Leimberg Information Services, Inc.

Steve Leimberg's Business Entities
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Subject: Alan Gassman and Brandon Ketron on Notice 2021-20 - March 1st IRS Notice Provides Essential Guidance and Safe Harbors for the Employee Retention Credit

"In the form of Notice 2021-20, the IRS delivered 102 pages of well-drafted and reasoned guidance on the Employee Retention Credit (ERC) on Monday, March 1st. Although additional insight on the application of these rules is forthcoming for 2021, the length of this newsletter is evidence of the ample guidance the provisions of the Notice provides in a number of areas.

IRS Notice 2021-20 provides numerous examples of businesses that can qualify to receive the Employee Retention Credit in instances where more than a 'nominal portion' of its business operations are fully or partially suspended by a governmental order that limits 'commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to the coronavirus disease 2019 (COVID-19).'

If more than a nominal portion of the business's operations are suspended, then the Employee Retention Credit can be claimed regardless of whether the employer had a reduction in revenue during the calendar quarter when the business's operations are suspended. This will continue to apply to any qualifying shutdown or reduction in operations occurring after March 12, 2020 through January 1, 2021.

The Notice also graciously imparts guidance on the interaction of the Employee Retention Credit with the Paycheck Protection Program (PPP) Loans. Initially, a business that received a PPP loan was not able to also claim the Employee Retention Credit. The Economic Aid Act subsequently eliminated this rule by allowing businesses to claim both the Employee Retention Credit and receive a PPP loan. However, the business is not allowed to count the same wages for both PPP loan forgiveness and the Employee Retention Credit. The Notice does give guidance on the process of how to 'elect out' of claiming the Employee Retention Credit so employers can use the wages for PPP loan forgiveness instead or vice versa."

Alan Gassman and **Brandon Ketron** provide members with commentary on Notice 2021-20. On Wednesday, March 10th at 1:00pm, the impact of this Notice and recent PPP guidance will be highlighted in a **LISI** Webinar by the authors titled: **"PPP and Employee Retention Credit (ERC) Update - What's New and What's Still to Come!"** Their webinar can be registered for by clicking here: Alan/Brandon

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Here is their commentary:

EXECUTIVE SUMMARY:

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FACTS:

Employers can get credit for 50% of Qualified Wages for its employees for 2020 with a maximum limit of $5,000 for the year. One of the following two tests must be met to gain eligibility:

(1) The operation of the business is fully or partially suspended due to orders from a government authority limiting commerce, travel, or group meetings due to COVID-19, in which case the credit applies for Qualified Wages paid during the period of suspension.

OR

(2) Gross receipts are less than 50% of the gross receipts for the same quarter in the previous year, in which case the credit will continue to apply up until the end of the quarter in which gross receipts are 80% of the gross receipts for the same quarter in the previous year.

The credit is increased to 70% of Qualified Wages with an upper limit of $7,000 of credit for each quarter in 2021. Furthermore, the gross receipts test only needs a 20% drop in gross receipts in order to qualify when comparing the first two quarters of 2021 to the same quarter in 2019.

COMMENT:

Under IRS Notice 2021-20, some of the more distinguished guidance are as follows:

1. Good News for PPP Borrowers Claiming the Credit.

For most people, the most relevant section revolves around where the Employee Retention Credit and loans under the Paycheck Protection Program meet. The same wages cannot be used to qualify for both PPP loan forgiveness and as Qualified Wages under the ERC. Before this Notice, borrowers had no guidance on how the two programs related to each other, nor the necessary steps to keep the programs separate.

Fortunately, the Notice makes this seemingly complex process rather simple in that the “election” only requires not claiming the ERC on the Form 941 Federal Employment Tax Return. The Notice also states where wages are included as a payroll cost on the PPP loan forgiveness application, the business is deemed to have made the "election" out of claiming the ERC with respect to such wages.

Much to the pleasure of many PPP borrowers, the Notice states a business will only be deemed to make the election out of claiming ERC for the minimum amount of wages that will result in loan forgiveness while accounting for any other eligible expenses reported on the PPP loan forgiveness application. As a result, borrowers that reported more payroll costs than necessary to achieve full PPP loan forgiveness no longer need

to consider amending a PPP loan forgiveness application to remove the excess payroll costs, since the deemed election out of ERC only applies to the minimum amount of wages needed to achieve full forgiveness. The Notice provides an illustration of this in the following example:

> Example: Employer A received a PPP loan of $100,000. Employer A is an eligible employer and paid $100,000 in qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. In order to receive forgiveness of the PPP loan in its entirety, Employer A was required, under the Small Business Administration (SBA) rules, to report a total of $100,000 of payroll costs and other eligible expenses (and a minimum of $60,000 of payroll costs). Employer A submitted a PPP Loan Forgiveness Application and reported the $100,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan. Employer A received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of $100,000.
>
> Employer A is deemed to have made an election not to take into account $100,000 of the qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. It may not treat that amount as qualified wages for purposes of the employee retention credit.

PPP borrowers are also saved from having to amend PPP loan forgiveness applications to remove excess wages when non-payroll costs are reported in addition to excess payroll costs. The following example shows how the deemed election out applies to this situation:

> Example 4: ... Employer C submitted a PPP Loan Forgiveness Application and reported the $200,000 of qualified wages as payroll costs, as well as $70,000 of other eligible expenses, in support of forgiveness of the PPP loan. Employer C received a

decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of $200,000. In this case, Employer C is deemed to have made an election not to take into account $130,000 of qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with the $70,000 of other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that was forgiven. As a result, $70,000 of the qualified wages reported as payroll costs may be treated as qualified wages for purposes of the employee retention credit.

In addition, in the event that wages are reported as payroll costs on the PPP loan forgiveness application (and thus deemed to have made the election out of claiming the ERC with respect to those wages), and PPP loan forgiveness is subsequently denied for all or a portion of the loan then such wages may subsequently be taken into account for purposes of claiming the ERC. The Notice provides several useful examples on the taxpayer friendly coordination between the ERC and PPP loans.

2. 10% Threshold Test for Determination of Partial Suspension of Business Opportunities.

The manner in which "partially suspended" is defined for purposes of closing a workplace due to government order is a key element of the Notice. The Notice provides that if an employer's workplace is closed, but may remain open for limited purposes, those operations may be considered "partially suspended" if "the operations that are closed are more than a nominal portion of its business operations and cannot be performed remotely in a comparable manner." (Q&A 17).

A portion of an employer's business operations is deemed by the IRS to be "nominal" if either:

(1) "the gross receipts from that portion of the business operations

is not less than 10 percent of the total gross receipts (both determined using the gross receipts of the same calendar quarter in 2019), or

(2) the hours of service performed by employees in that portion of the business is not less than 10 percent of the total number of hours of service performed by all employees in the employer's business[.]"

This provides a threshold test in determining if the closure order has more than a "nominal" impact on the business.

The Notice provides several other examples, including ones previously found in the IRS FAQs on the ERC, on when a business is considered to be "fully or partially suspended".

One such example involves a restaurant whose in-door dining has been suspended due to a state order but maintains a functioning drive-through / carry-out operation. Because the in-door dining accounts for more than a nominal portion of the business's operations, the restaurant's business is deemed "partially suspended." The Notice further states that even restaurants with a limited capacity due to social distancing guidelines will be considered "partially suspended."

The facts and circumstances affecting the business, its employees, and the state are important to consider when making a determination. The Notice mentions that governmental orders requiring individuals to stay at home (leading to a reduction in demand for the business) is not deemed to be full or partial suspensions of business operations. However, the above-mentioned gross receipts test may still qualify a business.

Furthermore, employers electing to limit business hours or suspend operations voluntarily due to Covid-19 do not qualify for the Employee Retention Credit by way of a full or partial suspension of business operations, but may qualify under the gross receipts test.

3. Definition of Orders From an Appropriate Governmental Authority.

It is vital to recognize only "orders from an appropriate governmental

authority" may be considered. The Notice provides orders from the Federal government along with the state or local government with jurisdiction over the business's operations are included. Further, the Notice provides that statements from a government official, including comments made during a press conference are not considered a governmental order for this purpose.

The Notice provides the following non-exhaustive list of factors to examine when determining an employers ability to continue comparable business operations (or whether they are fully or partially suspended):

(1) Employer's Telework Capabilities. Determine whether an employer has adequate support (IT and otherwise) such that operations can continue via work from another location.

(2) Portability of Employees' Work. Determine the amount of portable work, or work otherwise adaptable to be performed from a remote location, within an employer's trade or business operations.

(3) Need for Presence in an Employee's Physical Work Space. Evaluate the role that the employer's physical work space plays in an employer's trade or business (may be critical and necessary, beneficial but not necessary, or merely convenient). If the employer's physical work space is so critical to its trade or business operations that tasks central to the trade or business's operations are unable to be performed remotely, then this factor alone indicates that the employer is not able to continue comparable operations. Examples of work space that is critical include laboratories or manufacturing involving special equipment or materials that cannot be accessed or operated remotely.

(4) Transitioning to Telework Operations. If an employer can conduct comparable operations via telework, but the employer's operations did not previously allow for telework, or allowed for only minimal telework, then some adjustment period is expected, and, generally, the employer's operations are not considered partially suspended during that period. However, if an employer incurs a significant delay (for example,

beyond 2 weeks) in moving operations to comparable telework (for example, implementing telework policies or providing employees with equipment to telework), then the employer's trade or business operations may be deemed subject to a partial suspension during that transition period.

4. Requirement of No Work for Large Employers.

Employers with an average of more than 100 employees during 2019 may only claim a credit on wages paid to employees that did not provide any services due to Covid-19. This contrasts with employers of no more than 100 employees during 2019 who are able to receive the credit for wages of employees regardless of whether they actually worked in the business. For example, if a large employer pays an employee for 20 hours a week, but the employee only provided services for 12 of those hours, then the employer would be entitled to claim 8 hours of wages towards the ERC.

