

COVID-19-Related Employee Retention Credit: Updated IRS Guidance

The Coronavirus Aid, Relief, and Economic Security Act ([CARES Act](#)) provides a [refundable employee retention tax credit \(ERC\)](#) for [qualified wages](#) paid by certain employers impacted by COVID-19. The Internal Revenue Service (IRS) subsequently released comprehensive [Frequently Asked Questions \(FAQ\)](#), with an updated list released on May 7, 2020, to address many of the open questions related to application of the ERC. The IRS has also released a draft of a new [IRS Form 941, Employer's Quarterly Federal Tax Return](#), set to go into effect for the second quarter of 2020, to accommodate reporting for COVID-19-related payroll tax credits and the employment tax deferral.

This alert addresses the updates and clarifications provided in the new IRS guidance. While the IRS FAQs are not binding, they provide much needed guidance on the IRS' view of the credit. A comparison table related to COVID-19-related payroll tax credits is also provided below.

The key changes and clarification in the IRS guidance provide:

- Specific details and examples to assist in determining whether a business has been fully or partially suspended or experienced a significant decline in gross receipts;
- Clarification that employers who return their Payroll Protection Program (PPP) loans prior to the U.S. Small Business Administration's (SBA) safe harbor deadline of May 14, 2020¹ are eligible to claim the ERC;
- A reversed stance that an employer's health expenses can be treated as qualified wages for purposes of the ERC even if no wages are paid to an employee; and
- The ability to reduce payroll tax deposits by the amount of deferred employment tax prior to calculating an advanced payment of COVID-19-related payroll tax credits.

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Employee Retention Credit

The ERC is a refundable payroll tax credit for qualified wages paid by employers who either (1) are required by a governmental order to fully or partially suspend operations; or (2) experience a significant decline in gross receipts in 2020.

Fully or Partially Suspend Operations Due to a Governmental Order

Most government orders allowed essential businesses to continue to operate. Under the new IRS guidance, essential businesses allowed to stay open and operate under a governmental order will not qualify as fully or partially suspending operations. However, an essential business may qualify as suspended if it is unable to obtain critical goods from a supplier who is required to suspend operations under the order and the essential business cannot procure such critical goods from another supplier. Furthermore, the FAQs affirms that an essential business will not have a full or partial suspension for the sole reason that its customers are subject to a government order requiring them to stay at home.

If the order causes a partial suspension, an employer should be eligible for the ERC. For example, if a governmental order requires a business's hours of operation to be reduced or limits the purpose for which the business is allowed to operate (e.g., for carry-out orders at restaurants), the business will qualify as partially suspended.

A business that is required to close its workplace but is able to continue operations at a comparable level despite the order (i.e., through teleworking), will not qualify as fully or partially suspended. Additionally, an employer who voluntarily closes or reduces operating hours will not qualify as suspended. However, if a multi-jurisdictional employer, subject to an order to fully or partially suspend operations in one of its jurisdictions, adopts a company-wide policy in all locations to comply with the order, the employer qualifies as suspended in all jurisdictions. Furthermore, because all members of an aggregated group are treated as a single employer for purposes of the ERC, if the business of one member is suspended by a governmental order, then all members of the aggregated group are considered to have their operations partially suspended. Any employer's operations will only qualify as suspended for the time period that the governmental order is in effect.

Significant Decline in Gross Receipts

An employer who experiences a significant decline in gross receipts will not need

to prove that the decline is related to a governmental order or the COVID-19 crisis. We recommend that all employers track gross receipts during 2020 because, even if the business otherwise qualifies as fully or partially suspended due to a governmental order, once the order is lifted, the business may continue to qualify due to a significant decline in gross receipts.

Qualified Wages

The qualified wages subject to the ERC depend upon whether an eligible employer (taking into account aggregation rules) averages greater than 100 full-time employees during the 2019 calendar year. For purposes of the ERC, a full-time employee is defined as averaging at least 30 hours of service per week (130 hours per month).

If an eligible employer averages 100 or fewer full-time employees, all wages paid to employees qualify for the ERC. Alternatively, a larger employer is only able to claim the credit on wages paid to employees who are not providing services. However, of significance, the FAQs confirm that the ERC is available for a larger employer who pays its employees full wages for a reduced work schedule. To illustrate, if a larger employer pays 100 percent of wages to an employee whose service to the company has been reduced to 60 percent, the difference (40 percent) is eligible for the credit because the difference represents wages paid for time the employee is not providing services.

For an employee without a fixed work schedule, the hours for which the employee is not providing services may be determined using any reasonable method. The IRS specifically states the methods available to determine entitlement to leave under the Family Medical Leave Act (FMLA) or to determine hours of paid sick leave under the Families First Coronavirus Response Act (FFCRA) are reasonable. However, it is not reasonable to treat an employee's hours as having been reduced based merely on an assessment of the employee's lower productivity.

For a larger employer, amounts paid to employees pursuant to previously accrued vacation, sick and other personal days do not count as qualified wages because the benefits were accrued during a prior period in which the employees provided services. The FAQs also confirm that severance pay, payments exempt from social security and Medicare taxes and to related individuals do not constitute qualified wages.

