2020–2021 Retention Credit Opportunities

What is the Retention Credit and how can it help my organization for 2020-2021?

- The Employee Retention Credit is a refundable tax credit against certain employment taxes for employers experiencing difficulties related to the COVID-19 pandemic under either one of two criteria.

Sounds great! How much cash can I get to help my organization for 2020?

- The Employee Retention Credit is a **refundable** tax credit against certain employment taxes equal to <u>50 percent</u> of the **qualified wages** an **eligible employer** paid to employees after March 12, 2020, and before January 1, 2021.
- The qualified wages are equal to $10K per employee for the year and thus the maximum cash to the employer is $5K per employee for calendar year 2020.
- **Example:** Employer has 20 employees and the Retention Credit is $100K. The employer will receive $100K from the IRS following IRS procedures.

Same question for 2021. How much cash can I get to help my organization for 2021?

- The Employee Retention Credit for 2021 is a refundable tax credit against certain employment taxes equal to 70 percent of the **qualified wages** an **eligible employer** pays to employees between January 1, 2021 and July 1, 2021.
- Note: the American Rescue Plan Act added the Retention Credit to the Internal Revenue Code, extending this opportunity through December 31, 2021.
- Qualified wages are equal to $10K per employee per quarter and thus the maximum cash to the employer is $28K in 2021 (70%X$10K=$7Kx4Quarters).
- **Example:** Employer has 20 employees and the Retention Credit is $140K. The employer will receive $140K from the IRS following IRS procedures.

What is the definition of wages generally? Can I get the credit for independent contractors?

- Qualified wages are generally your employees’ FICA wages.
- Qualified wages also includes health insurance expenses, even in instances where no other wages are paid.
- Since qualified wages are generally those wages subject to FICA tax, independent contractors are not included.

How can I tell if I am an "Eligible Employer" for 2020?

- Employers are eligible for the credit if they operated a trade or business during calendar year 2020 and experienced either:
  1. A full or partial suspension of the operation of their trade or business during any calendar quarter because of government orders limiting commerce, travel, or group meetings due to COVID-19 ("Government Orders Test"); OR
  2. A "significant decline" in gross receipts, defined as more than 50% reduction in gross receipts as compared to the same quarter in 2019 ("Gross Receipts Test").

Tell me more about the Gross Receipts Test for 2020

- A significant decline in gross receipts begins:
  1. on the first day of the first calendar quarter of 2020
  2. in which an employer's gross receipts are less than 50% of its gross receipts
  3. as compared to the same calendar quarter in 2019.
- The significant decline in gross receipts ends:
  1. on the first day of the first calendar quarter following the calendar quarter
  2. in which gross receipts are more than of 80% of its gross receipts
  3. as compared to the same calendar quarter in 2019.

How can I tell if I am an “Eligible Employer” for 2021?

- Employers are eligible for the credit if they operate a trade or business during calendar year 2021 and experience:

  1. A full or partial suspension of the operation of their trade or business during any calendar quarter because of government orders limiting commerce, travel, or group meetings due to COVID-19 under the Government Orders Test; OR
  2. A “significant decline” in gross receipts, under the Gross Receipts Test defined as either:
     - A more than 20% reduction in gross receipts for the quarter when comparing to the same quarter in 2019; or
     - A 20% reduction in gross receipts calculated by using prior quarter receipts as compared to the same quarter in 2019.

Tell me more about the Gross Receipts Test for 2021

- A significant decline in gross receipts begins:
  1. on the first day of the first calendar quarter of 2021
  2. for which an employer’s gross receipts are less than 80% of its gross receipts
  3. as compared to the same calendar quarter in 2019.
- The significant decline in gross receipts ends:
  1. on the first day of the first calendar quarter following the calendar quarter
  2. in which gross receipts are more than of 80% of its gross receipts
  3. as compared to the same calendar quarter in 2019.

What wages count as “Qualified Wages” in 2020 and 2021?

