

## Employee Retention Credit – The Rules Become More Liberal, More Complex

Recent legislation hosts a multitude of tax law changes. Many of the changes, such as the Employee Retention Credit (ERC), are narrowly targeted to businesses impacted by COVID-19. Although the ERC calculations can be meticulous (especially for businesses that received a PPP loan) the potential benefits can be significant, particularly for businesses with a large number of employees. The maximum per-employee credit for 2020 is \$5,000. The maximum per employee credit for 2021 is \$14,000. The ERC is available to businesses (with employees) that have suffered COVID-19 related closures or have experienced a significant decline in gross receipts in 2020 and/or the first half of 2021. The credit is applied against federal employment tax deposits and is fully refundable if the credit exceeds the payroll tax deposit.

The ERC provision in the tax code originated with the March 27, 2020 Coronavirus Aid, Relief, and Economic Security Act (CARES Act). New ERC provisions were added with the Consolidated Appropriation Act (CAA), signed into law on December 27, 2020. This latest legislation liberalized the availability of the ERC retroactively to 2020 while expanding and enhancing the availability of the credit for the first half of 2021.

The retroactive 2020 ERC benefits must be claimed on amended 2020 quarterly Forms 941. The 2021 ERC benefits may be claimed by either reducing 2021 federal payroll tax deposits, filing Form 7200 to request an Advance Payment from the IRS or by claiming the credit on the 2021 Form 941.

Refer to the attached 2020 and 2021 Employee Retention Credit Decisions Trees for a birds-eye view of how the credit works and qualification requirements for each year. The rest of this article dives into the details of the qualification rules and credit calculations for 2020 and 2021, important exclusions from ERC wages of which you need to be aware, and the documentation you will need to retain to support any ERC credits claimed.

### Calculating the Credit

2020: The ERC is 50% of qualified 2020 wages (including certain health plan costs) that an eligible employer pays to employees from March 13, 2020, through December 31, 2020. The maximum credit is \$5,000 per year per employee.

2021: The ERC is 70% of up to \$10,000 of qualified 2021 wages per quarter (including health care costs) paid between January 1, 2021, and June 30, 2021. The maximum credit is \$7,000 per quarter per employee.

*Note: PPP borrowers were not initially eligible for the employee retention credit under the CARES Act, but that changed with the new CAA. PPP borrowers are now eligible for the ERC retroactively to 2020 and through June 30, 2021, but only with respect to wages not used to apply for PPP loan forgiveness.*

### The 2020 Qualification Trail

Qualification 1: The Shutdown Test. Was your business fully or partially shut down by government order during any 2020 calendar quarter? If Yes, you are an eligible employer for the period during which your business was fully or partially shut down. Note that the period of shut down (and therefore the resulting qualified wages)

may be shorter than the calendar quarter in which the shutdown occurred. Proceed to Qualification 2 below to determine if you also qualify under the revenue decline test.

For examples of full or partial suspension, see Note 1 below.

**Qualification 2: The Revenue Decline Test.** Calculate your gross receipts for each quarter in 2019. Does the comparable quarter in 2020 shows less than 50% of the gross receipts of the same quarter in 2019? If Yes, you are an eligible employer for the first 2020 quarter in which you meet the revenue decline test. You continue to be an eligible employer until the calendar quarter *following* the quarter in which gross receipts rise to more than 80% of the same period in 2019. If you meet the revenue decline test, proceed to the calculation details in the Employee Count paragraph below.

*NOTE: The decline in gross receipts does not need to be the result of COVID-19.*

If your answer to Qualification 1 and/or Qualification 2 above is Yes, you are an eligible employer for 2020. Proceed to the Employee Count paragraph below. If your answer to Qualification 1 and Qualification 2 above is No, you are not an eligible employer for 2020 and do not qualify for the 2020 credit.

**2020 Employee Count and Eligible Wages.** Up to \$10,000 of wages (including certain health care costs) that an eligible employer paid to employees after March 12, 2020, and before January 1, 2021 may qualify for the credit, depending on the size of your business.

\*100 or fewer FTE's – employee wages paid during the period operations were suspended or for the quarter in which the decline in gross receipts occurred, are considered eligible wages (regardless of whether the employees provided services).

\*More than 100 FTE's – employee wages paid during the period operations were suspended or for the quarter in which the decline in gross receipts occurred, are considered eligible wages only if the employees did not work during the calendar quarter as a result of the shutdown (i.e. the employees were getting paid, but not working).

To determine an "FTE" for purposes of these rules, see Note 2 below.

