

# COMPLIANCE ALERT

## IRS PROVIDES GUIDANCE ON CARES ACT EMPLOYEE RETENTION TAX CREDITS

April 1, 2020

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), enacted on March 27, 2020, is designed to encourage employers to keep employees on their payroll, despite experiencing economic hardship related to COVID-19, with an employee retention tax credit (Employee Retention Credit). The CARES Act does not require employers to pay qualified wages. Keep in mind, however, that the Families First Coronavirus Relief Act (FFCRA) requires certain employers to pay sick or family leave wages to employees who are unable to work or telework due to certain circumstances related to COVID-19. Employers are entitled to a refundable tax credit for the required FFCRA leave paid, up to specified limits, but the same wages cannot be counted for both credits.

### What is the Employee Retention Credit?

The Employee Retention Credit is a fully refundable tax credit for employers equal to 50% of qualified wages (including allocable qualified health plan expenses) that eligible employers pay their employees. This Employee Retention Credit applies to qualified wages paid after March 12, 2020, and before January 1, 2021. The maximum amount of qualified wages taken into account with respect to each employee for all calendar quarters is \$10,000, so that the maximum credit for an eligible employer for qualified wages paid to any employee is \$5,000.

### Who is an Eligible Employer?

Eligible Employers for the purposes of the Employee Retention Credit are those that carry on a trade or business during calendar year 2020, including a tax-exempt organization, but excluding governmental employers and self-employed individuals, that either:

- Fully or partially suspends operation during any calendar quarter in 2020 due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19; or
- Experiences a significant decline in gross receipts during the calendar quarter.

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The operation of a trade or business may be partially suspended if an appropriate governmental authority imposes restrictions upon the business operations by limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19 such that the operation can still continue to operate but not at its normal capacity.

*Example: A state governor issues an executive order closing all restaurants, bars, and similar establishments in the state in order to reduce the spread of COVID-19. However, the executive order allows those establishments to continue food or beverage sales to the public on a carry-out, drive-through, or delivery basis. This results in a partial suspension of the operations of the trade or business due to an order of an appropriate governmental authority with respect to any restaurants, bars, and similar establishments in the state that provided full sit-down service, a dining room, or other on-site eating facilities for customers prior to the executive order.*

A significant decline in gross receipts begins with the first quarter in which an employer's gross receipts for a calendar quarter in 2020 are less than 50% of its gross receipts for the same calendar quarter in 2019. The significant decline in gross receipts ends with the first calendar quarter that follows the first calendar quarter for which the employer's 2020 gross receipts for the quarter are greater than 80% of its gross receipts for the same calendar quarter during 2019.

*Example: An employer's gross receipts were \$100,000, \$190,000, and \$230,000 in the first, second, and third calendar quarters of 2020, respectively. Its gross receipts were \$210,000, \$230,000, and \$250,000 in the first, second, and third calendar quarters of 2019, respectively. Thus, the employer's 2020 first, second, and third quarter gross receipts were approximately 48%, 83%, and 92% of its 2019 first, second, and third quarter gross receipts, respectively. Accordingly, the employer had a significant decline in gross receipts commencing on the first day of the first calendar quarter of 2020 (the calendar quarter in which gross receipts were less than 50% of the same quarter in 2019) and ending on the first day of the third calendar quarter of 2020 (the quarter following the quarter for which the gross receipts were more than 80% of the same quarter in 2019). Thus the employer is entitled to a retention credit with respect to the first and second calendar quarters.*

## How Much is the Retention Credit?

The credit equals 50% of the qualified wages (including qualified health plan expenses) that an eligible employer pays in a calendar quarter. The maximum amount of qualified wages taken into account with respect to each employee for all calendar quarters is \$10,000, so that the maximum credit for qualified wages paid to any employee is \$5,000.