- In general, Qualified Wages for purposes of the retention credit include “wages” within the meaning of Section 3121(a) of the Code and qualified health plan expenses.
- In 2020, an employer cannot claim a credit under Section 45S of the Code (employer credit for paid family and medical leave) for qualified wages for which it claimed the retention credit.
- In Q1 and Q2 of 2021, in addition to the Section 45S credit, employers must exclude from qualified wages any wages taken into account under Sections 41, 45A, 45P, 51, 1396, 3131, and 3132 of the Code.
- Note that also wages for which a tax credit was claimed under the Families First Coronavirus Response Act (paid COVID-19 related sick and family leave) are excluded.

Does it matter how many employees I have for determining Qualified Wages and do I include employees of affiliates?

- The definition of Qualified Wages depends on how many employees an eligible employer has.
- The number of employees is determined on an affiliated group basis.
- Business entities are aggregated, or treated as a single employer, where they are members of the same controlled group of corporations, have employees under common control, or are part of an affiliated service group as provided under IRC Sections 52(a) or (b) (50% ownership) or 414(m) or (o). Note, private equity or other firms which are not a controlled group for benefit plan purposes because they are not a trade or business, may not be aggregated.

Qualified Wages for 2020 – Employee Count

- If an employer averaged more than 100 full-time employees during 2019, qualified wages only include amounts paid to employees on furlough or otherwise not providing services.
- For small employers, qualified wages include those wages, including health care costs, (up to 10,000 per employee) paid to any employee during the period operations were suspended or the period of the decline in gross receipts, regardless of whether its employees provided services.
- In 2020, employers can only count wages up to the amount that the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period of economic hardship.
    1. E.g., recent bonuses or pay rate increases would be excluded.

Qualified Wages for 2021 – Employee Count

- If an employer averaged more than 500 full-time employees during 2019, qualified wages only include amounts paid to employees on furlough or otherwise not providing services.
- For smaller employers, qualified wages are those wages, including health care costs, (up to $10,000 per employee per quarter) paid to any employee during the period operations were suspended or the period of the decline in gross receipts, regardless of whether its employees are providing services.
- Unlike for 2020, there is no limitation on the amount of wages paid to the employee in the last 30 days.
    1. E.g., An employer increasing an employee’s pay from $15/hour to $17/hour during a hardship period could count the entire new wage of $17/hour as a qualified wage. In 2020, the $2 pay raise would have been excluded, so only $15/hour would be qualified.

Qualified Wages for 2021 – Distressed Employers

- The American Rescue Plan Act of 2021 extends the retention credit through December 31, 2021 for wages paid after June 30, 2021 and before January 1, 2022.
- If an employer qualifies as a "severally financially distressed employer," the qualified wages eligible for the retention credit are any wages paid – they are not restricted to wages paid to employees that are not providing services.
- To qualify as a "severally financially distressed employer" for this purpose, the gross receipts for the employer for the calendar quarter must be less than 10% of the gross receipts for such quarter in 2019.
- The effect is that even very large employers meeting the distressed criteria, i.e., those with over 500 employees, are eligible for the credit for employees that remain working during the last two quarters of 2021.

My organization got a PPP loan. Am I out of luck?

- Originally, If an employer received a CARES Act Small Business Interruption Loan under the Paycheck Protection Program, then the employer was not eligible for the Employee Retention Credit.
- Now, retroactively, employers can get the retention credit if they meet the Government Orders Test or the Gross Receipts test, **but not on the same wages used for PPP loan forgiveness.**
- Most employers will have other wages not used for the loan forgiveness because the period of wages covered for the loans are less than the entire year in any regard.

How does retroactive coordination between the PPP loan and Employee Retention Credit work?

- The IRS guidance, Notice 2021-20, clarifies that if an employer applied for and received a PPP loan in 2020, such employer is “deemed” to have elected not to have taken the retention credit for the amount of qualified wages included in payroll costs up to (but not exceeding) the minimum amount of payroll costs, plus other eligible expenses sufficient to support the amount of the PPP loan that was forgiven. If the employer reported on its PPP loan application more in eligible expenses than it received in loan payments, the balance for qualified wages can generally be applied for the retention credit.

    1. E.g., an employer applied for a $200,000 PPP loan. This employer was required and did report a minimum of $120,000 of payroll costs and also reported $80,000 of other eligible expenses on the loan forgiveness application. The SBA approved forgiveness of the $200,000 PPP loan, so this employer may now claim a retroactive retention credit on qualified wages paid above the $120,000 covered by the PPP loan during 2020.

