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PERSPECTIVE

Simplify tax breaks: maximizing employee retention credit for businesses

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The Employee Retention Credit (ERC) is a refundable payroll tax credit enacted to provide financial incentives to businesses that retained employees amidst the Covid-19 pandemic. The credit's popularity unwittingly resulted in an uptick of ERC scamming companies that persistently misinform taxpayers of the very strict requirements that must be met in order to claim the credit. This article was written to provide business owners with an overview of these strict requirements and some key points to consider when filing the credit.

Eligibility Overview

Businesses that meet all necessary requirements may be eligible to claim up to $26,000 per employee retained in 2020 and 2021 if:

- The employer paid wages to employees in 2020 or 2021 (payments to independent contractors or majority owners and their relatives generally do not qualify);
- If the business began operating prior to Feb. 15, 2020, its eligibility for its credit will be limited to wages paid after March 12, 2020 through Sept. 30, 2021.
- Such businesses will be eligible for the credit if they sustained at least one of the following:
- A full or partial suspension of operations due to a governmental Covid-19 order; or
- A significant decline in 2020 or 2021 quarterly gross receipts compared to 2019.
- If the business began operations after Feb. 15, 2020, it may be eligible to claim the ERC as a "Recovery Startup Business." Such businesses may only claim the ERC for wages paid after June 30, 2021 through Dec. 31, 2021.

Eligibility Based on Full or Partial Suspension

Whether your business or organization was fully or partially suspended depends on your specific situation. Suspension generally arises if a Covid-19 governmental order prohibits or limits the business' operations fully or partially. For example, in March of 2020, several government orders were issued that required non-essential businesses to close their doors or limit their hours of operation. These limitations are examples of suspension.

Businesses that continued operating but had to undergo modifications may also be eligible if they incurred partial suspension. Such a suspension occurs when a Covid-19 governmental order(s) has "more than a nominal effect" on business operations. The IRS considers "more than a nominal effect" to be at least a 10% reduction in the business' ability to provide goods or services in the normal course of its business.

However, not all modifications may qualify as suspension of business operations. For example, if you changed business practices to alter behavior, such as making store aisles one-way or requiring customers or employees to wear masks, the IRS won't consider that change to have had a more than a nominal effect on your business operations.

Be Wary of Eligibility Based on Supply Chain Issues

The IRS also provided a narrow and very limited exception in cases where a business was not fully or partially suspended but their supplier was affected. This is called the "supply chain exception" and will only apply if all of the following conditions are met:

• The business was absolutely unable to operate without the supplier's product;

• The business could not obtain the supplier's goods or materials elsewhere - regardless of cost; and

• The supplier was fully or partially suspended.

The IRS has notified taxpayers that very few businesses are likely to qualify under this exception.

Eligibility Based on a Reduction in Gross Receipts

Generally, this test is met by comparing the gross receipts of the calendar quarter in which you would like to claim the ERC to the gross receipts of the same respective quarter in 2019. For example, if you are determining whether you are eligible in Quarter 2 of 2021, you would need to compare the gross receipts from Quarter 2 of 2019 to determine whether you meet the reduction requirement. The reduction requirements are different for 2020 and 2021 quarters.

• For 2020 credits, the quarterly gross receipts must be less than 50% of the gross receipts for the same quarter in 2019.

• The quarterly gross receipts for 2021 credits must be less than 80% of the gross receipts for the same quarter in 2019.

• Businesses that have a reduction in gross receipts in any 2020 or 2021 quarter may also be eligible for additional quarters.

Recovery Startup Businesses

In order to be eligible as a Recovery Startup Business the business must have:

• Began carrying on a trade or business after Feb. 15, 2020;

• Had average annual gross receipts of $1 million or less for the three years preceding the quarter for which they are claiming the ERC; and

• The business must not be eligible under the full or partial suspension test or the gross receipts test.

Recovery Startups are also the only businesses that may claim the ERC in Quarter 4 of 2021. However, their claims are limited to $50,000 per quarter and they can only claim the ERC in Quarters 3 and 4 of 2021.

Coordination With Covid-19 Relief Programs Including PPP Forgiveness

The credit is limited for businesses that received other Covid-19 relief programs such as Shuttered Venue Operators Grants, Restaurant Revitalization Grants, or Paycheck Protection Program Loans ("PPP"). Below is an explanation of how the credit works in coordination with the most popular form of Covid-19 relief - PPP forgiveness.

• The ERC's Double-Benefit Limitation

Taxpayers that received PPP forgiveness are not automatically disqualified from claiming the credit. However, wages claimed as eligible payroll costs when seeking PPP forgiveness cannot be used to claim the ERC. This is due to the double benefit rules that disallow a taxpayer from receiving the "double benefit" of claiming the ERC and receiving PPP forgiveness on the same wages.

• Claiming the ERC Against Wages That Were Paid During Your PPP Forgiveness Period.

The calculation of eligible wages during a business's covered period (usually 8 or 24 weeks after the date the loan was issued) is based on your PPP forgiveness application. If all your wages were allocated to forgivable PPP wages, your ERC may be limited during that period. Excess wages that didn't qualify for PPP forgiveness or non-payroll costs disclosed to the SBA may increase your ERC eligible wages.

For example, if a business with a $100,000 PPP loan incurred $100,000 in payroll costs during their forgiveness period, and the business did not report other non-payroll expenses as part of their forgiveness such as utilities, rent, etc. - the business cannot claim the ERC during their forgiveness period even if they are eligible for the credit. However, if the wages paid during the covered period were $150,000, the employer may potentially use the excess $50,000 wages to claim the credit.

Tax Implications of the Employee Retention Credit

The ERC will give rise to federal and state tax implications that vary depending on each taxpayer's business and individual income tax returns. It is imperative that any employer that claims the credit consult with their tax preparer regarding any necessary reporting requirements.

The IRS' Moratorium on ERC Claims Filed After Sept. 14, 2023

The IRS announced a moratorium on newly filed ERC claims commencing Sept. 14, 2023 until at least the end of the year. For previously filed claims, the processing time will be delayed due to the new safeguards the IRS has implemented to prevent future abuse. Although the IRS has not provided an estimated time on the processing of claims submitted after Sep. 14th, eligible taxpayers should continue to submit their applications for immediate consideration after the moratorium is lifted.

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