the number of full-time employees in each full calendar month in 2021 that the business operated and divides by that number of months

Qualified Wages (2020)

- **Step 1:** Identify that the business had an "eligible quarter" in 2020; either because business was partially or fully suspended or because gross receipts have dropped precipitously
- **Step 2:** Determine how many average monthly FTEs the business had for 2019, as that will drive whether the credit is based on wages paid only to employees NOT to work (over 100 FTEs), or to ALL employees during an eligible quarter (under 100 FTEs)
- **Step 3:** Remove wages used for PPP loans, shuttered venues operators grants, restaurant revitalization grants, paid family medical leave and work opportunity tax credits
- **Step 4:** Starting March 12, 2020, for every employee to whom the business paid eligible wages to during an eligible quarter, you get a credit equal to 50% of those wages

Maximum Credit (2020)

- The MAXIMUM amount of wages you can take for ANY ONE EMPLOYEE for the ENTIRE year is $10,000.
- Once you've paid an employee $10,000 in qualified wages, you are tapped out at a $5,000 credit.
- **Example:**
  - Business X has its operations shut down by government order for Q2 and Q3 of 2020.
  - During Q2, X pays employee A $8,000 in qualified wages.
  - During Q3, X pays A another $6,000 in eligible wages.
  - In Q2, X can claim a credit of $4,000 (50% of $8,000) related to A.
  - In Q3, X's credit for wages paid to A is limited to $1,000 (maximum wages of $10,000 less $8,000 taken in Q2).
  - For the rest of 2020, X cannot take ANY additional credit related to employee A.

Certain Health Care Costs (2020)

- You can increase the wages paid to an employee by the employee's allocable share of certain health care costs
- Alternatively, if you didn't pay someone wages (for example, if they were on furlough) but you did cover their health care costs, you can claim the credit against JUST the health care costs

Example

In Q2, my business is entirely shut down by government orders. I have fewer than 100 average monthly FTEs in 2019. During Q2, I pay the following wages and payroll taxes:

	Wages*	Fed withholding	ER SS Tax	ER Medicare	EE SS Tax	EE Medicare
A	$8,000	$1,000	$496	$116	$496	$116
B	$10,000	$1,500	$620	$145	$620	$145
C	$15,000	$2,000	$930	$217	$930	$217
Totals	**$33,000**	**$4,500**	**$2,046**	**$478**	**$2,046**	**$478**

The total credit is $14,000 (50% of $8,000 + $10,000 + $10,000) since each employee's wages are capped at $10,000.

Coordination Between PPP and ERC

- Any payroll costs (W-2 wages or health care costs) are NOT eligible to be forgiven as part of the PPP process
- Thus, while a taxpayer may BOTH claim the ERC and borrow a PPP loan, they cannot do it on the SAME wages or health care costs, and the priority goes to the ERC rather than the PPP

Retroactive Credit

- ALL the changes above are to be implemented as if they were part of the initial CARES Act passed in March of 2020
- PPP borrowers can still claim the credit for 2020
- Claim the credit by filing amended Forms 941X for the applicable quarters of 2020

Extension of the ERC Program

- The ending date for the ERC was extended from December 31, 2020 to December 31, 2021
- The computational changes enacted by the Consolidated Appropriations Act of 2021 only apply from January 1, 2021 through December 21, 2021
- These computational changes are NOT retroactive to 2020
- The only retroactive change back to March 12, 2020 was to expand the eligibility rules for the ERC to include borrowers of a PPP loan

Computational Changes from 2020 to 2021

- **OLD:** For 2020, allows an employer to claim a credit of 50% of qualified wages
- **NEW:** For 2021 the credit percentage is increased from 50% to 70%
- **OLD:** For 2020, "qualified wages" are capped at $10,000 paid to any one employee for ALL quarters
  - In 2020, if A were paid $10,000 in Q3 and $10,000 in Q4, the resulting credit would be $5,000 (capped at 50% of $10,000 in wages <u>TOTAL</u>)
- **NEW:** For 2021, increases the maximum amount of creditable, qualified wages to $10,000 for ANY quarter
  - In 2021, if A were paid $10,000 in each of Q1, Q2, Q3 and Q4, the resulting credit would be $28,000, 70% of $10,000 wages for <u>EACH QUARTER</u>)
- **NEW:** Recovery startup businesses not otherwise eligible for the credit *(started after Feb. 15, 2020 with annual gross receipts less than $1 million and that were forced to shut down due to government order or a significant drop in receipts)* may be allowed a credit of up to $50,000 per quarter

Computational Changes from 2020 to 2021 (Continued)

OLD: to be eligible for a credit, an employer needed to experience at least one quarter in 2020 in which

1. operations were fully or partially suspended by government order, or
2. if during 2020, the business experienced a quarter in which gross receipts were less than 50% of the receipts in the same quarter in 2019 *(From that point on, every subsequent quarter was also an eligible quarter until the END of the first quarter in which gross receipts exceeded 80% of the receipts from the same quarter in 2019)*

NEW: the gross receipts test is significantly changed

- For 2021, the test is satisfied for any quarter in which gross receipts is less than 80% of the same quarter in <u>2019</u>
- Thus, in the first quarter of 2021, a business would compare its receipts in that quarter to the first quarter of 2019, NOT the first quarter of 2020
- If, however, a business did not exist at the beginning of the same quarter of 2019, the same quarter in 2020 is substituted

Computational Changes from 2020 to 2021 (Continued)

For 2021 only the option to elect to satisfy the gross receipts test by looking at the immediately preceding calendar quarter and comparing that quarter to the corresponding quarter in 2019 is added.