Large employers are also barred from claiming a credit to the extent that wages paid to an employee would be more than the employee would have earned for working the same amount of time during the 30 days immediately prior to the period the qualified wages are paid or incurred. The relevant part of the Notice reads as follows:

> Section 2301(c)(3)(A)(i) of the CARES Act provides that if an eligible employer averaged more than 100 employees during 2019 (large eligible employer), qualified wages are those wages paid by the eligible employer with respect to which an employee is not providing services due to circumstances described in section 2301(c)(2)(A)(ii)(I) of the CARES Act (relating to a full or partial suspension of the operation of a trade or business due to a governmental order) or section 2301(c)(2)(A)(ii)(II) of the CARES Act (relating to a significant decline in gross receipts). For large eligible employers, section 2301(c)(3)(B) of the CARES Act limits qualified wages that may be taken into account to the amount that the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period in which the qualified wages are paid or incurred.
>
> With an increase of the threshold to 500 employees for 2021, the

number of employers able to claim the credit will increase in 2021.

The following chart helps depict the rules that apply to “large employers” and “small employers” under the ERC.

	Large Employer		Small Employer	
	2020	2021	2020	2021
Definition*	Averaged more than 100 full-time employees during 2019	Averaged more than 500 full time employees during 2019	Averaged 100 full-time employees or less during 2019	Averaged 500 full-time employees or less during 2019
Are Wages eligible for ERC if Employee is working?	NO	NO	YES	YES
Are Wage increases eligible for credit?	Cannot exceed amount that the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period in which the qualified wages are paid or incurred.	YES	YES	YES

*The term “full-time employee” means an employee who, with respect to any calendar month in 2019, had an average of at least 30 hours of service per week or 130 hours of service in the month (130 hours of service in a month is treated as the monthly equivalent of at least 30 hours of service per week), as determined in accordance with section 4980H of the Code.

An employer that operated its business for the entire 2019 calendar year determines the number of its full-time employees by taking the sum of the number of full-time employees in each calendar month in 2019 and dividing that number by 12.

5. Calculating Gross Receipts.

Whether the employer is a tax-exempt entity changes how gross receipts are defined and calculated.

For businesses that are not tax-exempt, Section 448(c) of the IRC defines “gross receipts” as "gross receipts of the taxable year and generally [include] total sales (net of returns and allowances) and all amounts received for services." (Q&A 24). For example, gross receipts for a non tax-exempt employer include:

- Total sales (net of returns and allowances) and all amounts received for services.

- Any income from investments and from incidental or outside sources.
- Interest (including original issue discount and tax-exempt interest within the meaning of section 103 of the Code)
- Dividends
- Rents
- Royalties
- Annuities

Gross receipts are not reduced by costs of goods sold, but may be reduced by basis in any capital asset sold. In addition, gross receipts do not include the repayment of a loan, or amounts received with respect to sales tax if the tax is legally imposed on the purchaser of the good or service, and the taxpayer merely collects and remits the sales tax to the taxing authority.

The other definition of "gross receipts," which governs a tax-exempt business, is provided under Section 6033 of the IRC stating "the gross amount received by the organization from all sources without reduction for any costs or expenses including, for example, cost of goods or assets sold, cost of operations, or expenses of earning, raising, or collecting such amounts." (Q&A 25). Gross receipts for tax-exempt employers include:

- Gross receipts from all operations, and not only from activities that constitute unrelated trades or businesses.
- Amounts received by the organization from total sales (net of returns and allowances)
- All amounts received for services, whether or not those sales or services are substantially related to the organization's exercise or performance of the exempt purpose or function constituting the basis for its exemption.
- Investment income, including from dividends, rents, and royalties
- The gross amount received as contributions, gifts, grants, and similar amounts
- The gross amount received as dues or assessments from members or affiliated organizations.

6. Claiming the Credit.

In order to benefit, a qualifying employer must report the wages and the amount of credit it is entitled on the designated lines of the federal employment tax return to claim the Employee Retention Credit for qualified wages.

Eligible employers can claim the credit on the Form 941 federal employment tax return and can choose to either (1) reduce up to the amount of the anticipated credit their deposits of federal employment taxes, (2) request a refund in the event credit surpasses the amount of payroll taxes required to be paid, or (3) file a Form 7200 to request an advance of the amount of the anticipated credit.

Employers must file an amended Form 941-X for the applicable quarter in which the wages were paid if they did not previously claim the ERC for qualified wages on Form 941in order to retroactively claim the credit.

An employer may include the wages paid in the second or third quarter on the fourth quarter Form 941 in order to retroactively claim the credit. This special fourth quarter rule may only be applied if wages paid in the second or third quarter of 2020 were reported as payroll costs on a PPP loan forgiveness application, and forgiveness of the loan is subsequently denied. As this special rule is optional, the employer may choose to follow the normal procedure for filing the Form 941-X to amend the second or third quarter return to claim the ERC on the qualified wages instead.

The following examples are contained in the Notice to illustrate these procedures:

> Example 1: Employer D is an eligible employer and paid qualified wages during the second quarter of 2020 but did not claim an employee retention credit on its second quarter 2020 Form 941. Employer D did not receive a PPP loan. If Employer D subsequently decides to claim the credit to which it is entitled for the second quarter of 2020, Employer D should file a Form 941-X for the previously filed second quarter 2020 Form 941 within the appropriate timeframe to make an interest-free adjustment or claim a refund. Employer D should not use a subsequent Form 941 to claim an employee retention credit for qualified wages paid in the second quarter of 2020.

Example 2: Employer E received a PPP loan of $200,000. Employer E is an eligible employer and paid $250,000 of qualified wages that would qualify for the employee retention credit during the second quarter of 2020. Employer E submitted a PPP Loan Forgiveness Application and reported the $250,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan. Employer E received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of $200,000.

Employer E is not deemed to have made an election with respect to the excess $50,000 of qualified wages that are included in the payroll costs reported on the PPP Loan Forgiveness Application. Accordingly, Employer E may take into account the $50,000 of qualified wages for purposes of the employee retention credit. If Employer E decides to take the $50,000 into account to claim the credit to which it is entitled for 2020, Employer E should file a Form 941-X for the previously filed second quarter 2020 Form 941 within the appropriate timeframe to make an interest-free adjustment or claim a refund for the second quarter, as appropriate. Under these facts, Employer E should not use a subsequent Form 941 to claim an employee retention credit for qualified wages paid in the second quarter of 2020.

Example 3: Same facts as Example 2, except that Employer E's PPP loan is not forgiven by reason of a decision under section 7A(g) of the Small Business Act. If Employer E decides to claim the credit to which it is entitled for 2020 with regard to the $250,000 of qualified wages, Employer E may file a Form 941-X for the previously filed second quarter Form 941 within the appropriate time frame to make an interest-free adjustment or claim a refund for the second quarter in 2020. Alternatively, Employer E may use the special fourth quarter rule with respect to the $200,000 of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application since the PPP loan was not forgiven, but not with respect to the excess $50,000 of qualified wages even though those amounts were included in the payroll costs reported on the PPP Loan

Forgiveness Application.

The Notice also provides the following guidance with respect to using the "special fourth quarter" rule:

> If an eligible employer received a PPP loan, and reported qualified wages paid in the second and/or third quarter of 2020 as payroll costs on its PPP Loan Forgiveness Application, but the loan was not forgiven by reason of a decision under section 7A(g) of the Small Business Act, then the eligible employer may take the qualified wages reported as payroll costs on its PPP Loan Forgiveness Application into account for purposes of the employee retention credit and claim the employee retention credit on those qualified wages on the fourth quarter Form 941. An eligible employer may also claim the employee retention credit on the fourth quarter Form 941 with respect to any qualified health plan expenses paid in the second and/or third quarter of 2020, for which the employer had not claimed the employee retention credit.
> If an eligible employer elects to use this special fourth quarter rule, the eligible employer should add the employee retention credit attributable to the second and/or third quarter qualified wages and qualified health plan expenses on line 11c or line 13d (as relevant) of the original fourth quarter Form 941 (along with any other employee retention credit for qualified wages paid in the fourth quarter). The eligible employer should also:
>
> - Include the amount of these qualified wages paid during the second and/or third quarter (excluding qualified health plan expenses) on line 21 of the original fourth quarter Form 941 (along with any qualified wages paid in the fourth quarter);
> - Enter the same amount on Worksheet 1, Step 3, line 3a;
> - Include the amount of these qualified health plan expenses from the second and/or third quarter on line 22 of the fourth quarter Form 941 (along with any qualified health plan expenses for the fourth quarter);

- Enter the same amount on Worksheet 1, Step 3, line 3b.

This special fourth quarter rule is not required to be used by eligible employers. These employers may also choose the regular process of making an interest-free adjustment or using Form 941-X for the previously filed Form 941 to file a claim for refund for the appropriate quarter to which the additional employee retention credit relate.

Conclusion

The Internal Revenue Service should be applauded for providing this well written and thorough 71-question, 102 page Notice that answered important questions and established important safe harbors regarding the Employee Retention Credit, including who qualifies as eligible employers, what constitutes a partial suspension of business and what qualified wages consist of in mostly a taxpayer friendly manner. Please stay tuned as there will be much more to learn from further analysis of the Notice and as further guidance is released on the ERC for 2021!

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Alan Gassman
Brandon Ketron

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LISI Business Entities Newsletter #223 (March 9, 2021) at http://www.leimbergservices.com

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Employee Retention Credit Whitepaper

By: Alan S. Gassman, Brandon L. Ketron,
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This document is an abridged version of *The Employee Retention Credit Guide* available digitally through Leimberg Information Services. Unlike *The Employee Retention Credit Guide*, this document will not be updated to include IRS Notice 2021-20 but does remain factually correct.

PREFACE

The Employee Retention Credit ("ERC") was established under the March 27th, 2020 CARES Act as a dollar-for-dollar credit against employment taxes available to certain employers as reimbursement for "qualified wages" paid to employees during periods of economic hardship or when a business is closed in 2020 (and now 2021). As with the Paycheck Protection Program ("PPP"), the intent behind the ERC is to incentivize employers to avoid laying employees off and to maintain their workforce at normal pre-pandemic levels.

The ERC was set to expire on January 1st, 2021 but it was given a second life following the passage of the Economic Aid Act on December 27th, 2020. Now that eligibility for the Credit has been expanded it is an appropriate time to review the rules governing it.

The rules of the credit are somewhat complicated, but they are understandable with the step by step methodology and explanation found in this book, which was written to explain the program in coherent terms, while delving into the more niche areas of the law, and discussing questions that remain unanswered.

We will begin by discussing the rules as they applied in 2020 and then transition to considerations for 2021 following the enactment of the Economic Aid Act on December 27th, 2020.

Note: This book will use the terms "business" and "employer" interchangeably.