Qualified Health Expenses

The IRS has reversed its position and updated Questions 64 and 65 of the FAQ to specifically allow employers who do not pay wages but continue to pay health coverage to include the expenses as qualified wages for purposes of the ERC. Employers who average 100 or fewer full-time employees in 2019 may include health care expenses paid for employees who are laid off, furloughed or whose working hours are reduced during the qualifying period. For larger eligible employers, health care expenses are treated as qualified wages for the time the employee is not providing services, even if no wages are paid for that time.

Impact of PPP Loan

An employee who receives a PPP loan may not take advantage of the ERC. For employers treated as a single employer under the ERC aggregation rules, no employer can receive the ERC if any member of the aggregated group receives a PPP loan. However, if an employer received a PPP loan, but repaid such loan by May 14, 2020¹, under the SBA limited safe harbor rules, the employer will be treated as though it had not received a PPP loan for purposes of the ERC.

Employment Tax Deferral

Under the updated IRS guidance, employers are able to defer the employer portion of social security taxes associated with wages for which a tax payment or deposit is due between March 27, 2020 and December 31, 2020 (Deferral Period). Therefore, tax amounts related to wages accrued prior to March 27, 2020, but for which a tax payment is due during the Deferral Period are eligible for the deferral. Conversely, any tax payments or deposits due after December 31, 2020, even if related to wages accrued during the Deferral Period, are not eligible for deferral. Based on the draft Form 941, social security tax amounts already paid may not be retroactively deferred.

Reporting of the Credits and Deferral

The updated IRS guidance provides a comprehensive example on the interaction between the credits and employment tax deferral. Question 73 of the FAQ illustrates that an employer may first reduce its required payroll tax deposits by the amount of the deferred social security taxes. The payroll deposits are then reduced by the credits, and an employer is able to claim a refund of any excess using [IRS Form 7200](#). An employer may file multiple Forms 7200 in a single quarter so long as the amounts claimed do not exceed the amount of the credits. The complete IRS response to Question 73 of the FAQ can be found [here](#).

COMPARISON OF COVID-19-RELATED PAYROLL TAX CREDITS

Criteria	Emergency Paid Sick Leave Credit	Expanded FMLA Credit	Employee Retention Credit
Qualifying Employers	Businesses and Tax-Exempt Entities	Businesses and Tax-Exempt Entities	Employers that operate a trade or business who experience one of the following: · A full or partial suspension of operations by a governmental order due to COVID-19; or · A significant decline in gross receipts during 2020.

Criteria	Emergency Paid Sick Leave Credit	Expanded FMLA Credit	Employee Retention Credit
Qualified Wages	<p>Employee is unable to work because employee is either:</p> <ol style="list-style-type: none"> 1. Subject to a government quarantine or isolation order related to COVID-19; 2. Self-quarantined at the order of a health care provider due to COVID-19; 3. Experiencing COVID-19 symptoms and seeking a medical diagnosis; 4. Caring for an individual subject to quarantine by a government order or health care provider due to COVID-19; 5. Caring for a child because childcare provider is closed or unavailable due to COVID-19; or 6. Experiencing any other substantially similar condition. 	<p>Employee is unable to work due to caring for a child because childcare provider is closed or unavailable due to COVID-19.</p>	<p>Businesses that average:</p> <ul style="list-style-type: none"> >100 full-time employees in 2019: wages paid only for employees not providing services; or 100 or less full-time employees in 2019: all wages paid to employees.
Wage Rate (subject to caps below)	Employee's regular rate	2/3 employee's regular rate	Employee's regular rate

Criteria	Emergency Paid Sick Leave Credit	Expanded FMLA Credit	Employee Retention Credit
Are Health Expenses included in the Credit?	Yes	Yes	Yes
Is Medicare Tax included in the Credit?	Yes	Yes	No
Dates for Qualified Wages Paid	April 1, 2020-December 31, 2020	April 1, 2020-December 31, 2020	March 13, 2020-December 31, 2020
Amount of Credit	100% of Qualified Wages	100% of Qualified Wages	50% of Qualified Wages
Credit Maximum Amount	Reasons 1-3, \$511 per day, \$5,110 total Reasons 4-6, \$200 per day, \$2,000 total	\$200 per day, \$10,000 total	\$5,000 total per employee
Available to Payroll Protection Program Loan Recipients?	Yes	Yes	No. However, if an employer returned a PPP loan by the SBA safe harbor deadline of May 14, 2020, the employer is eligible to claim the credit.

Criteria	Emergency Paid Sick Leave Credit	Expanded FMLA Credit	Employee Retention Credit
Should the credit be included in gross income of the Employer?	Yes. The amount of the credit is required to be included in gross income but, generally, employers are eligible for a deduction for the qualified wages paid as "ordinary and necessary business expenses" without any deduction for the credit taken against the wages so the inclusion in income has a zero net effect.	Yes. The amount of the credit is required to be included in gross income but, generally, employers are eligible for a deduction for the qualified wages paid as "ordinary and necessary business expenses" without any deduction for the credit taken against the wages so the inclusion in income has a zero net effect.	No, the credit is not included in gross income. However, the amount of the qualified wages that would otherwise be deductible as "ordinary and necessary business expenses" must be reduced by the credit amount claimed.

If you have questions regarding the COVID-19-related payroll tax credits or employment tax deferral, please contact your Reinhart attorney.

¹ The SBA has extended the safe harbor deadline to May 18, 2020; however, as of the time of publication of this alert, the IRS has not yet updated its FAQ to be consistent with the SBA rules.

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