



## Employee Retention Credits Under the CARES Act

By Timothy S. Oberst, Partner and Ben Bowers, Manager

As a part of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) enacted on March 27th, Congress created a new employee retention credit (ERC) for businesses adversely impacted by the ongoing COVID-19 pandemic. This provision was one of several measures included in the Act which are designed to help employers retain employees during the health crisis. The ERC provides immediate relief to employers through a refundable payroll credit for up to 50% of the first \$10,000 in qualifying wages paid to each of its employees during the period in which the business is adversely affected. This article summarizes the requirements for claiming the ERC, the calculation of the credit amount and how businesses can apply for this payroll relief.

### Who is Eligible

To be eligible for the ERC, an employer must be adversely affected by the COVID-19 pandemic in one of two ways:

1. The employer's operations have been fully or partially suspended because of a government order limiting commerce, travel or group meetings due to COVID-19; or
2. The employer experiences a decline in gross receipts of 50% or more for at least one quarter in 2020 when compared to the same quarter in 2019.

*Example:* A restaurant is restricted by a government order to selling to the public on a carry-out, drive-through or delivery basis only. Prior to the order, the restaurant provided a dining room with full sit-down service to its customers. This employer qualifies under the first category as experiencing a partial suspension of operations.

The credit is available to all types of business entities, including corporations, LLCs, S corporations, partnerships and sole proprietorships. Non-profit organizations are also eligible for the credit, although they can only qualify if they have experienced a full or partial suspension of operations, and not based on the gross receipts test. The credit is **not** available to individuals to offset payroll taxes on their self-employment income.

The credit is not available to employers receiving Small Business Interruption Loans under the new Paycheck Protection Program ("PPP"), so businesses should carefully review which relief provision will be the most beneficial. While the PPP loan program is generally limited to employers with 500 or fewer employees, there are no size restrictions on eligibility for the ERC. However, there is a more restrictive definition of qualified wages for ERC purposes (discussed below) if an employer has more than 100 employees.

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Riverwood 200 3300 Riverwood Parkway Suite 700 Atlanta, GA 30339 phone 770.396.2200 fax 770.390.0394

[www.btcpa.net](http://www.btcpa.net)



### **Period of Eligibility**

Eligibility for the ERC is determined independently for each calendar quarter in 2020. For employers qualifying for the credit based on a government shutdown order, eligibility begins in the quarter that the government order is put in place and continues until the quarter in which the order is lifted.

Employers qualifying based on a significant decline in gross receipts are eligible for the credit beginning in the quarter in which gross receipts are less than 50% of what they were for the same calendar quarter in 2019. Eligibility ends at the conclusion of the quarter in which gross receipts equal at least 80% of the previous year's amount in the same quarter.

*Example:* An employer's gross receipts were \$150,000, \$200,000, \$180,000 and \$250,000 during the four calendar quarters of 2019. The gross receipts for the same quarters in 2020 are \$70,000, \$120,000, \$175,000, and \$190,000, respectively. Thus, the employer's 2020 gross receipts are approximately 47%, 60%, 97% and 76% of its gross receipts for each quarter in 2019. The period of eligibility for the ERC begins in the first quarter, when gross receipts are less than 50% of the amount for the same quarter in the previous calendar year, and continues until the end of the third quarter, when gross receipts equal at least 80% of the previous calendar year's amount for that quarter.

### **Qualified Wages and Calculating the Credit**

Qualified wages for purposes of calculating the ERC include both wages and qualified health expenses for employees that are paid during the period from March 13, 2020 through December 31, 2020. As stated previously in this article, the amount of qualified wages that can be considered for the credit is capped at \$10,000 per employee for *all* calendar quarters in 2020. The amount of the credit is 50% of qualified wages, meaning that the maximum credit that can be claimed for each employee during 2020 is \$5,000.

The definition of qualified wages is different depending on the size of the employer. For employers with 100 or fewer full-time employees, all wages paid to its employees, subject to the \$10,000 cap and the limitations discussed below, can be treated as qualified wages during the quarters of eligibility. Employers with more than 100 full-time employees can only take into account wages paid for time that employees are not providing services because of a full or partial suspension of operations or a significant decline in gross receipts. Qualified wages 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.

*Observation:* For purposes of the ERC, the number of employees is determined by taking the average of full-time employees for the business throughout 2019. In addition, in applying the 100-employee limit and determining whether a 50% drop in gross receipts has occurred, related



businesses (such as controlled groups of corporations, or partnerships or proprietorships under common control) must be aggregated together.

Not all wages paid to employees can be considered for purposes of the ERC. In addition to the cap of \$10,000 per employee, an employee's wages must be reduced by any qualified sick and family leave wages for which a tax credit is claimed under the Families First Coronavirus Response Act. If an employer claims a work opportunity tax credit for an employee, that employee's wages must also be excluded.

### **How to Claim the Credit**

Although the credit is claimed on the quarterly payroll tax returns that are filed after the end of each quarter, employers can begin receiving the tax benefits immediately upon determining that they are eligible. The first way that businesses can do this is by reducing the amount of federal employment taxes deposited with the IRS by the anticipated ERC amount. Employers can keep the employer's share of social security and Medicare taxes as well as amounts withheld from employees' pay for their share of employment taxes. The reduction in deposits will be reconciled on the Form 941 payroll tax return filed for the quarter.

*Example:* XYZ Corp., an eligible employer during the second calendar quarter of 2020, pays \$50,000 in qualified wages from April through June. XYZ is otherwise required to deposit \$30,000 in employer and employee social security and Medicare taxes with the IRS on all wages paid to its employees during that period. XYZ is allowed to keep up to \$25,000 (50% of qualified wages) of the employment taxes that are due for the second quarter, and is only required to deposit \$5,000 with the IRS.

Secondly, if the anticipated ERC amount exceeds the federal employment taxes that are due in that calendar quarter, an employer can request an advance payment of the excess by filing Form 7200, Advance Payment of Employer Credits Due to COVID-19. This can only be done after the employer has reduced its federal employment tax deposits by the maximum amount. If the employer does not have sufficient qualified wages to support the credit claim, the shortfall will have to be reconciled on the quarterly Form 941 and there may be an underpayment of federal employment taxes for the quarter.

The ERC provides an avenue for businesses that have been adversely affected by the COVID-19 pandemic to retain and compensate their employees during these difficult times. While this tax credit alone will not solve all the financial challenges faced by businesses, it does offer immediate cash flow and can be used in conjunction with other provisions of the CARES Act to provide meaningful relief.



**Learn More**

If you have any questions regarding the employee retention credit, please contact your Bennett Thrasher tax advisor by calling [770.396.2200](tel:770.396.2200).