INTRODUCTION

Please note that we both explain the law and provide the relevant sections of the law throughout this book, for those who want verification and more information and detail. We have also provided all Frequently Asked Questions (FAQs) issued by the Internal Revenue Service (IRS) on the ERC to date in the Appendix; however please note that the FAQs have not been updated since the passage of the Economic Aid Act so some may be out of date. This book will be updated as guidance is released.

We begin by describing how businesses determine if they are eligible to receive the ERC, what quarters, or time period, that they are eligible to receive the ERC for, and then how to calculate and claim the ERC.

Perhaps the most consequential change from 2020 to 2021 is that employers who received PPP loans in 2020, and were therefore not eligible to receive ERCs, are now permitted to retroactively claim the ERCs they would have qualified for. Prior to the passage of the Economic Aid Act, there was a strict prohibition against employers receiving both PPP loans and ERC credits. Now businesses have the opportunity to apply for the ERC so long as they do not use the same wages for the ERC and also for PPP forgiveness, as further described herein.

Another consequential change is that employers can now retroactively claim the ERCs for wages paid in previous quarters if the business filed their payroll tax return before December 27th, 2020. This is described in greater detail in subsection 7 of this book.

Interestingly, the law does not require that any decline in Gross Receipts or damage to the business had to be attributable to COVID-19. Any employer that satisfies the Gross Receipts reduction test is eligible for the credit, even if the employer made more profits in 2020 or 2021 than in 2019! This could be a huge windfall for many business owners.

The first step for businesses is to determine whether they are eligible to receive the ERC.

WHAT BUSINESSES ARE ELIGIBLE TO RECEIVE THE ERC?

There are very few restrictions regarding what type of businesses can claim ERCs. There are no size limitations, and the only real stipulation is that an employer must be "carrying on a trade or business in the year 2020" and must be an "Eligible Employer."

An Eligible Employer is defined in the CARES Act as follows:

> *(2) ELIGIBLE EMPLOYER.—*
>
> *IN GENERAL.—The term ''eligible employer'' means any employer—*
>
> *(i) which was carrying on a trade or business during calendar year 2020, and…*

Even 501(c) organizations that are exempted from federal taxation, and can include organizations considered to be charities will be permitted to receive the ERC. The CARES Act states as follows:

> *(C) TAX-EXEMPT ORGANIZATIONS.—In the case of an organization which is described in section 501(c) of the Internal Revenue Code of 1986 and exempt from tax under section 501(a) of such Code, clauses (i) and (ii)(I) of subparagraph (A) shall apply to all operations of such organization.*

The IRS defines a "trade or business" as "any activity carried on for the production of income from selling goods or performing services," and IRS FAQ #17 additionally provides the following guidance:

> *17. What is a "trade or business" for purposes of the Employee Retention Credit?*
>
> *For purposes of the Employee Retention Credit, "trade or business" has the same meaning as when used in section 162 of the Internal Revenue Code (the "Code") other than the trade or business of performing services as an employee. Under section 162 of the*

Code, an activity does not qualify as a trade or business unless its primary purpose is to make a profit and it is carried on with regularity and continuity. The facts and circumstances of each case determine whether an activity is a trade or business. A taxpayer does not necessarily need to make a profit in any particular year in order to be in a trade or business as long as a good faith profit motive is present.

For purposes of the Employee Retention Credit, a tax-exempt organization described in section 501(c) of the Code that is exempt from tax under section 501(a) of the Code is deemed to be engaged in a "trade or business" with respect to all operations of the organization.

Despite the great number of businesses that will qualify for the ERC, the following entities will not qualify:

1. Sole proprietors and independent contractors who file a Form 1040 Schedule C income tax return, and business entities taxed as S corporations, C corporations and partnerships will not qualify for the credit unless they paid W-2 wages in 2020 or 2021 to one or more individuals who are not related to the employer. (See IRS FAQ # 23)

2. Employers having more than 100 employees for 2020, or more than 500 employees for 2021, will only qualify to the extent of wages that were paid to employees for time where the employee was not working whatsoever (i.e. furloughs), as further discussed below.

3. Federal, state, or local government entities.

4. Household Employers. (See IRS FAQ #24)

DID THE ELIGIBLE BUSINESS HAVE (1) A SUFFICIENT REDUCTION IN REVENUES OR (2) FULL OR PARTIAL SUSPENSION OF THE BUSINESS TO QUALIFY FOR THE CREDIT?

Once it is determined whether or not a business will qualify to receive the ERC on its face, advisors can determine if a business has any quarters in which they are eligible to actually receive credits.

HOW TO DETERMINE WHAT PERIOD A BORROWER IS ELIGIBLE TO RECEIVE THE ERC FOR

Eligibility to receive ERCs is determined on a quarter-by-quarter basis if the revenue reduction test is met and on a per day basis if the business is fully or partially suspended.

To qualify for the ERC, an employer must demonstrate that their business was a victim of either one of the following:

1. Full or Partial Suspension - For the Days Applicable. The operation of the business was fully or partially suspended due to orders from a government authority limiting commerce, travel, or group meetings due to COVID-19; or

2. Reduction in Gross Receipts for a Calendar Quarter. Gross Receipts are less than 50% of the Gross Receipts for the same quarter in the previous year until Gross Receipts are 80% of the Gross Receipts in the same quarter for the previous year, as further described below (this changed for 2021 but more on that later).

The CARES Act provision that provides these rules in far less simple terms is as follows:

> *(A) IN GENERAL.—The term ''eligible employer'' means any employer—*
>
> > *(i) which was carrying on a trade or business during calendar year 2020, and*
> >
> > *(ii) with respect to any calendar quarter, for which—*

(I) the operation of the trade or business described in clause (i) is fully or partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to the coronavirus disease 2019 (COVID–19), or

(II) such calendar quarter is within the period described in subparagraph (B).

(A) SIGNIFICANT DECLINE IN GROSS RECEIPTS.—The period described in this subparagraph is the period—

(i) beginning with the first calendar quarter beginning after December 31, 2019, for which gross receipts (within the meaning of section 448(c) of the Internal Revenue Code of 1986) for the calendar quarter are less than 50 percent of gross receipts for the same calendar quarter in the prior year, and

(ii) ending with the calendar quarter following the first calendar quarter beginning after a calendar quarter described in clause (i) for which gross receipts of such employer are greater than 80 percent of gross receipts for the same calendar quarter in the prior year.

Obviously, there are a lot of moving parts to consider here.

Let's start by defining exactly what kind of governmental orders have had the effect of "suspending the operation of your business." According to the IRS in Employee Retention Credit FAQ #28, orders, proclamations, or decrees from the Federal government, or any State or local government are considered to be "orders from an appropriate governmental authority," if they limit commerce, travel, or group meetings due to COVID-19 in a manner that affects an employer's operation of its trade or business, including orders that limit hours of operation. Some examples of these kinds of orders are as follows:

- An order from the city's mayor stating that all non-essential businesses must close for a specified period;

- A State's emergency proclamation that residents must shelter in place for a specified period, other than residents who are employed by an essential business and who may travel to and work at the workplace location;

- An order from a local official imposing a curfew on residents that impacts the operating hours of a trade or business for a specified period;

- An order from a local health department mandating a workplace closure for cleaning and disinfecting.

A business that becomes eligible for the ERC because of a shutdown resulting from government orders can only claim the credit for wages paid during the time that the business was totally or partially suspended.

While this may seem to have limited applicability at first, it is important to understand that even businesses that did not meet the revenue reduction test can qualify for the credit if the business is just partially suspended as a result of government orders. According to IRS guidance, a partial suspension is considered to have occurred if under the facts and circumstances, more than a nominal portion of its business operations are suspended by a governmental order. This may occur if as a result of an order a business is required to close for a period of time during working hours, a portion of the business is limited even if others are operating at full capacity (such as a restaurant that has limited indoor seating but is able to provide full outdoor seating and takeout orders as illustrated by IRS FAQ #34 below), a supplier of the business is shut down by an order and the business is unable to obtain critical goods or materials from the supplier, or a trade or business that operates in multiple jurisdictions has one location subject to a shutdown order but not others.

Some examples from IRS FAQs illustrating when a business is considered to be partially suspended are as follows:

Example from IRS FAQ #31:

Employer A operates an auto parts manufacturing business that is considered an essential trade or business in the jurisdiction where it operates. Employer A's supplier of raw materials is required to shut down its operations due to a governmental order. Employer A is unable to procure these raw materials from an alternate supplier. As a consequence of the suspension of Employer A's supplier, Employer A is not able to perform its operations. Under these facts and circumstances, Employer A would be considered an Eligible Employer because its operations have been suspended as a result of the governmental order that suspended operations of its supplier.

Examples from IRS FAQ #34:

Example 1: Employer F, a restaurant business, must close its restaurant to on-site dining due to a governmental order closing all restaurants, bars, and similar establishments for sit-down service. Employer F is allowed to continue food or beverage sales to the public on a carry-out, drive-through, or delivery basis. Employer F's business operations are considered to be partially suspended because a portion of its business operations – its indoor and outdoor dining service – is closed due to the governmental order.

Example 2: Same facts as Example 1, except that two months later, under a subsequent governmental order, Employer F is permitted to offer sit-down service in its outdoor space, but its indoor dining service continues to be closed. During the period in which Employer F is allowed to operate only its outdoor sit-down and carry-out service in accordance with the order, Employer F's business operations are considered to be partially suspended because, under the facts and circumstances, a more than nominal portion of its business operations – its indoor dining service -- is closed due to a governmental order. The following month, under a further governmental order, Employer F is permitted to offer indoor dining service, in addition to outdoor sit-down and carry-out service,

provided that all tables in the indoor dining room must be spaced at least six feet apart. Under the facts and circumstances, the governmental order restricting the spacing of tables limits Employer F's indoor dining service capacity and has more than a nominal effect on its business operations. During this period, Employer F's business operations continue to be considered to be partially suspended because the governmental order restricting its indoor dining service has more than a nominal effect on its operations.

Example 3: Employer G, a retail business, must close its retail storefront locations due to a governmental order. The retail business also maintains a website through which it continues to fulfill online orders; the retailer's online ordering and fulfillment system is unaffected by the governmental order. Employer G's business operations are considered to have been partially suspended due to the governmental order requiring it to close its retail store locations.