- To illustrate, an employer who could not satisfy the gross receipt test in Q1 of 2021 could nonetheless have an eligible quarter for that stretch of time by electing to compare gross receipts in Q4 of 2020 to Q4 of 2019.
- *If there is a drop of more than 20% quarter-over-quarter, Q1 of 2021 will be an eligible quarter.*

Computational Changes from 2020 to 2021 (Continued)

OLD

- For 2020, the definition of "qualified wages" hinged on whether the business had more than 100 full-time equivalent employees in 2019
- If the business had MORE than 100 FTEs, only wages paid to employees *not to provide services* during an eligible quarter were "qualified wages."
- If the business had fewer than 100 FTEs, however, then ALL wages paid to employees during an eligible quarter (or eligible part of quarter if the business were only shut down for a portion of the quarter) were "qualified wages."

Computational Changes from 2020 to 2021 (Continued)

NEW

- For 2021, the threshold number of employees before a change in treatment arises increases from 100 to 500
- The old rules had previously capped qualified wages paid to any one employee at what the employee would have been paid for working an equivalent duration during the 30-day period immediately before the eligible quarter in which wages were paid
- This rule prevented an employer from artificially inflating the ERC by increasing pay to an employee during an eligible quarter
- That rule no longer exists, meaning an employer could pay bonuses to an employee and increase the credit, subject to the $10,000 per quarter cap
- The ARPA provides that for the 3rd and 4th quarter of 2021 certain severely financially distressed large employers (with more than 500 employees) may receive the retention credit for all employees. A severely distressed large employer has gross receipts for a 2021 calendar quarter of less than 10% of the gross receipts it had for the same calendar quarter in 2019. The amount of qualified wages for severely financially distressed employers is not subject to any cap

New Rules for 2021

- Small employers can receive the credit by reducing required payroll tax deposit in ADVANCE
- If an employer has fewer than 500 FTEs, it may elect for any calendar quarter to receive an advance payment of the credit for that quarter in an amount not to exceed 70% of the average quarterly wages paid by the employer in 2019
- The advance credit would then need to be reconciled against the actual credit
- If the advance payments end up exceeding the actual credit due, the employer's payroll tax is increased for the calendar quarter by the excess

Example for 2020

- In 2020, X Co. has gross receipts for Q2, Q3 and Q4 of $100,000, $120,000, and $150,000. In 2019, X Co. had gross receipts for Q2, Q3 and Q4 of $210,000, $155,000, and $180,000.
  - Gross receipts in Q2 dropped by more than 50% when compared to Q2 of 2019 and were then at 77% for Q3 and 83% for Q4.
  - Because eligible quarters for 2020 start once receipts drop by more than 50% and continue until the END of a quarter in which receipts exceed 80% of the receipts for the same quarter in 2019, each quarter is an eligible quarter.
  - X Co. has fewer than 100 FTEs, and during those quarters, paid salary to employees in the following sums:

	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

Example for 2020 (Continued)

- 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, because in 2020, the maximum amount of qualified wages for any one employee is $10,000 for ALL quarters.
- 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). C was topped out during the quarter.
- **The total credit is $18,000 (50% * $36,000)**

Example for 2021

- In 2021, X Co. has gross receipts of $140,000 in Q1 and $160,000 in Q2 and gross receipts in Q1 and Q2 of 2019 were $180,000 and $210,000 respectively.
- Because gross receipts for each of Q1 and Q2 in 2021 were less than 80% of the receipts for the same quarters in 2019, both quarters are eligible quarters.
- During Q1 and Q2, X Co. paid its employees as follows:

	Q1	Q2
A	$8,000	$7,000
B	$12,000	$14,000
C	$4,000	$4,000
D	$6,000	$6,000

Example for 2021 (Continued)

- In Q1, X Co. has $28,000 in qualified wages ($8,000 + $10,000 + $4,000 + $6,000).
- In Q2, X Co. has $27,000 in qualified wages ($7,000 + $10,000 + $4,000 + $6,000).
- As opposed to 2020, B has eligible wages even after being paid $10,000 in a previous quarter, because the limit is now $10,000 per employee PER QUARTER.
- **The total credit is $38,500 (70% * $55,000)**

Example 2020 to 2021 Comparison

- Employer P is a local chain of full-service restaurants in State X that averaged 250 FTEs in 2019.
- State X forced P to discontinue sit-down service to customers for Q2 and Q3 of 2020.
- P continues to pay its kitchen staff to come in and prepare food every day. It also pays its wait staff to stay at home and not work.
- Even though P had its operations partially suspended, because P has more than 100 FTEs for 2019, only those wages paid to employees **NOT TO WORK** are eligible for the credit. The amount P pays its kitchen staff to cook are not eligible for the ERC. The wages paid to the wait staff, however, are eligible wages.

Fast forward to 2021, however, and the wages paid to BOTH the wait staff and the kitchen staff are eligible wages, because beginning in 2021, the change in treatment of wages does not kick in until P has more than 500 FTEs.

Final Thoughts

- **Income tax deductions must be reduced by the amount of the credit received in the year the credit was generated**
  - Credits received from the 2020 tax year will reduce the deductions of related expenses in 2020 regardless of when the credits were subsequently received
- **Any amended payroll tax returns filed for the year 2020 must be received by the IRS by April 15, 2024**
- **The period of limitations on assessment of any amount attributable to an ERC credit claimed is extended to five years**

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