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*Example 1: Eligible employer pays \$10,000 in qualified wages to Employee A in Q2 2020. The Employee Retention Credit available to the eligible employer for the qualified wages paid to Employee A is \$5,000.*

*Example 2: Eligible employer pays Employee B \$8,000 in qualified wages in Q2 2020 and \$8,000 in qualified wages in Q3 2020. The credit available to the eligible employer for the qualified wages paid to Employee B is equal to \$4,000 in Q2 and \$1,000 in Q3 due to the overall limit of \$10,000 on qualified wages per employee for all calendar quarters.*

Qualified wages are wages (as defined in section 3121(a) of the Internal Revenue Code (the Code)) and compensation (as defined in section 3231(e) of the Code) paid by an eligible employer to employees after March 12, 2020, and before January 1, 2021. Qualified wages include the eligible employer's qualified health plan expenses that are properly allocable to the wages.

If the eligible employer averaged more than 100 full-time employees in 2019, qualified wages are the wages paid to an employee for time that the employee is not providing services due to either:

- a full or partial suspension of operations by order of a governmental authority due to COVID-19, or
- a significant decline in gross receipts.

For these employers, qualified wages taken into account for an employee may not exceed what the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period of economic hardship.

If the eligible employer averaged 100 or fewer full-time employees in 2019, qualified wages are the wages paid to any employee during any period of economic hardship described in the immediately preceding bullets.

## **How Does the Credit Work?**

The credit is allowed against the employer portion of Social Security taxes under Code section 3111(a), and the portion of taxes imposed on railroad employers under section 3221(a) of the Railroad Retirement Tax Act (RRTA) that corresponds to the Social Security taxes under Code section 3111(a).

The credits are fully refundable because the eligible employer may get a refund if the amount of the credit is more than certain federal employment taxes the eligible employer owes. That is, if for any calendar quarter the amount of the credit the eligible employer is entitled to exceeds the employer portion of the Social

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Security tax on all wages (or on all compensation for employers subject to RRTA) paid to all employees, then the excess is treated as an overpayment and refunded to the employer. Consistent with its treatment as an overpayment, the excess will be applied to offset any remaining tax liability on the employment tax return and the amount of any remaining excess will be reflected as an overpayment on the return. Like other federal tax overpayments, the overpayment will be subject to offset prior to being refunded to the employer.

*Example: Eligible employer pays \$10,000 in qualified wages to Employee A in Q2 2020. The Employee Retention Credit available to the eligible employer for the qualified wages paid to Employee A is \$5,000. This amount may be applied against the employer share of Social Security taxes that the eligible employer is liable for with respect to all employee wages paid in Q2 2020. Any excess over the employer's share of Social Security taxes is treated as an overpayment and refunded to the eligible employer after offsetting other tax liabilities on the employment tax return and subject to any other offsets under section 6402(a) of the Code.*

## **How does an Eligible Employer Claim the Retention Credit?**

Eligible employers will report their total qualified wages and the related credits for each calendar quarter on their federal employment tax returns, usually Form 941, Employer's Quarterly Federal Tax Return, which employers use to report income and Social Security and Medicare taxes withheld by the employer from employee wages, as well as the employer's portion of Social Security and Medicare tax.

In anticipation of receiving the credits, eligible employers can fund qualified wages by accessing federal employment taxes, including withheld taxes, that are required to be deposited with the IRS or by requesting an advance of the credit from the IRS.

An eligible employer may fund the qualified wages by accessing federal employment taxes, including those that the eligible employer already withheld, that are set aside for deposit with the IRS, for other wage payments made during the same quarter as the qualified wages.

That is, an eligible employer that pays qualified wages to its employees in a calendar quarter before it is required to deposit federal employment taxes with the IRS for that quarter may reduce the amount of federal employment taxes it deposits for that quarter by half of the amount of the qualified wages paid in that calendar quarter. The eligible employer must then account for the reduction in deposits on the Form 941, Employer's Quarterly Federal Tax Return, for the quarter.