Example 4: Employer H, a hospital, is considered to be operating an essential business under a governmental order with respect to its emergency department, intensive care, and other services for conditions requiring urgent medical care. However, the governmental order treats Employer H's elective and non-urgent medical procedures as non-essential business operations and prevents Employer H from performing these services. Employer H suspends operations related to elective and non-urgent medical procedures. Although Employer H is an essential business, Employer H is considered to have a partial suspension of operations due to the governmental order that prevents Employer H from performing elective and non-urgent medical procedures.

Example 5: Employer I, a grocery store, is considered to be operating an essential business under a governmental order. However, the governmental order requires grocery stores to discontinue their self-serve offerings, such as salad bars, though

they may offer prepared or prepackaged food. Employer I modifies its operations to close its salad bar and other self-serve offerings and instead offers prepackaged salads and other items. The governmental order requiring Employer I to discontinue its self-serve offerings does not have more than a nominal effect on Employer I's business operations under the facts and circumstances, even though Employer I was required to modify its business operations. Employer I's business operations are not considered to be partially suspended because the governmental order requiring closure of self-serve offerings does not have more than a nominal effect on its business operations.

Example 6: Employer J, a large retailer, is required to close its storefront location due to a governmental order, but is permitted to provide customers with curbside service to pick up items ordered online or by phone. During this period, Employer J's business operations are considered to have been partially suspended due to the governmental order requiring it to close its storefront location. Two months later, under a subsequent governmental order, Employer J is permitted to reopen its storefront location. Under the subsequent governmental order, however, Employer J must enforce social distancing guidelines that require Employer J to admit only a specified number of customers into the store per 1,000 square feet. While the governmental order results in customers waiting in line for a short period of time to enter the store during certain busy times of the week, the size of Employer J's storefront location is large enough that it is able to accommodate all of its customers after these short waits outside the store. The governmental order requiring Employer J to enforce social distancing guidelines does not have more than a nominal effect on Employer J's business operations under the facts and circumstances, even though Employer J is required to modify its business operations. During this period, Employer J's business operations are not considered to be partially suspended because the governmental order requiring enforcement of social distancing

guidelines does not have more than a nominal effect on its operations.

Example from IRS FAQ 35:

Example: Employer K operates a food processing facility that normally operates 24 hours a day. A governmental order issued by the local health department requires all food processing businesses to deep clean their workplaces once every 24 hours in order to reduce the risk of COVID-19 exposure. In order to comply with the governmental order, Employer K reduces its daily operating hours by five hours per day so that a deep cleaning may be conducted within its workplace once every 24 hours. Employer K is considered to have partially suspended its operations due to the governmental order requiring it to reduce its hours of operation.

Example from IRS FAQ 36:

Example: Employer F is a national retail store chain with operations in every state in the United States. In some jurisdictions, Employer F is subject to a governmental order to close its stores, but it is permitted to provide customers with curbside service to pick up items ordered online or by phone. In other jurisdictions, Employer F is not subject to any governmental order to close its stores or is considered an essential business permitting its stores to remain open. Employer F establishes a company-wide policy, in compliance with the local governmental orders and consistent with the CDC and DHS recommendations and guidance, requiring the closure of all stores and operating with curbside pick-up only, even in those jurisdictions where the business was not subject to a governmental order. As a result of the governmental orders requiring closure of Employer F's stores in certain jurisdictions, Employer F has a partial suspension of operations of

its trade or business. The partial suspension results in Employer F being an Eligible Employer nationwide.

There are circumstances where even if a governmental order affects the operations of a business, the business is not considered to be partially suspended for purposes of the ERC. For example, if the business is not required to close but a governmental order causes customers to stay at home, the business is not considered to be under a partial suspension (although they likely experienced a significant decline in gross receipts and may qualify under the second test discussed below).

32. If a governmental order causes the customers of an essential business to stay at home is the essential business considered to have a suspension of operations?

No. An employer that operates an essential business that is not required to close its physical locations or otherwise suspend its operations is not considered to have a full or partial suspension of its operations for the sole reason that its customers are subject to a government order requiring them to stay at home.

The employer may be considered an Eligible Employer and may be eligible for the Employee Retention Credit if it experiences a significant decline in gross receipts. For more information on what constitutes a significant decline in gross receipts, see Determining When an Employer is Considered to have a Significant Decline in Gross Receipts.

Example: Employer B, an automobile repair service business, is an essential business and is not required to close its locations or suspend its operations. Due to a governmental order that limits travel and requires members of the community to stay at home except for certain essential travel, such as going to the grocery store, Employer B's business has declined significantly. Employer B is not considered to have a full or partial suspension of operations due to a governmental order. However, Employer B may be

considered an Eligible Employer if it has a significant decline in gross receipts.

Additionally, the business will not be considered partially suspended if the employees of the business can carry on comparable operations by having employees telecommute or work from home.

The following examples from IRS FAQ #33 illustrate this rule:

Example 1: Employer C, a software development company maintains an office in a city where the mayor has ordered that only essential businesses may operate. Employer C's business is not essential under the mayor's order which requires Employer C to close its office. Prior to the governmental order, all employees at the company teleworked once or twice per week, and business meetings were held at various locations. Following the governmental order, the company ordered mandatory telework for all employees and limited client meetings to telephone or video conferences. Employer C's business operations are not considered to be fully or partially suspended by the governmental order because its business operations may continue in a comparable manner.

Example 2: Employer D operates a physical therapy facility in a city where the mayor has ordered that only essential businesses may operate. Employer D's business is not considered essential under the mayor's order, which requires Employer D to close its workplace. Prior to the governmental order, none of Employer D's employees provided services through telework and all appointments, administration, and other duties were carried out at Employer D's workplace. Following the governmental order, Employer D moves to an online format and is able to serve some clients remotely, but employees cannot access specific equipment or tools that they typically use in therapy and not all clients can be served remotely. Employer D's business operations are considered

to be partially suspended by the governmental order because Employer D's workplace, including access to physical therapy equipment, is central to its operations, and the business operations cannot continue in a comparable manner.

Example 3: Employer E, a scientific research company with facilities in a state in which the governor has ordered that only essential businesses may operate, conducts research in a laboratory setting and through the use of computer modeling. Employer E's business is not essential under the governor's order, which requires Employer E to close its workplace. Prior to the governmental order, Employer E's laboratory-based research operations could not be conducted remotely (other than certain related administrative tasks) and employees involved in laboratory-based research worked on-site; however, Employer E's computer modeling research operations could be conducted remotely and employees engaged in this portion of the business often teleworked. Following the governmental order, all employees engaged in computer modeling research are directed to telework, and those business operations are able to continue in a comparable manner. In contrast, the employees engaged in the laboratory-based research cannot perform their work while the facility is closed and are limited to performing administrative tasks during the closure. Employer E's business operations are considered to be partially suspended by the governmental order because Employer E's laboratory-based research business operations cannot continue in a comparable manner.

Determining whether a business has been partially suspended will be an important analysis function for advisors and businesses. As illustrated by the examples above, many businesses will qualify as partially suspended even if operating in some capacity, and notwithstanding whether or not they meet the revenue reduction test described below. All of the IRS FAQs issued are contained in the Appendix and should be read closely by advisors to determine if a partial suspension of business activities has occurred.

The Gross Receipts reduction test for the purpose of determining eligibility for the ERC is a little trickier than the suspension of business test.

First, we will start by understanding what Gross Receipts are for the purposes of the ERC.

Gross Receipts:

The IRS provides the following definition for Gross Receipts for purposes of ERC in IRS FAQ #40, which we have adapted to a line by line format:

Gross Receipts include:

- total sales (net of returns and allowances)
- all amounts received for services
- income from investments
- income from incidental or outside sources
- interest
- dividends
- rents
- royalties
- annuities

Regardless of whether such amounts are derived in the ordinary course of the taxpayer's trade or business.

Note: As indicated below Gross Receipts do not include Cares Act payments received under the PPP, EIDL, Provider Relief or Shuttered Venue programs!

Gross Receipts are generally:

- not reduced by the cost of goods sold,

- but are generally reduced by the taxpayer's adjusted basis in capital assets sold.

- not reduced by the repayment of a loan, or

- reduced by amounts received with respect to sales tax if the tax is legally imposed on the purchaser of the good or service, and the taxpayer merely collects and remits the sales tax to the taxing authority.

As mentioned above, The December 2020 Economic Aid Act also provides that many loans or grant amounts that an employer receives as a result of programs established by the CARES Act will not count towards Gross Receipts. This includes PPP loans, EIDL loans, shuttered venue loans, and other CARES Act debt forgiveness programs.

The language to describe the above Gross Receipts definition under the statute reads as follows:

> *Gross receipts include total sales (net of returns and allowances), all amounts received for services, income from investments, income from incidental or outside sources, interest, dividends, rents, royalties, and annuities, regardless of whether such amounts are derived in the ordinary course of the taxpayer's trade or business.*
>
> *Gross receipts are generally not reduced by the cost of goods sold, but are generally reduced by the taxpayer's adjusted basis in capital assets sold.*
>
> *Gross receipts do not include the repayment of a loan, or amounts received with respect to sales tax if the tax is legally imposed on the purchaser of the good or service, and the taxpayer merely collects and remits the sales tax to the taxing authority.*

Definition of Gross Receipts for Non Profits. A different definition for the words "Gross Receipts" appropriately applies for 501(c)(3) entities and other tax-exempt

employers. IRS FAQ #46 reads as follows, as reformatted for the reader's convenience:

> Solely for purposes of determining eligibility for the Employee Retention Credit,
>
> Gross Receipts for a tax-exempt employer include:
>
> Gross Receipts from all operations, not only from activities that constitute unrelated trades or businesses.
>
> For example, Gross Receipts for this purpose include amounts received by the organization from total sales (net of returns and allowances) and all amounts received for services, whether or not those sales or services are substantially related to the organization's exercise or performance of the exempt purpose or function constituting the basis for its exemption.
>
> Gross Receipts also include the organization's investment income, including from dividends, rents, and royalties,
>
> as well as the gross amount received as contributions, gifts, grants, and similar amounts,
>
> and the gross amount received as dues or assessments from members or affiliated organizations.
>
> To determine whether there has been a significant decline in Gross Receipts, a tax-exempt employer computes its Gross Receipts received from all of its operations during the calendar quarter and compares those Gross Receipts to the same Gross Receipts received for the same calendar quarter in 2019.

