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EMPLOYEE RETENTION CREDIT (ERC): MAXIMIZING COVID RELIEF BY SUPPLEMENTING PPP

The Paycheck Protection Program has been commonly heralded as the foremost source of financial relief for businesses during COVID-19. However, the Employee Retention Credit or "ERC," is a lesser-known replacement or supplement for PPP that has remained largely unleveraged by employers. Enacted in March of 2020 under the CARES Act, the ERC provides qualifying employers with tax relief and potential refundable tax credits for all or a portion of the 2020 and 2021 tax years, up to $26,000 per full time employee in the best-case scenarios. Although originally created under the CARES Act, the ERC has been the subject of numerous amendments, modifications and IRS interpretations, all of which have muddied the waters for employers seeking to responsibly and accurately file for the credit. With this complex backdrop, this article will describe the general requirements and procedure for claiming the credit in addition to answering frequently asked questions regarding the same. However, any employer seeking to file for the ERC should first coordinate with its advisors, particularly its accountants and attorneys, to ensure accuracy, navigate potential pitfalls, and to avoid liabilities in applying for and claiming the credit.

How to Qualify – Eligible Employers

The threshold question for any business seeking to claim ERC is whether the business constitutes an "eligible employer," a requirement that can be met in one of three ways. Eligible employers must fall into one of the following categories:

1. The business was fully or partially suspended due to a government order during 2020, 2021, or some period therein ("Full or Partial Suspension");
2. The business experienced a significant decline in gross receipts during a 2020 or 2021 quarter ("Sales Testing"); or
3. The business was a "recovery startup."

For clarity, both for-profit as well as non-profit organizations may take advantage of the ERC provided that the entity constitutes an eligible employer.

Full or Partial Suspension: For a business to constitute an eligible employer via Full or Partial Suspension, the Federal government, or a state or local government having

jurisdiction over the business, must have promogulated orders or other mandatory proclamations or decrees that suspend more than a nominal portion of the business's operations. Under Full or Partial Suspension, a business will constitute an eligible employer for those periods of time that the applicable governmental orders caused the business to be fully or partial suspended.

Sales Testing: For a business to constitute an eligible employer via Sales Testing, the business must have experienced a significant decline in gross receipts for each calendar quarter in which the business is claiming the ERC.

- For 2020, a business will be deemed to experience a significant decline in gross receipts beginning as of the first 2020 calendar quarter in which the business's gross receipts measure less than 50% of gross receipts for the same calendar quarter in 2019, and this Sales Testing period will continue to run until the first calendar quarter after the business's gross receipts measure more than 80% of gross receipts for the same calendar quarter in 2019.
- For 2021, a business will be deemed to experience a significant decline in gross receipts for each calendar quarter in which the business's gross receipts measure less than 80% of gross receipts for (i) the same calendar quarter in 2019 or (ii) the immediately preceding calendar quarter in 2019. Additionally, for businesses not in existence in 2019, a business may opt to use 2020 calendar quarters as the comparative quarters for Sales Testing.

Recovery Startups: For a business to constitute an eligible employer as a recovery startup, the business must have begun operations after February 15, 2020, and have less than $1,000,000 in revenue for the applicable calendar year(s).

Extent of Employee Retention Credit – Qualified Wages

For those businesses that constitute an eligible employer, the ERC is (i) limited to a percentage of "qualified wages" paid to employees during the applicable calendar quarter, and (ii) first credited against "applicable employment taxes," with the remainder refunded to the taxpayer, all with different rules applicable in different calendar quarters.

- **2020 Q1 – Q4:**
  - For eligible employers with no more than 100 full time employees, qualified wages mean all wages paid to any W-2, full time employee, during the Full or Partial Suspension or Sales Testing Period.
  - ERC is limited to $5,000 per employee, equivalent to 50% of the qualified wages paid to each employee during the applicable Full or Partial Suspension or Sales Testing period up to $10,000 in qualified wages per employee for the entire 2020 calendar year.
- **2021 Q1 – Q3:**
  - For eligible employers with no more than 500 full time employees, qualified wages mean all wages paid to any W-2, full time employee, during the Full or Partial

Suspension or Sales Testing Period.
    - ERC is limited to $7,000 per employee per fiscal quarter, equal to $21,000 across the first three quarters of 2021, equivalent to 70% of the qualified wages paid to each employee during the applicable Full or Partial Suspension or Sales Testing period up to $10,000 in qualified wages per employee per fiscal quarter.
- **2021 Q3 – Q4:**
    - The same rules as 2021 Q1 – Q3 apply, but recovery startup businesses may claim ERC not to exceed $50,000 for quarters 2021 Q3 and 2021 Q4, provided that the recovery startup does not qualify for or claim ERC under Full or Partial Suspension or Sales Testing.
    - Additionally, for 2021 Q4, ERC is only available for businesses that constitute post recovery startups and is no longer available for businesses via Full or Partial Suspension or Sales Testing.

Coordination with Other Programs – PPP and ERC

ERC may be limited for otherwise eligible employers when the business took part in other COVID relief or tax credit programs. Although an eligible employer may claim ERC even if the business received PPP loan forgiveness, the employer's qualified wages taken into account for ERC purposes must be reduced by any qualified wages constituting "payroll costs" in connection with PPP loan forgiveness. Additionally (among several other limitations), to avoid double-dipping on wage-based tax credits, wages taken into account for various other tax credits, including the following, may not also be utilized in claiming ERC: (i) R&D tax credit; (ii) Indian Employment Credit; (iii) Active-Duty Members Credit; (iv) Work Opportunity Tax Credit; and (v) Empowerment Zone Employment Credit.

Claiming the Employee Retention Credit – Procedure and Applicable Deadlines:

Today, the method by which an eligible employer claims the ERC is by amending its Form 941 quarterly federal tax returns (via Form 941-X). Additionally, businesses will generally have to amend their income tax returns in connection with claiming the ERC as any deductions taken for qualified wages will have to be reduced to the extent of the ERC received. The credit is available for as long as a business is able to amend its original form 941s. For an eligible employer's 941s filed in connection with the 2020 fiscal year, the business will generally have until April 15, 2024, to file a 941-X, three years after the general deemed filing date for such 941s. For an eligible employers 941s filed in connection with the 2021 fiscal year, the business will generally have until April 15, 2025, to file a 941-X, three years after the general deemed filing date for such 941s. However, due to the lead time associated with filing for, being approved for and receiving any applicable refund in connection with the ERC, as well as the general requirement that the business's applicable income tax returns be amended, businesses desiring to claim the ERC should consider taking steps to claim the credit sooner rather than later, allowing for significant lead time.

Disclaimer – Seek Legal and Accounting Advice

Given the legal and accounting complexity associated with the Employee Retention Credit, any individual or business seeking to claim the credit must reach out and coordinate with their attorneys and accountants to determine the extent to which they qualify for ERC, if at all. This article is for informational purposes only and should not be relied on as either legal or accounting advice.

For questions or further information relating to the Employee Retention Credit please contact Attorney Samuel D. Nelson or Attorney Chad J. Richter.