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Understanding The Employee Retention Credit

"A Deep Dive Into The New Stimulus Bill"

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OVERVIEW OF CREDIT UNDER THE CARES ACT

ERC – OVERVIEW OF CARES ACT CREDIT

- The CARES Act provides a refundable payroll tax credit for 50% of qualifying wages paid by an eligible employer whose business has been financially impacted by COVID-19.
 - Wages are capped at the first \$10,000 paid to each eligible employee for all quarters (i.e. the credit is capped at \$5,000 per employee)
- ***Employers were not eligible for the employee retention credit if they received an SBA/PPP loan.***
- Qualifying employers must fall into one of two categories:
 - The employer's business is fully or partially suspended by government order due to COVID-19 during the calendar quarter, OR
 - The employer's gross receipts are below 50% of the comparable quarter in 2019. Once the employer's gross receipts go above 80% of a comparable quarter in 2019, they no longer qualify after the end of that quarter.

ERC – OVERVIEW OF CARES ACT CREDIT

- Qualifying wages for the credit are based on the average number of a business's employees in 2019
 - **Employers with less than 100 employees:** If the employer had 100 or fewer employees on average in 2019, the credit is based on wages paid to all employees, regardless if they worked or not. If the employees worked full time and were paid for full time work, the employer still receives the credit.
 - **Employers with more than 100 employees:** If the employer had more than 100 employees on average in 2019, then the credit is allowed only for wages paid to employees who did not work during the calendar quarter.

ERC – OVERVIEW OF CARES ACT CREDIT

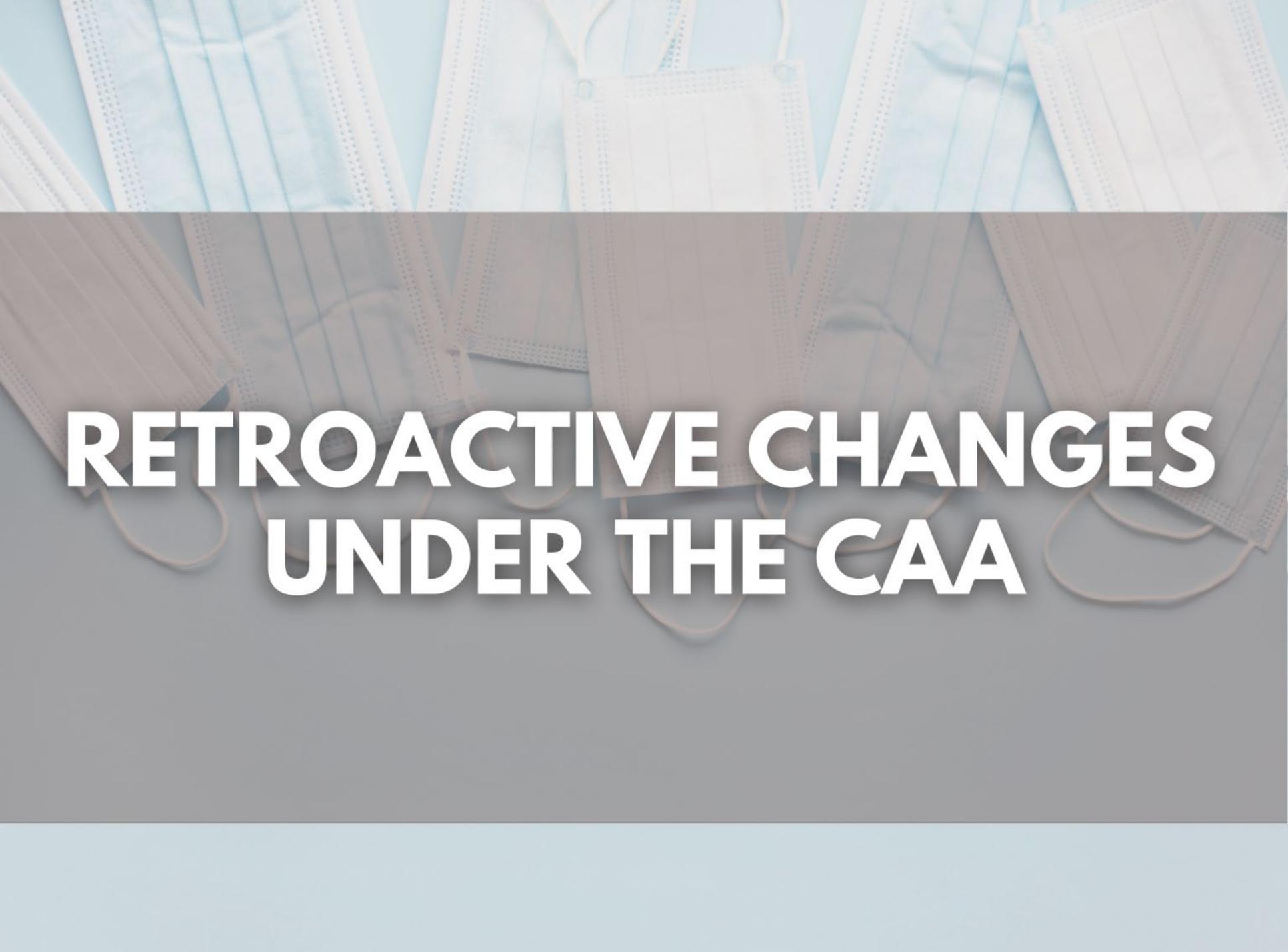
- Qualifying wages are wages and compensation paid by an eligible employer to some or all of its employees after March 12, 2020 and before January 1, 2021
- Includes wages paid to both full and part time employees
- Qualified wages also include employer's qualified health plan expenses that are properly allocable to wages
- Does not include wages paid by an employer to employees who are related individuals