In FAQ #43, the IRS took a very broad sweep in providing the methodology for determining when Gross Receipts are to be calculated on a cumulative basis for an affiliated group by adopting the broadly applied "affiliated service group and leased employee rules that apply for pension planning purposes:

> *All entities are considered a single employer for purposes of determining whether the employer had a significant decline in*

gross receipts if they are aggregated as a controlled group of corporations under section 52(a) of the Internal Revenue Code (the "Code"); are partnerships, trusts or sole proprietorships under common control under section 52(b) of the Code; or are entities that are aggregated under section 414(m) or (o) of the Code.

To be an Eligible Employer on the basis of a significant decline of gross receipts, the employer must take into account the gross receipts of all members of the aggregated group. If the aggregated group does not experience a significant decline in gross receipts, then no member of the group may claim the Employee Retention Credit on that basis.

IRC sections 414(m), (n) and (o) are a very broad and all-encompassing affiliation standard that does not require common ownership or control. For example, a secretarial services company owned by a publicly traded company can be considered to be in the same affiliated service group as a law firm that purchases the services of the secretaries for purposes of these rules. It is of interest that the ERC rule above does not mention Section 414(n), but mentions Section 414(o), which causes Section 414(n) to apply to Section 414(m). Section 414(n) causes leased employees to be considered as owned by their leased employer under certain circumstances.

Relevant text of IRC 414 is reproduced below for the convenience of the reader:

I.R.C. § 414

(m) Employees Of An Affiliated Service Group

(1) In General — For purposes of the employee benefit requirements listed in paragraph (4), except to the extent otherwise provided in regulations, all employees of the members of an affiliated service group shall be treated as employed by a single employer.

(2) Affiliated Service Group — For purposes of this subsection, the term "affiliated service group" means a group consisting of a service organization (hereinafter in this paragraph

referred to as the "first organization") and one or more of the following:

(A) — any service organization which—

(i) — is a shareholder or partner in the first organization, and

(ii) — regularly performs services for the first organization or is regularly associated with the first organization in performing services for third persons, and

(B) — any other organization if—

(i) — a significant portion of the business of such organization is the performance of services (for the first organization, for organizations described in subparagraph (A), or for both) of a type historically performed in such service field by employees, and

(ii) — 10 percent or more of the interests in such organization is held by persons who are highly compensated employees (within the meaning of section 414(q)) of the first organization or an organization described in subparagraph (A).

(3) Service Organizations — For purposes of this subsection, the term "service organization" means an organization the principal business of which is the performance of services.

(4) Employee Benefit Requirements — For purposes of this subsection, the employee benefit requirements listed in this paragraph are—

(A) — paragraphs (3), (4), (7), (16), (17), and (26) of section 401(a), and

(B) — sections 408(k), 408(p), 410, 411, 415, and 416.

(5) Certain Organizations Performing Management Functions — For purposes of this subsection, the term "affiliated service group" also includes a group consisting of—

(A) — an organization the principal business of which is performing, on a regular and continuing basis, management functions for 1 organization (or for 1 organization and other organizations related to such 1 organization), and

(B) — the organization (and related organizations) for which such functions are so performed by the organization described in subparagraph (A).

For purposes of this paragraph, the term "related organizations" has the same meaning as the term "related persons" when used in section 144(a)(3).

(6) Other Definitions — For purposes of this subsection—

(A) Organization Defined — The term "organization" means a corporation, partnership, or other organization.

(B) Ownership — In determining ownership, the principles of section 318(a) shall apply.

(n) Employee Leasing

Note: 414(n) is not mentioned in the Statute but may be intended to be included because the statute mentions section 414(o) which modifies the applicability of Section 414(n), which causes Leased Employees to be considered to be employees of the employer that leases them. In general Section 414(n) causes an individual who is "hired out" to a business for more than a year to be an employee of that business for pension planning purposes.

(1) In General — For purposes of the requirements listed in paragraph (3), with respect to any person (hereinafter in this subsection referred to as the "recipient") for whom a leased employee performs services—

> *(A) — the leased employee shall be treated as an employee of the recipient, but*
>
> *(B) — contributions or benefits provided by the leasing organization which are attributable to services performed for the recipient shall be treated as provided by the recipient.*

(2) Leased Employee — For purposes of paragraph (1), the term "leased employee" means any person who is not an employee of the recipient and who provides services to the recipient if—

> *(A) — such services are provided pursuant to an agreement between the recipient and any other person (in this subsection referred to as the "leasing organization"),*
>
> *(B) — such person has performed such services for the recipient (or for the recipient and related persons) on a substantially full-time basis for a period of at least 1 year, and*
>
> *(C) — such services are performed under primary direction or control by the recipient.*

(3) Requirements — For purposes of this subsection, the requirements listed in this paragraph are—

> *(A) — paragraphs (3), (4), (7), (16), (17), and (26) of section 401(a),*
>
> *(B) — sections 408(k), 408(p), 410, 411, 415, and 416, and*

(C) — sections 79, 106, 117(d), 125, 127, 129, 132, 137, 274(j), 505, and 4980B.

(4) Time When First Considered As Employee

(A) In General — In the case of any leased employee, paragraph (1) shall apply only for purposes of determining whether the requirements listed in paragraph (3) are met for periods after the close of the period referred to in paragraph (2)(B).

(B) Years Of Service — In the case of a person who is an employee of the recipient (whether by reason of this subsection or otherwise), for purposes of the requirements listed in paragraph (3), years of service for the recipient shall be determined by taking into account any period for which such employee would have been a leased employee but for the requirements of paragraph (2)(B).

(5) Safe Harbor

(A) In General — In the case of requirements described in subparagraphs (A) and (B) of paragraph (3), this subsection shall not apply to any leased employee with respect to services performed for a recipient if—

(i) — such employee is covered by a plan which is maintained by the leasing organization and meets the requirements of subparagraph (B), and

(ii) — leased employees (determined without regard to this paragraph) do not constitute more than 20 percent of the recipient's nonhighly compensated work force.

(B) Plan Requirements — A plan meets the requirements of this subparagraph if—

(i) such plan is a money purchase pension plan with a nonintegrated employer contribution rate for each participant of at least 10 percent of compensation,

(ii) such plan provides for full and immediate vesting, and

(iii) each employee of the leasing organization (other than employees who perform substantially all of their services for the leasing organization) immediately participates in such plan.

Clause (iii) shall not apply to any individual whose compensation from the leasing organization in each plan year during the 4-year period ending with the plan year is less than $1,000.

(C) Definitions — For purposes of this paragraph—

(i) Highly Compensated Employee — The term "highly compensated employee" has the meaning given such term by section 414(q).

(ii) Nonhighly Compensated Work Force — The term "nonhighly compensated work force" means the aggregate number of individuals (other than highly compensated employees)—

(I) — who are employees of the recipient (without regard to this subsection) and have performed services for the recipient (or for the recipient and related persons) on a substantially full-time basis for a period of at least 1 year, or

(II) — who are leased employees with respect to the recipient (determined without regard to this paragraph).

(iii) Compensation — The term "compensation" has the same meaning as when used in section 415; except that such term shall include—

(I) — any employer contribution under a qualified cash or deferred arrangement to the extent not included in gross income under section 402(e)(3) or 402(h)(1)(B),

(II) — any amount which the employee would have received in cash but for an election under a cafeteria plan (within the meaning of section 125), and

(III) — any amount contributed to an annuity contract described in section 403(b) pursuant to a salary reduction agreement (within the meaning of section 3121(a)(5)(D)).

(6) Other Rules — For purposes of this subsection—

(A) Related Persons — The term "related persons" has the same meaning as when used in section 144(a)(3).

(B) Employees Of Entities Under Common Control — The rules of subsections (b), (c), (m), and (o) shall apply.

(o) Regulations — The Secretary shall prescribe such regulations (which may provide rules in addition to the rules contained in subsections (m) and (n)) as may be necessary to prevent the avoidance of any employee benefit requirement listed in subsection

(m)(4) or (n)(3) or any requirement under section 457 through the use of—

(1) separate organizations,

(2) employee leasing, or

(3) other arrangements.

The regulations prescribed under subsection (n) shall include provisions to minimize the recordkeeping requirements of subsection (n) in the case of an employer which has no top-heavy plans (within the meaning of section 416(g)) and which uses the services of persons (other than employees) for an insignificant percentage of the employer's total workload.

THE GROSS RECEIPTS REDUCTION TEST

Now that we have covered how to calculate Gross Receipts for each quarter, we will discuss how to determine whether a business can satisfy the Gross Receipts reduction test. To pass this test for 2020, a business must show that Gross Receipts for a quarter in 2020 were at least 50% lower than they were for the same quarter in 2019.

The best way to illustrate this is with examples.

> **Example:** In 2Q 2020, Gross Receipts were $49,000. In 2Q 2019 Gross Receipts were $100,000. This means that the business suffered a 51% reduction in Gross Receipts from quarter to quarter, and is eligible to receive the ERC for 2Q 2020.

THE 80% NEXT QUARTER RULE FOR 2020. Once the above 50% or more reduction has applied to a quarter in 2020, the employer will automatically qualify for the next subsequent quarter in 2020, and for the next quarter after that in 2020 unless or until the reduction of Gross Receipts for that next subsequent quarter, as compared to the same quarter in 2019, has been less than 20% of the 2019 Receipts amount. This consecutive calendar quarter rule does not carry over to the first quarter of 2021, which is subject to a different test, as described below.

This is hard to understand until illustrated.

The below chart demonstrates how this rule works.

Quarter	Gross Receipts 2019	Gross Receipts 2020	2019 vs. 2020	Eligible quarter?
1*	$300,000	$300,000	100%	No
2	$300,000	$100,000	33%	Yes
3	$300,000	$255,000	85%	Yes
4	$300,000	$255,000	85%	No

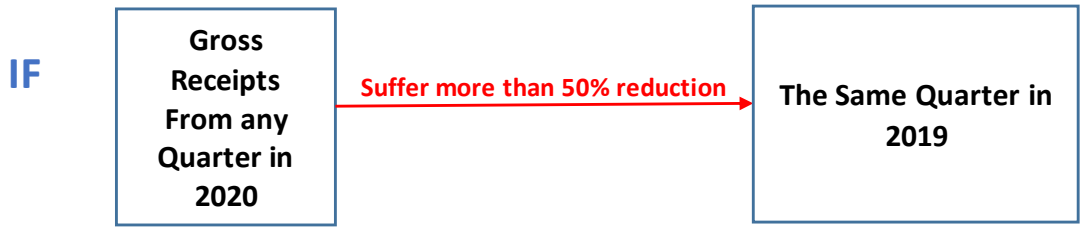
*Quarter 1 is from March 14 through March 30, 2020

In the chart above you can see that in 3Q 2020, even though Gross Receipts were back above 80% of what they were for 3Q 2019, the employer was still eligible for the ERC because that was the first quarter that Gross Receipts rose back above 80%. The Employer not be eligible for the ERC in 4Q 2020 because that is the quarter after the first quarter in which Gross Receipts rose back above 80%.

