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Consolidated Appropriations Act Expands Employee Retention Credit

Posted by Jenn McCabe



When the CARES Act was passed, it created both the SBA Payment Protection Program (PPP) and the Employee Retention Credit (ERC) program. They were mutually exclusive, but now the Consolidated Appropriations Act (CAA), and the American Recovery Plan Act (ARPA) **significantly expand the ERC and allows employers who borrowed PPP funds to take advantage of both programs.**

That raises questions for taxpayers who have already filed for PPP forgiveness (stay tuned for future details).

Why is the ERC so exciting?

- It's refundable.
- It's a dollar-for-dollar credit against *employment* tax. Businesses losing money may not owe much income tax, but they often employ people and incur payroll taxes.
- It's instant cash relief. You can get the credit in advance of filing your quarterly payroll returns if you're certain that you'll qualify.
- The credits are big.

2020 Employee Retention Credit Summary

This is mostly unchanged, other than that 2020 PPP borrowers are now eligible for the ERC **providing they do not use the same wages to qualify for the ERC and the PPP**. It is worth mentioning that this same double-dipping prohibition applies to R&D credits, Work Opportunity Credits and *Families First Coronavirus Response Act* (FFCRA) leave credits.

- **The amount:** Up to \$5000/employee in 2020. Technically, it is defined as 50% of eligible wages up to \$10,000.
- **Time period:** March 13, 2020 – December 31, 2020
- **Qualifying employers:** The credit rewards employers who continued to pay staff wages and healthcare expenses despite hardship. Hardship is defined as either:
 - Subjected to government orders which suspended or interrupted productivity, *or*
 - A 50% or more reduction in gross receipts when comparing a 2020 quarter to the comparable quarter in 2019
- **Eligible wages:** Count employees carefully!
 - **If over 100** average full-time employee staff (see our recommended FTE definition below) in 2019, eligible wages are only those paid to staff who are *not* working.
 - **If 100 or less** 2019 FTE staff, *all* wages are eligible for the credit.
- If the credit is calculated based on business disruption, the credit only applies to wages paid during the government-ordered suspension of services (the same applies to 2021).
- If the credit is calculated based on a drop in receipts of 50% or more, the credit continues in subsequent quarters until the end of a quarter in which the business gross receipts get back up to at least 80% of the comparative prior year quarter.

2021 Employee Retention Credit (here's where it gets good)

- **The amount:** The maximum total per employee in 2021 is \$28,000. Technically, it's 70% of eligible wages up to \$10,000 in all four quarters of 2021.
- **Time period:** January 1, 2021 – December 31st, 2021
- **Qualifying employers:** The credit rewards employers who continued to pay wages and healthcare expenses despite hardship, which is defined as either:
 - Government orders which suspended or disrupted the business, *or*
 - A 20% or more reduction in gross receipts when comparing a quarter in 2021 to that quarter in 2019. In some cases, a comparison to 2020 quarterly revenue applies.
- **Eligible wages:**
 - **If over 500 full-time employees** in 2019 (using a 30-hour week standard), eligible wages are monies paid to staff while they were unable to perform their duties.
 - **If 500 or less** 2019 full-time staff, *all* wages are eligible for the credit!
- If the credit is calculated based on a drop in receipts of 20% or more, the taxpayer would compare Q1 or Q2 2021 versus *the same quarter in 2019*.
 - That's not a typo. It's Q1 2021 versus Q1 2019, not 2020. Using 2019 is to the taxpayer's advantage in almost all cases.

- Interestingly, Q1 of 2021 could qualify for the credit one more way. If Q4 2020 versus Q4 2019 exhibits a drop of at least 20%, the company qualifies for the Q1 2021 ERC. This brings forward the 2020 method, whereby an organization is eligible for the credit in subsequent quarters until they achieve a level of at least 80% of gross receipts versus the look-back quarter.

Claiming the Credit (it's tricky)

- An advance can be claimed on Form 7200. Taxpayers can file it more than once a quarter.
- Claim the credit on a Form 941, which is the federal quarterly payroll tax return.
- If filing after the due date, a 941-X can be filed to amend the return.
- It's unclear as to whether the IRS will amend the 941 so that taxpayers can claim the ERC on a current 941 form, rather than going back to amend. We remain hopeful.

Your payroll folks might not be happy with the forms or the complexity of the reconciliation.

Examples

Here are some examples (assuming either there is a government order or a drop in receipts to qualify):

- a. A restaurant with 40 full-time staff in 2019 that is subject to a government order to partially suspend operations is eligible for the credit on all wages paid to staff, even if the staff are working and productive during the paid time. ***The potential credit for this qualified small business is 40 x \$5000 = \$200,000 in 2020. It's potentially 40 x \$7000 = \$280,000/quarter in 2021(!).***
- b. A restaurant chain with more than 500 full-time workers can take the credit for staff who were paid only when they were not working, or for furloughed staff healthcare costs they continue to pay while those staff are not working. The credit doesn't apply to wages paid to those who are working.
- c. A restaurant continues to pay staff for 40 hours a week, though they only work for 20.
 1. If they have more than 500 (or 100 in 2020) workers, they can claim a credit for the 20 hours of paid, not working, time.
 2. If they have less than 500 (100 in 2020) staff, they can claim the credit for all 40 hours.

Pointers and Pitfalls

1. This most recent legislation allows an employer to take an ERC on the healthcare costs for a furloughed employee, even if they are not collecting wages.
2. There is complexity in defining "partial" business, or commercial, interruption.
3. Be careful. There's room for interpretive trouble when it comes to counting full-time workers. Legislation refers to full-time staff and points to prior language indicating that full-time employees are those who worked *30 hours a week or more on average in 2019*. The text of the law reads "full-time" but we interpret this to mean "full-time equivalent." We recommend counting any worker who works at least 30 hours as one full-time person, and then doing

- the math to add up the part-time workers to create full-time equivalent persons to add. This is a conservative approach.
4. Zoom can rule out qualifying. If everyone goes home and promptly telecommutes, even if there's a government stay-at-home order, the business has not been disrupted.
 5. The CAA eliminated, at least for now, the requirement that eligible wages for an employee not be higher than they were in a prior quarter.

Recommendation

Approach the ERC process methodically, using a well-coordinated team comprised of HR, payroll and tax professionals.

We recommend documenting entity eligibility thoroughly before rushing to the (more exciting) math. The IRS has announced they are extending the audit period from three to five years, which is a clear message that they will evaluate eligibility.

We're here to help! For questions or assistance with ERC, contact our cross-disciplinary team of professionals.



Jenn McCabe

Jenn has more than 25 years of outsourced accounting and finance experience, with a particular expertise in startups and the advertising and creative production industries. She is passionate about seeing companies utilize the latest accounting technology to maximize their efficiency, productivity, and ultimately, success.

Before joining Armanino, Jenn founded and led Team Jenn Corp., a firm dedicated to the strategic financial management of startups and small businesses, offering a comprehensive back office solution with accounting, finance and HR solutions. Previous roles include stints at advertising giant Ogilvy and Mather, and in the cash management industry.

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