Can I “swap” payroll expenses I previously reported to the SBA for PPP loan purposes for other eligible expenses?

- When applying for a 2020 PPP loan, many employers listed payroll expenses only, while leaving off other eligible expenses because they exceeded the PPP loan cap.
- Because both the PPP loan and retention credit can now be claimed for 2020, employers would be tempted to “swap out” payroll expenses in place of other PPP-eligible expenses to take advantage of the retroactive retention credit (while avoiding “double dipping”). The IRS takes the position that this is not allowed.

    1. E.g., an employer applied for a $200,000 PPP loan and submitted $200,000 payroll on its forgiveness application. This employer also had $70,000 in other eligible expenses but did not report this to the Small Business Administration in the forgiveness application. Although the employer would be tempted to argue that the PPP loan actually covered only $130,000 in payroll and $70,000 in other eligible expenses, the IRS prohibits this type of after-the-fact recalibration. This employer is deemed to have elected not to have taken the retention credit for the full wages covered by the $200,000 PPP loan.

How can I claim the credit?

- There are generally 3 ways to claim the employee retention credit:
    1. Withhold employment taxes in anticipation of receiving the credit;
    2. Request a refund via employment tax returns (i.e., Form 941); and
    3. Request an advance through the form designated by the IRS (with some limitations).

- **Note: the IRS released Notice 2021-23 on claiming the retention credit for the first two quarters of 2021. Additional guidance is anticipated on how to claim the retention credit in the latter quarters of 2021, in accordance with the American Rescue Plan Act.**

What is the first way to claim the credit?

- In anticipation of claiming the credit, employers can retain a corresponding amount of the employment taxes that otherwise would have been deposited, including:

  1. federal income tax withholding;
  2. the employees' share of Social Security and Medicare taxes; and
  3. the employer's share of Social Security and Medicare taxes for all employees, up to the amount of the credit, without penalty, taking into account any reduction for deposits in anticipation of the paid sick and family leave credit provided in the Families First Coronavirus Response Act.

Is there a second way to claim the credit?

- In order to claim the new Employee Retention Credit, eligible employers can also report their total qualified wages and related health insurance costs for each quarter on their quarterly employment tax returns (Form 941 for most employers).
- The credit is currently permitted to be taken against all the Federal employment tax owed for the quarter on Form 941.
- **Example:** Employer has 100 employees and a Retention Credit of $500K. Employer paid $600K in all Federal employment taxes shown on the Form 941 for the quarter. Employer claims a refund or credit of $500K of the $600K shown on the Form 941.

Is there a third way to claim the credit?

- Some eligible employers can also request an advance of the Employee Retention Credit by submitting Form 7200, Advance of Employer Credits Due To COVID-19.
- Note that under IRS guidance, the employer can only use this method if there are insufficient employment taxes set aside for deposit to cover the amount of the anticipated credit.
- In addition, effective January 1, 2021, this method is limited to small employers (i.e. employers with an average of 500 or fewer full time employees in 2019).
- **Example**: A small employer who is eligible for a $100,000 retention credit but has an employment tax liability of $80,000 for the relevant quarter may withhold the $80,000 and use the Form 7200 to request an advance of the remaining $20,000.

How can I claim the retention credit retroactively for 2020?

- Employers that received a PPP loan in 2020 may be eligible for the employee retention credit and can claim it retroactively.
- Employers who filed quarterly tax returns in 2020 but did not claim the retention credit can now file a claim for a refund using a Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, for a past calendar quarter.

Where can I get more information?

- IRS Frequently Asked Questions:

  https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act
- IRS Guidance on Claiming the Retention Credit:

  https://www.irs.gov/coronavirus/employee-retention-credit
- IRS Guidance on Claiming the Retention Credit Including PPP Loan Coordination:

  https://www.irs.gov/pub/irs-drop/n-21-20.pdf
- Latest IRS Guidance on Claiming the Retention Credit in Q1 and Q2 of 2021:

  https://www.irs.gov/pub/irs-drop/n-21-23.pdf