#### ***EXCLUSIONS FROM ERC WAGES:***

- If you obtained a PPP Loan, wages that may otherwise qualify aren't eligible if the same wages were or plan to be used to apply for PPP loan forgiveness.
- Wages paid under the family and/or sick leave provisions of the Families First Coronavirus Response Act (FFCRA).
- Wages claimed under the Work Opportunity Credit do not qualify.
- Presumably, wages paid to an owner of the business qualify, however wages paid to relatives or family members do not qualify.
- Related employers must be aggregated as a single employer for all aspects of the ERC.

### **The 2021 Qualification Trail**

**Qualification 1: The Shutdown Test.** Was your business fully or partially shut down by government order during either of the first two quarters of 2021? If Yes, you are an eligible employer for the period during which your

business was fully or partially shut down. Note that the period of shut down (and therefore the resulting qualified wages) may be shorter than the calendar quarter in which the shutdown occurred. Proceed to Qualification 2 below to determine if you also qualify under the revenue decline test.

For examples of full or partial suspension, see Note 1 below.

**Qualification 2: The Revenue Decline Test.** Calculate your gross receipts for each of the first two quarters in 2019. Does the comparable quarter in 2021 shows less than 80% of the gross receipts of the same quarter in 2019? If Yes, you are an eligible employer for the relevant 2021 quarter(s). If you meet the revenue decline test, proceed to the calculation details in the Employee Count paragraph below.

**2021 election available.** When doing the math for 2021, the taxpayer can elect to use the preceding quarter for applying the 80% revenue decline test. For example, when looking at the revenue decline for Q1 of 2021, the employer can apply the 80% revenue decline test by comparing Q4 of 2020 (the preceding quarter) to Q4 of 2019.

If your answer to Qualification 1 and/or Qualification 2 above is Yes, you are an eligible employer for 2021. Proceed to the Employee Count paragraph below. If your answer to Qualification 1 and Qualification 2 above is No, you are not an eligible employer for 2021 and do not qualify for the 2021 credit.

**2021 Employee Count and Eligible Wages.** Up to \$10,000 of wages per quarter (including certain health care costs) that an eligible employer paid to employees from January 1, 2021 through June 30, 2021 may qualify for the credit, depending on the size of your business.

\*500 or fewer FTE's – employee wages paid during the period operations were suspended or for the quarter in which the decline in gross receipts occurred, are considered eligible wages (regardless of whether the employees provided services).

\*More than 500 FTE's – employee wages paid during the period operations were suspended or for the quarter in which the decline in gross receipts occurred, are considered eligible wages only if the employees did not work during the calendar quarter as a result of the shutdown (i.e. the employees were getting paid, but not working).

To determine an "FTE" for purposes of these rules, see Note 2 below.

#### **EXCLUSIONS FROM ERC WAGES:**

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- Presumably, wages paid to an owner of the business qualify, however wages paid to relatives or family members do not qualify.
- Related employers must be aggregated as a single employer for all aspects of the ERC.

**Advance Payment.** For 2021, qualified employers with 500 or fewer FTE's in 2019 may file Form 7200 to request an Advance Payment of the credit (subject to certain limitations). This is an elective provision.

**2021 Illustration.** The maximum 70% credit for an employee earning \$9,000 in Q1 and \$10,000 in Q2 would be \$6,300 in Q1 plus \$7,000 in Q2, or \$13,300 in total for 2021.

## **Documenting the Credit**

The following items should be retained as supporting documentation when claiming the 2020 and 2021 employee retention credit:

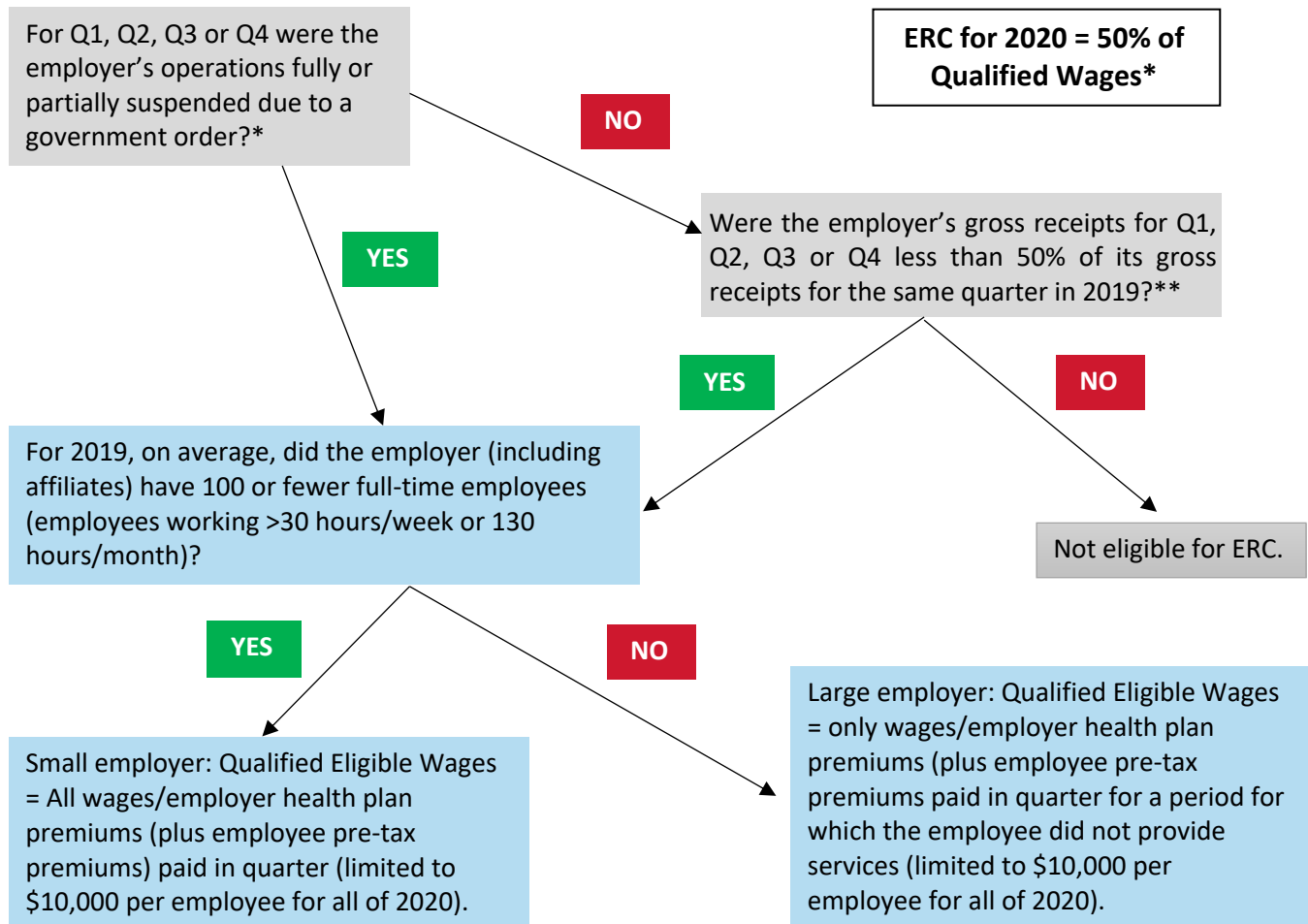
1. Support for qualification as an eligible employer under the shut down and/or revenue decline tests, including a copy of the relevant government order and/or documentation to show the decline in gross receipts for the applicable quarters.
2. Support for the employee count/FTE calculations that show how you arrived at the FTE count.
3. Schedules to support the qualified wage and credit calculations by employee, including quarterly payroll tax reports and qualified health care expenses.
4. For businesses with PPP loans, retain documentation to prove the same wages used to apply for PPP loan forgiveness were not also used to claim the employee retention credit.

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**Note 1:** For examples of full or partial suspension, see the Employee Retention Credit article in the COVID-19 Resource Center on our website at the following link: <https://beachfleischman.com/tax-bites/2020/04/employee-retention-credit/>.

**Note 2:** What is an “FTE” for purposes of these rules? Generally, an employee working an average of 30 hours a week, or 130 hours in the month, are included in the FTE calculation for that month. An employer in business for all of 2019 would measure full-time employees (FTE’s) by summing the FTE’s for each month and then dividing by 12.