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*Example: An eligible employer paid \$10,000 in qualified wages (including qualified health plan expenses) and is therefore entitled to a \$5,000 credit, and is otherwise required to deposit \$8,000 in federal employment taxes, including taxes withheld from all of its employees, for wage payments made during the same quarter as the \$10,000 in qualified wages. The eligible employer has no paid sick or family leave credits under the FFCRA. The eligible employer may keep up to \$5,000 of the \$8,000 of taxes the eligible employer was going to deposit, and it will not owe a penalty for keeping the \$5,000. The eligible employer is required to deposit only the remaining \$3,000 on its required deposit date. The eligible employer will later account for the \$5,000 it retained when it files Form 941, Employer's Quarterly Federal Tax Return, for the quarter.*

An eligible employer will not be subject to a penalty under Code section 6656 if:

- it paid qualified wages to its employees in the calendar quarter before the required deposit,
- the amount of federal employment taxes that it does not timely deposit, reduced by any amount of federal employment taxes not deposited in anticipation of the credits claimed under the FFCRA, is less than or equal to the amount of the eligible employer's anticipated Employee Retention Credit for the qualified wages for the calendar quarter at the time of the required deposit, and
- it did not seek payment of an advance credit by filing Form 7200, Advance Payment of Employer Credits Due to COVID-19, as to any portion of the anticipated credits by which it reduced its deposits.

Because quarterly returns are not filed until after qualified wages are paid, some eligible employers may not have sufficient federal employment taxes set aside for deposit to the IRS to fund their qualified wages. Accordingly, the IRS has established a procedure for obtaining an advance of the refundable credits.

The eligible employer should first reduce its remaining federal employment tax deposits for wages paid in the same calendar quarter by the maximum allowable amount. If the anticipated credit for the qualified wages exceeds the remaining federal employment tax deposits for that quarter, the eligible employer can file a Form 7200, Advance Payment of Employer Credits Due to COVID-19, to claim an advance refund for the full amount of the anticipated credit for which it did not have sufficient federal employment tax deposits.

If an eligible employer fully reduces its required deposits of federal employment taxes otherwise due on wages paid in the same calendar quarter to its employees in anticipation of receiving the credits, and it has not paid qualified wages in excess of this amount, it should not file the Form 7200. If it files the Form 7200, it will need to reconcile this advance credit and its deposits with the qualified wages on Form 941 (or other applicable federal employment tax return such as Form 944 or Form CT-1), and it may have an underpayment of federal employment taxes for the quarter.

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*Example: An eligible employer paid \$20,000 in qualified wages, and is therefore entitled to a credit of \$10,000, and is otherwise required to deposit \$8,000 in federal employment taxes, including taxes withheld from all of its employees, on wage payments made during the same calendar quarter. The eligible employer has not paid sick or family leave credits under the FFCRA. The eligible employer can keep the entire \$8,000 of taxes that it was otherwise required to deposit without penalties as a portion of the credits it is otherwise entitled to claim on the Form 941. The eligible employer may file a request for an advance credit for the remaining \$2,000 by completing Form 7200.*

## **Coordinating Employee Retention Credit and FFCRA Tax Credits**

An eligible employer can receive both the tax credits for the qualified leave wages under the FFCRA and the Employee Retention Credit under the CARES Act, but not for the same wages. The amount of qualified wages for which an eligible employer may claim the Employee Retention Credit does not include the amount of qualified sick and family leave wages for which the employer received tax credits under the FFCRA.

An eligible employer may not receive the Employee Retention Credit if the eligible employer receives a Small Business Interruption Loan under the Paycheck Protection Program that is authorized under the CARES Act (Paycheck Protection Loan). Thus, an eligible employer that receives a paycheck protection loan should not claim Employee Retention Credits.

## **Conclusion**

These are extraordinary times, and the ramifications of COVID-19 will continue to evolve rapidly in the coming weeks. We will continue to monitor developments, including further departmental and agency guidance as we receive them and will provide the latest updates as they become available.

We express to all of our clients and friends our deep appreciation for our ongoing relationships, and we look forward to strengthening those ties as we work through this shared adversity. Stay safe and be well.

### ***EPIC Employee Benefits Compliance Services***

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