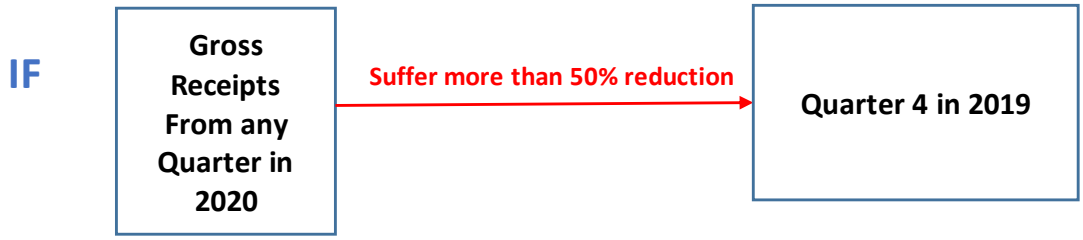
A MARCH 14 – MARCH 30 FIRST QUARTER 2020? You may have noticed that the ERC wasn't even created until Mid-March of 2020, leaving a mere 12 days left in the 1Q 2020 on which an employer could claim credits on qualified wages. Most employers would not have known to claim credit on their 1Q 2020 Form 941. In recognition of this fact, the IRS has provided that if 1Q 2020 was an eligible quarter for an employer and they paid qualified wages that will qualify for the ERC, then the employer may claim those credits on their 2Q 2020 Form 941.

The following charts illustrate the applicable testing periods to determine if the business has experienced a significant decline in gross receipts:

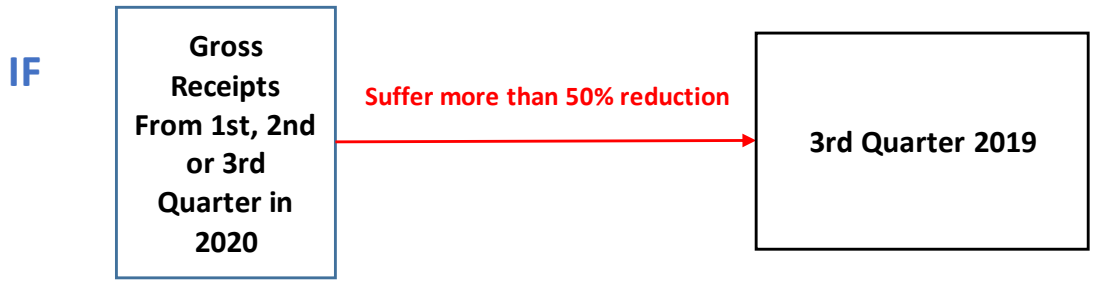
For Businesses That Were Open All of 2019 And 2020



For Businesses That Opened During 4th Quarter 2019



For Businessess That Opened During 3rd Quarter 2019



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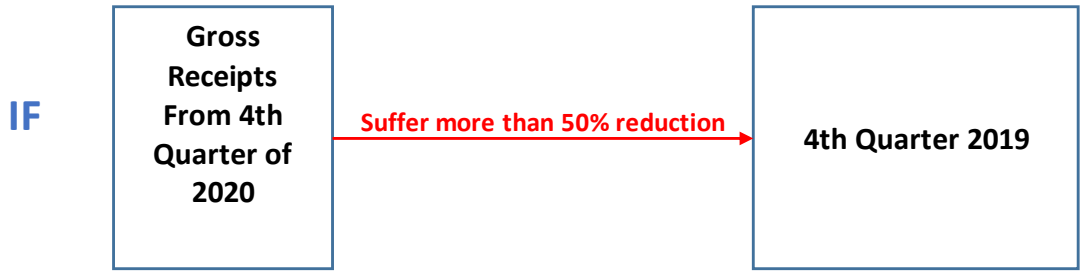
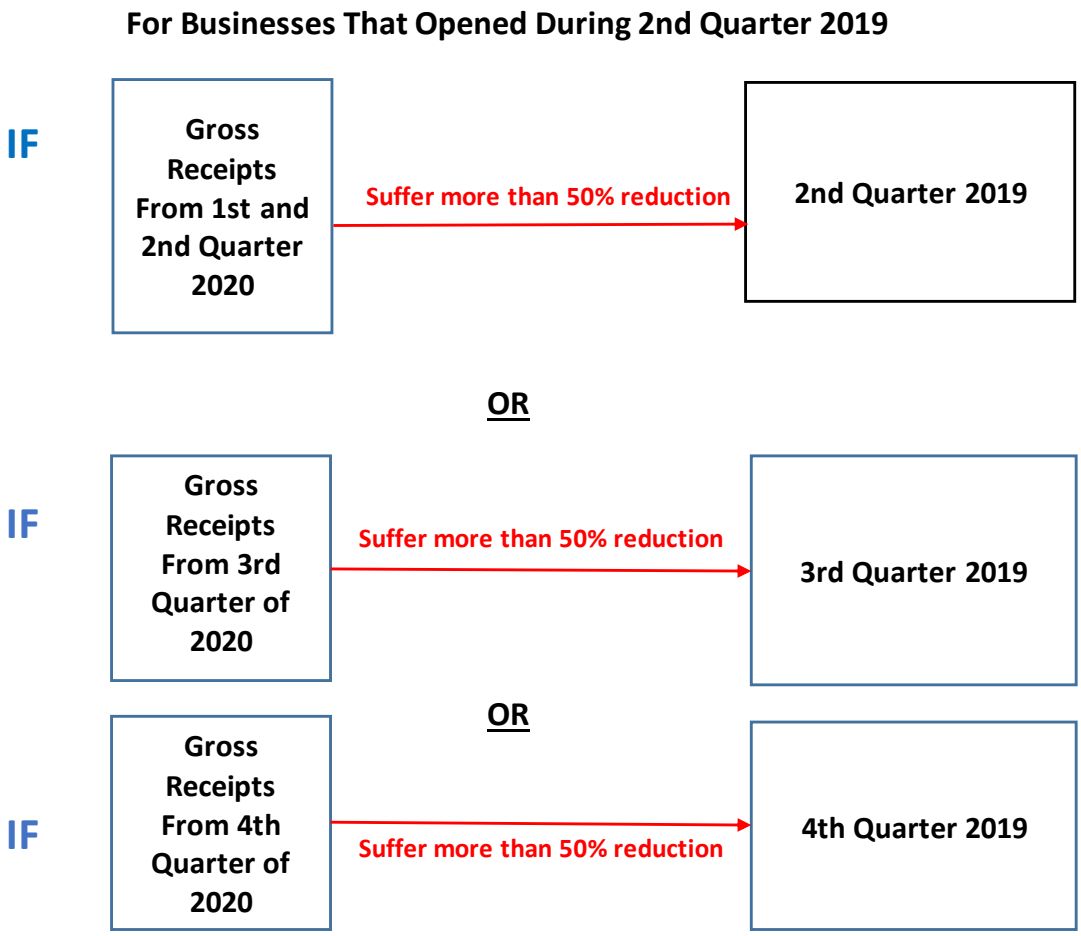




So far, we have talked a lot about *how* to qualify but not exactly *what* it is that the employer is qualifying for. Simply put, the employer earns credits equal to the amount of "Qualified Wages" that are paid to employees during Eligible Quarters.

What exactly are "Qualified Wages"?

Qualified Wages:

Generally speaking, according to the IRS, "qualified wages" for the purpose of calculating ERCs are those wages paid to employees during the period that operations were suspended, or the period of the decline in Gross Receipts, including healthcare costs for a group health plan to the extent that they are excluded from an employee's gross income.

More specifically, the CARES Act defines "Qualified Wages" as those defined in subsection 3121(a)(2) of the Internal Revenue Code, which reads as follows:

(1) QUALIFIED WAGES.—

(A) IN GENERAL.—The term ‘‘qualified wages’’ means—

(i) in the case of an eligible employer for which the average number of full-time employees (within the meaning of section 4980H of the Internal Revenue Code of 1986) employed by such eligible employer during 2019 was greater than 100, wages paid by such eligible employer with respect to which an employee is not providing services due to circumstances described in subclause (I) or (II) of paragraph (2)(A)(ii), or

(ii) in the case of an eligible employer for which the average number of full-time employees (within the meaning of section 4980H of the Internal Revenue Code of 1986) employed by such eligible employer during 2019 was not greater than 100—

(I) with respect to an eligible employer described in subclause (I) of paragraph (2)(A)(ii),wages paid by such eligible employer with respect to an employee during any period described in such clause, or

(II) with respect to an eligible employer described in subclause (II) of such paragraph, wages paid by such eligible employer with respect to an employee during such quarter.

Such term shall not include any wages taken into account under section 7001 or section 7003 of the Families First Coronavirus Response Act.

NOTE ON FAMILY LEAVE ACT PAYMENTS - The above statute refers to the Family First Coronavirus Response Act (FFCRA), which provides for payroll credits or payments for wages paid to certain employees to enable them to be paid for being out with COVID-19, or caring for family members as a result of the virus

crisis. It makes perfect sense that such amounts paid by the government will not qualify as being eligible for the ERC since this would result in a double benefit to the entity.

> *. . .*
>
> *(5) WAGES.—The term ''wages'' means wages (as defined in section 3121(a) of the Internal Revenue Code of 1986) and compensation (as defined in section 3231(e) of such Code).*

I.R.C. Section 3121(a) is far too extensive to include in its entirety, but some of the most important items that can be provided for an employee that are included as "wages" are as follows:

- group health costs
- paid sick or disability leave
- pension or retirement plan contributions
- payment by the employer of a tax imposed on an employee
- payment for a service not normally in the course of the employer's business
- payment for agricultural labor
- tips (including cash tips)
- severance pay
- stock options
- any payment that the employee may exclude from their gross income

The following statutory language is pertinent.