## 2020 Employee Retention Credit (ERC) Decision Tree



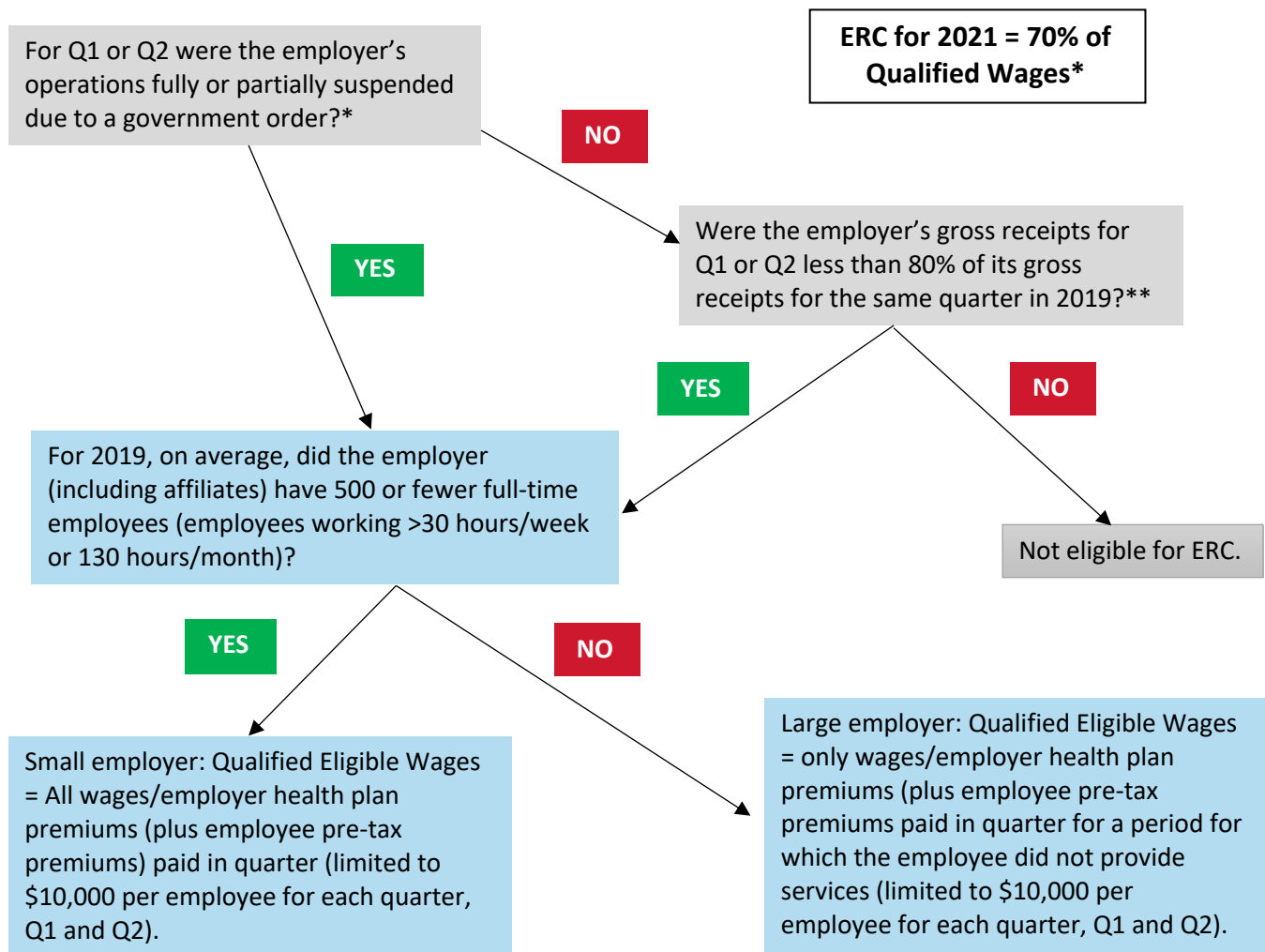
\*Only the wages/health plan premiums paid during the period of the shut-down would be Qualified Eligible Wages, not the wages for the full quarter. For example, if your business was shut down under government order from April 1 – April 30, wages paid during this period are considered eligible wages under the suspension of operation test.

\*\* For 2020: 1<sup>st</sup> applicable quarter is 1<sup>st</sup> quarter in that the revenue had a 50% or more decrease and eligibility continues until the first day of the quarter after the quarter that gross receipts increase to greater than 80% of the gross receipts of the same quarter in 2019.

**NOTE for PPP Loan recipients:** Qualified Eligible Wages cannot be the same wages you used for the PPP Loan forgiveness calculation.

**NOTE Aggregation Rules for Related Employers:** Related employers will need to be aggregated as a single employer for all aspects of the ERC.

## 2021 Employee Retention Credit (ERC) Decision Tree



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\*\* An election is available to use the immediately preceding calendar quarter (for 1<sup>st</sup> quarter of 2021, an employer may elect to compare gross receipts of the 4<sup>th</sup> quarter of 2020 to the 4<sup>th</sup> quarter of 2019 and for 2<sup>nd</sup> quarter of 2021, an employer may elect to compare gross receipts of the 1<sup>st</sup> quarter of 2021 to the 1<sup>st</sup> quarter of 2019).

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**NOTE Aggregation Rules for Related Employers:** Related employers will need to be aggregated as a single employer for all aspects of the ERC.