ERC – OVERVIEW OF CARES ACT CREDIT

- The ERC can either be claimed by reducing payroll tax deposits, reconciling on quarterly payroll tax returns, or advanced payments of credits may be requested by filing Form 7200
- Employers may claim the employee retention credit and credits for FMLA and paid sick leave under the Families First Act, but not for the same wages.
- An employee included for purposes of the Work Opportunity Tax Credit may not be included for purposes of the ERC

ERC – OVERVIEW OF CARES ACT CREDIT

- Reduction in wage expense under IRC Section 280(c), no deduction allowed for portion of wages paid equal to the sum of the credits claimed
- An employer may elect to forego the ERC for any calendar quarter by not claiming the credit on the employer's tax return
 - Employer may change this election quarter by quarter provided it continues to meet the other requirements to claim the credit



RETROACTIVE CHANGES UNDER THE CAA

ERC – RETROACTIVE CHANGES UNDER THE CAA

- Improved coordination with the Payroll Protection Program
 - Employer's who received PPP loans are now eligible to claim the Employee Retention Credit
 - However, the same payroll costs may not be used for purposes of the ERC and PPP loan forgiveness
- The CAA amends the definition of payroll costs in determining PPP loan forgiveness by adding “such payroll costs shall not include qualified wages taken into account in determining the credit”
 - Effectively creates an ordering rule where wages in a given period would be used first for ERC purposes

ERC – RETROACTIVE CHANGES UNDER THE CAA

- The CAA also amends CARES Act 2301(g) which previously allowed for an election to forego the credit for a quarter
 - Employers may now elect to not include any amount of otherwise qualified wages for purposes of the ERC
 - Presumably designed to preserve these payroll costs for PPP loan forgiveness
 - Also requires SBA to issue guidance for providing that if a taxpayer makes this election, but does not receive full forgiveness, the wages will then qualify for ERC
- We will need more guidance on the interaction between PPP and ERC

ERC – RETROACTIVE CHANGES UNDER THE CAA

- The CAA provides that group health care expenses are considered “qualified wages” even when no other wages are paid to the employee
- Also, the Act clarifies how tax-exempt organizations determine “gross receipts”
 - Includes reference to IRC Section 6033
 - Gross receipts from all sources without reduction for cost of goods sold
 - Includes contribution/grant income unrelated business income, and investment income