> *(C) ALLOWANCE FOR CERTAIN HEALTH PLAN EXPENSES.—*

(i) IN GENERAL.—The term ''qualified wages'' shall include so much of the eligible employer's qualified health plan expenses as are properly allocable to such wages.

(ii) QUALIFIED HEALTH PLAN EXPENSES.—For purposes of this paragraph, the term ''qualified health plan expenses'' means amounts paid or incurred by the eligible employer to provide and maintain a group health plan (as defined in section 5000(b)(1) of the Internal Revenue Code of 1986), but only to the extent that such amounts are excluded from the gross income of employees by reason of section 106(a) of such Code.

(iii) ALLOCATION RULES.—For purposes of this paragraph, qualified health plan expenses shall be allocated to qualified wages in such manner as the Secretary may prescribe. Except as otherwise provided by the Secretary, such allocation shall be treated as properly made if made on the basis of being pro rata among employees and pro rata on the basis of periods of coverage (relative to the periods to which such wages relate).

It appears from subsection (C)(ii) above, that health plan expenses paid on behalf of an individual or the spouse of an individual who owns 2% or more of an S corporation cannot be included as an additional expense eligible for the credit, due to the fact that these expenses are already included in the W-2 wage amount of such individuals.

Wages paid to individuals that are "related" to a more than 50% owner of the eligible entity are not counted as wages for purposes of the ERC, even though wages paid to an owner and the owner's spouse will be counted.

Individuals who are "Related Individuals" of the business owner or owners for the purposes of the ERC are as follows:

a. A child or a descendant of a child

b. A brother, sister, stepbrother, or stepsister

c. The father or mother, or an ancestor of either

d. A stepfather or stepmother

e. A niece or nephew

f. An aunt or uncle

g. A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law

The IRS issued FAQ #59 which describes who is considered to be a "Related Individual" for purposes of the ERC:

> *59. Are wages paid by an employer to employees who are related individuals considered qualified wages?*
>
> *No. Wages paid to related individuals, as defined by section 51(i)(1) of the Internal Revenue Code (the "Code"), are not taken into account for purposes of the Employee Retention Credit. A related individual is any employee who has of any of the following relationships to the employee's employer who is an individual:*
>
> *A child or a descendant of a child;*
>
> *A brother, sister, stepbrother, or stepsister;*
>
> *The father or mother, or an ancestor of either;*
>
> *A stepfather or stepmother;*
>
> *A niece or nephew;*
>
> *An aunt or uncle;*
>
> *A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.*
>
> *In addition, if the Eligible Employer is a corporation, then a related individual is any person that bears a relationship described above*

with an individual owning, directly or indirectly, more than 50 percent in value of the outstanding stock of the corporation.

If the Eligible Employer is an entity other than a corporation, then a related individual is any person that bears a relationship described above with an individual owning, directly or indirectly, more than 50 percent of the capital and profits interests in the entity.

If the Eligible Employer is an estate or trust, then a related individual includes a grantor, beneficiary, or fiduciary of the estate or trust, or any person that bears a relationship described above with an individual who is a grantor, beneficiary, or fiduciary of the estate or trust.

Further, wages paid or incurred cannot take into account compensation increases based upon what would have normally been paid for the work performed in the same amount of time during the 30-days immediately before the period when business was suspended or the revenue reduction occurred, but only if the business had more than 100 average monthly FTEs in 2019. The CARES Act provision for this reads as follows:

(B) LIMITATION.—Qualified wages paid or incurred by an eligible employer described in subparagraph (A)(i) with respect to an employee for any period described in such subparagraph may not exceed the amount such employee would have been paid for working an equivalent duration during the 30 days immediately preceding such period.

ONLY FOR PAYING EMPLOYEES FOR NOT WORKING IF THE EMPLOYER HAS 100 OR MORE EMPLOYEES FOR 2019 OR 500 OR MORE FOR 2021 CREDIT. As indicated below, there is one important exception to the rules that applies for large employers. If a business had an average of no more than 100 monthly full-time employee equivalents ("FTEs") in 2019, then all wages paid to an employee during an eligible quarter are eligible for ERCs. However, if a business averaged more than 100 monthly FTEs in 2019, then only wages paid to a non-working employee during eligible time periods may be claimed. You read that right. Larger employers, as defined above had to be paying the employee NOT to work in order to claim the credit. This rule was likely implemented to encourage

large employers to, at the very least, furlough workers and continue providing them with benefits, as opposed to totally laying them off if they could not continue to fund their entire payroll.

This threshold is increased to 500 employees for purposes of calculating the credit in 2021 as discussed in more detail below.

For the purposes of the above rules, a Full-Time Employee ("FTE") is defined as one who worked at least 30 hours per week or 130 hours in a month during any calendar month in 2019.

As a result of the above, if the business has less than 100 average monthly FTEs in 2019 then all wages paid to employees will be eligible, regardless of whether the employee was providing services, or the wages paid to the employee were increased.

It is also noteworthy that self-employed individuals, such as sole proprietors reporting income on a Schedule C or partners in a partnership, cannot include earnings from self-employment as the equivalent of a wage for purposes of the ERC, even though such individuals treat such amounts as being the equivalent of wages for purposes of determining loan amounts and loan forgiveness under the PPP rules. IRS FAQ #23 explains this rule:

> *23. Are self-employed individuals eligible for the Employee Retention Credit?*
>
> *Self-employed individuals are not eligible for the Employee Retention Credit with respect to their own self-employment earnings. However, a self-employed individual who employs individuals in its trade or business and who otherwise meets the requirements to be an Eligible Employer may be eligible for the Employee Retention Credit with respect to qualified wages paid to the employees.*

Now that we understand how to qualify for the ERC and wages can be claimed, we will now take a look at how much ERC credit an employer will be eligible for.

HOW TO CALCULATE THE ERC AMOUNTS YOU ARE ELIGIBLE TO RECEIVE

For each eligible quarter in 2020, an employer may claim a credit equal to 50% of the wages and allocable qualified health plan expenses paid to each employee, based upon counting up to $10,000 of wages paid for that employee to reach the $5,000 limit (i.e. after an employee receives $10,000 of wages, the ERC credits can no longer be available for amounts paid for such employee). The CARES Act legislates this as follows:

> *(a) IN GENERAL.—In the case of an eligible employer, there shall be allowed as a credit against applicable employment taxes for each calendar quarter an amount equal to 50 percent of the qualified wages with respect to each employee of such employer for such calendar quarter.*
>
> *(b) LIMITATIONS AND REFUNDABILITY.—*
>
> > *(1) WAGES TAKEN INTO ACCOUNT.—The amount of qualified wages with respect to any employee which may be taken into account under subsection (a) by the eligible employer for all calendar quarters shall not exceed $10,000.*

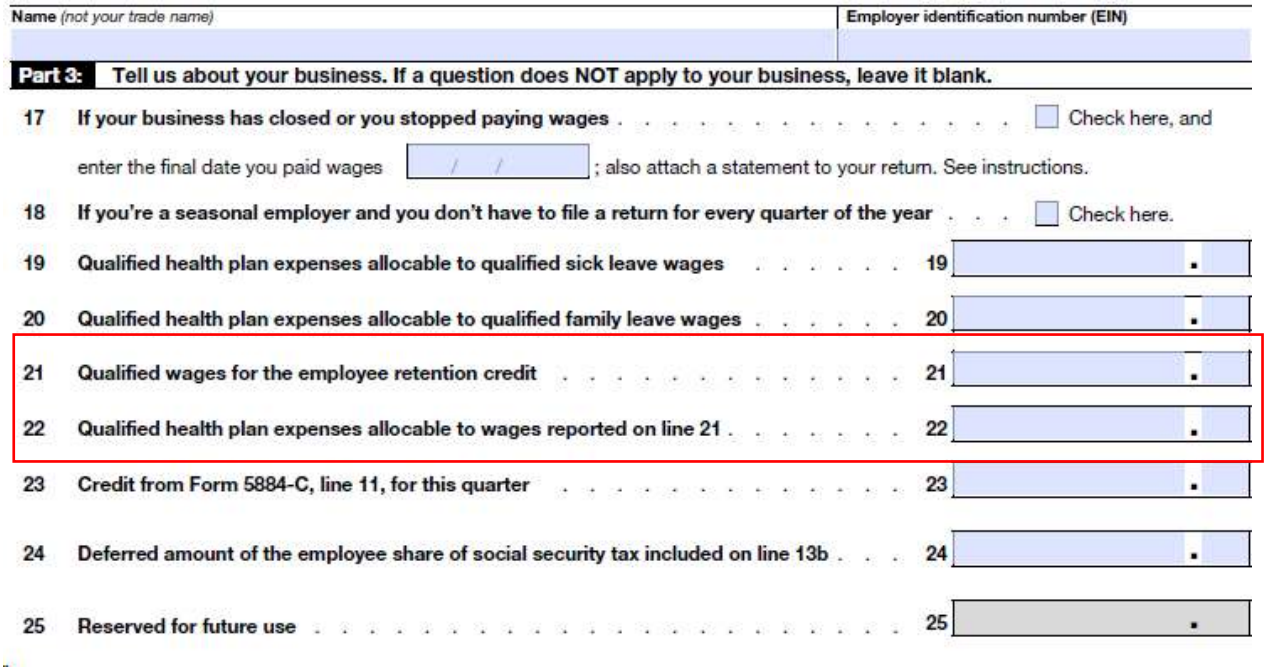
We will now illustrate this through the following example:

> **Example:** An employer had 4 employees who made $40,000 a year ($10,000 per quarter). 2Q 2020 is an eligible quarter for an employer. The employer may receive a credit equal to $5,000 per employee for the quarter (50% x $10,000) for a total of $20,000. Keep in mind, however, that this employer will not be eligible to receive any more ERC attributable to these employees in 2020 since the employer has already received $5,000 for each employee, which is the maximum amount an employer is permitted to receive per employee per year.

Now we can discuss how to actually apply to get the credit.

HOW TO CLAIM THE EMPLOYEE RETENTION CREDITS

To claim ERCs, an eligible employer will need to report their total Qualified Wages, including the related health insurance costs for each quarter. This can be done on a Form 941 Quarterly Employment Tax Return.



Name *(not your trade name)*	Employer identification number (EIN)

Part 3: Tell us about your business. If a question does NOT apply to your business, leave it blank.