ERC – RETROACTIVE CHANGES UNDER THE CAA

- How to claim the Employee Retention Credit retroactively
 - Employers now eligible for the credit would have already remitted payroll deposits and filed quarterly payroll returns for Q1/Q2/Q3 of 2020
 - The CAA allows employers who have already filed payroll tax returns before the enactment of the Act to claim a “catch up” credit on their Q4 2020 payroll tax returns for all eligible wages paid in 2020
 - Presumably a taxpayer may also file amended payroll tax returns however the CAA does not specifically address this



**EXTENSION &
ENHANCEMENTS
UNDER THE CAA**

ERC – ENHANCEMENTS UNDER THE CAA

- The CAA extends the Employee Retention Credit from December 31, 2020 to June 30, 2021
- Enhancement of the credit applies to period from January 1, 2021 to June 30, 2021 only (not retroactive)
 - The credit rate is increased from 50% to 70% of qualified wages
 - The limit on per-employee wages is increased from \$10,000 for the year to \$10,000 per quarter
 - Thus, maximum credit per employee in 2021 is \$14,000 (70% x \$10,000 x 2 quarters)

ERC – ENHANCEMENTS UNDER THE CAA

- The CAA also enhanced eligibility requirements for 2021
- Employers are now eligible for the credit for any quarter in which gross receipts are less than 80% of the comparable quarter in 2019
 - Increased from the previous 50% threshold
 - The provision for full or partial government shutdown continues to apply
- The credit is now available to certain government entities, including colleges, universities, and organizations providing medical or hospital care

ERC – ENHANCEMENTS UNDER THE CAA

- Employer may also elect to satisfy the gross receipts test by using the immediately preceding calendar quarter and comparing to the same quarter in 2019
 - For example, in order to qualify Q1 2021 as an eligible quarter you may compare Q4 2020 gross receipts to Q4 2019
- The 100 full time employee threshold for determining qualifies wages was increased to fewer than 500 full time employees
 - If under the threshold, any wages paid to employees during a qualified quarter will be considered qualified wages
 - If over the threshold, only wages paid to employees who are not providing services will qualify

ERC – ENHANCEMENTS UNDER THE CAA

- Claiming the ERC in 2021 is similar to 2020, option to reduce payroll deposits, reconcile on Form 941, or file Form 7200 for advance payments
- New option for advanced payment of the ERC available in 2021 for small employers (fewer than 500 FTEs)
 - Allows an advanced payment of the credit in an amount not to exceed 70% of the average quarterly wages paid by the employer in calendar year 2019
 - Must be reconciled and paid back if an excess credit is received

ERC – ENHANCEMENTS UNDER THE CAA

- The CAA includes an additional provision that denies a double benefit, stating that any wages taken into account in determining the ERC may not be taken into account for purposes of:
 - Section 41 – R&D Credit
 - Section 51 – Work Opportunity Tax Credit
 - Section 45A – Indian Employment Credit
 - Section 45P – Employer Wage Credit for Active Duty Members
 - Section 45S – Employer Credit for Paid Family and Medical Leave
 - Section 1396 – Empowerment Zone Employment Credit
- This rule appears to apply to 2021 only (not retroactive)



OPPORTUNITIES & NEXT STEPS

ERC – OPPORTUNITIES AND NEXT STEPS

- Review eligibility requirements for both 2020 and 2021
 - Full or partial shutdown provisions likely apply to many food service / hospitality businesses for the duration of the eligibility period
 - Most other businesses will need to review gross receipts tests
- Coordination with PPP forgiveness
 - If forgiveness application was already filed, consider elections to exclude wages for ERC purposes – automatic?
 - If forgiveness application has yet to be filed, some additional analysis may be necessary
 - Same rules apply for PPP 2.0 in and 2021 ERC
 - No necessity requirement for the ERC

ERC – OPPORTUNITIES AND NEXT STEPS

- Coordination with other IRC provisions
 - R&D Credit
 - WOTC and other employment credits
 - 199A
- Timing considerations
 - Q4 Payroll tax returns due February 1, 2021 – will we have more guidance before then?
 - Advanced payments – only if cash flow is needed

Resources

- IRS FAQs
- <https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act>

QUESTIONS?



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