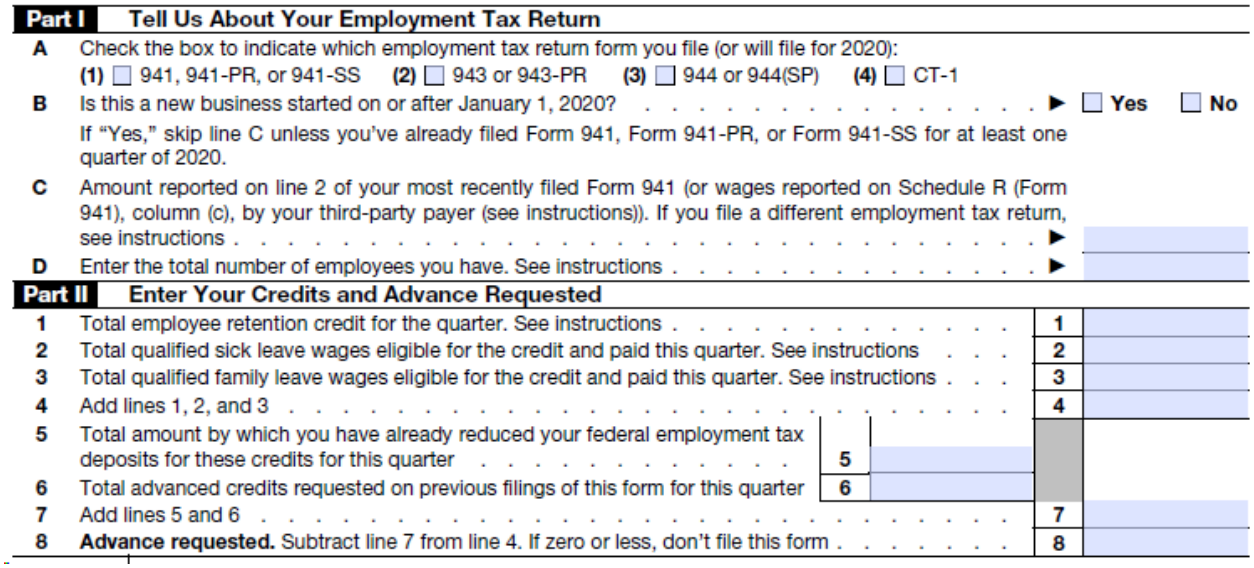
17	If your business has closed or you stopped paying wages . . . . . ☐ Check here, and enter the final date you paid wages ___/___/___ ; also attach a statement to your return. See instructions.		
18	If you're a seasonal employer and you don't have to file a return for every quarter of the year . . . ☐ Check here.		
19	Qualified health plan expenses allocable to qualified sick leave wages	19	.
20	Qualified health plan expenses allocable to qualified family leave wages	20	.
21	Qualified wages for the employee retention credit	21	.
22	Qualified health plan expenses allocable to wages reported on line 21	22	.
23	Credit from Form 5884-C, line 11, for this quarter	23	.
24	Deferred amount of the employee share of social security tax included on line 13b . . .	24	.
25	Reserved for future use	25	.

The credit typically reduces what would otherwise be payable by an employer for social security taxes, but any excess of the credit over what is otherwise owed for Social Security Taxes will be paid to the employer, as if the employer was entitled to a refund under normal IRS procedures.

Employers may choose to retain an amount of the employment taxes that would have otherwise been deposited, including federal income tax withholding, the employees' share of Social Security and Medicare taxes, and the employer's share of Social Security and Medicare taxes for all employees, up to the amount of the credit.

ADVANCE PAYMENT BEFORE FORM 941 IS FILED

Employers who have not yet completed a Form 941 but would like to claim an advance on their ERCs, can also file a Form 7200, which includes the following:



Part I Tell Us About Your Employment Tax Return

A Check the box to indicate which employment tax return form you file (or will file for 2020):
(1) ☐ 941, 941-PR, or 941-SS (2) ☐ 943 or 943-PR (3) ☐ 944 or 944(SP) (4) ☐ CT-1

B Is this a new business started on or after January 1, 2020? ▶ ☐ Yes ☐ No
If "Yes," skip line C unless you've already filed Form 941, Form 941-PR, or Form 941-SS for at least one quarter of 2020.

C Amount reported on line 2 of your most recently filed Form 941 (or wages reported on Schedule R (Form 941), column (c), by your third-party payer (see instructions)). If you file a different employment tax return, see instructions ▶

D Enter the total number of employees you have. See instructions ▶

Part II Enter Your Credits and Advance Requested

1	Total employee retention credit for the quarter. See instructions		1
2	Total qualified sick leave wages eligible for the credit and paid this quarter. See instructions		2
3	Total qualified family leave wages eligible for the credit and paid this quarter. See instructions		3
4	Add lines 1, 2, and 3		4
5	Total amount by which you have already reduced your federal employment tax deposits for these credits for this quarter	5	
6	Total advanced credits requested on previous filings of this form for this quarter	6	
7	Add lines 5 and 6		7
8	**Advance requested.** Subtract line 7 from line 4. If zero or less, don't file this form		8

2021 RULES

At this point you know how to calculate and claim the Employee Retention Credit on behalf of a business for 2020 activity. Now we can cover how it will apply for January through June 30 of 2021, as extended by the Economic Aid Act that was enacted on December 27th, 2020.

WHAT'S NEW IN 2021?

As noted before, the ERC has been extended to apply through June 30th, 2021 on much more lenient terms. As noted, this presently is set to apply only for the first two quarters of 2021, and time will tell whether Congress and the President act in the future to clarify and extend this.

You can see from the headings below that the 2021 rules are very different and employer friendly than the 2020 rules. These are as follows:

- The business only needs a 20% reduction in receipts to qualify.

- The comparison to qualify for Q1 2021 is Q1 2021 to Q1 of 2019 or Q4 2020 compared to Q4 or 2019.

- To qualify for Q2 2020 the employer can compare Q2 2021 to Q2 2019 or Q1 2021 to Q1 of 2019.

- The credit is for up to 70% of wages per employee for up to $10,000 per quarter of wages.

- The credit is for each of Q1 and Q2 2021, and not limited to a total of 70% of up to $10,000 cumulatively (up to $14,000 per employee if wages equal or exceed $10,000 per quarter).

- The business only needs a 20% reduction in receipts to qualify. The next most important thing to be aware of is that it will now be much easier to qualify to receive ERCs. In 2020, in order to initiate an eligible quarter, an employer had to have suffered a 50% decline in gross revenues from any given quarter in 2020 to the corresponding quarter in 2019. Now in 2021, however, an employer is only required to have suffered a 20% reduction in Gross Receipts as between the applicable quarter in 2021 and 2 different previous quarters:

    - Q1 2021 can be compared to Q1 2019, or the previous quarter can be compared, which would be Q4 of 2020 to Q4 of 2019.

    - Q2 2021 can be compared to Q2 2019, or the previous quarter can be compared, which would be Q1 of 2021 compared to Q1 of 2019.

What happened in 2020 is irrelevant for 2021 credit eligibility and calculation purposes, except that the Q4 of 2020 can be compared to Q4 2019 to see if there is a 20% or more reduction in Gross Receipts for purposes of qualifying for the credit in Q1 of 2021.

Here is an example of how these rules work:

Quarter	Gross Receipts 2019	Gross Receipts 2021	2021 vs 2019	Eligible Quarter
1	$300,000	$225,000	75%	YES
2	$300,000	$300,000	100%	YES

Question	2020	2021
Does a business qualify for ERC if they experienced a large drop in Gross Receipts?	Yes, a company is ERC eligible beginning with the quarter of 2020 that produced 50% less Gross Receipts than the corresponding quarter in 2019. Eligibility continues until the END of a quarter where Gross Receipts have increased to at least 80% of that same quarter in 2019.	Yes, a company is ERC eligible for each of the first and second quarters of 2021 if they produce less than 80% of the Gross Receipts in the corresponding quarter in 2019 or the immediately preceding quarter, as described above (i.e. if a business is trying to qualify for Q1 in 2021, they can compare Q4 in 2020 to Q4 in 2019).

This new provision will drastically increase the number of employers that will receive the ERC, and reads as follows:

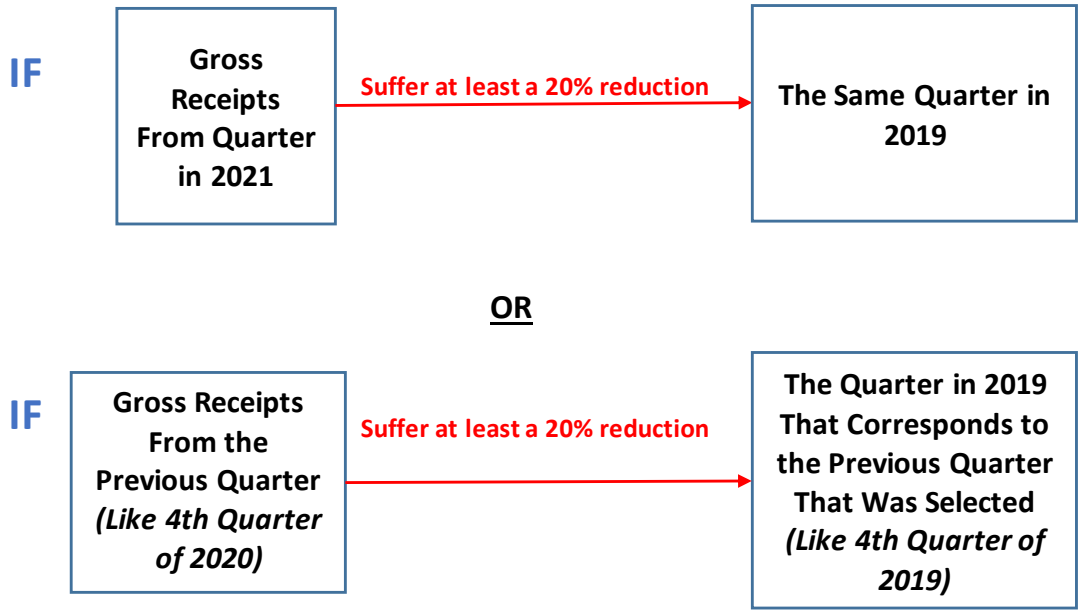
(d) MODIFICATIONS TO DEFINITION OF ELIGIBLE EMPLOYER.—

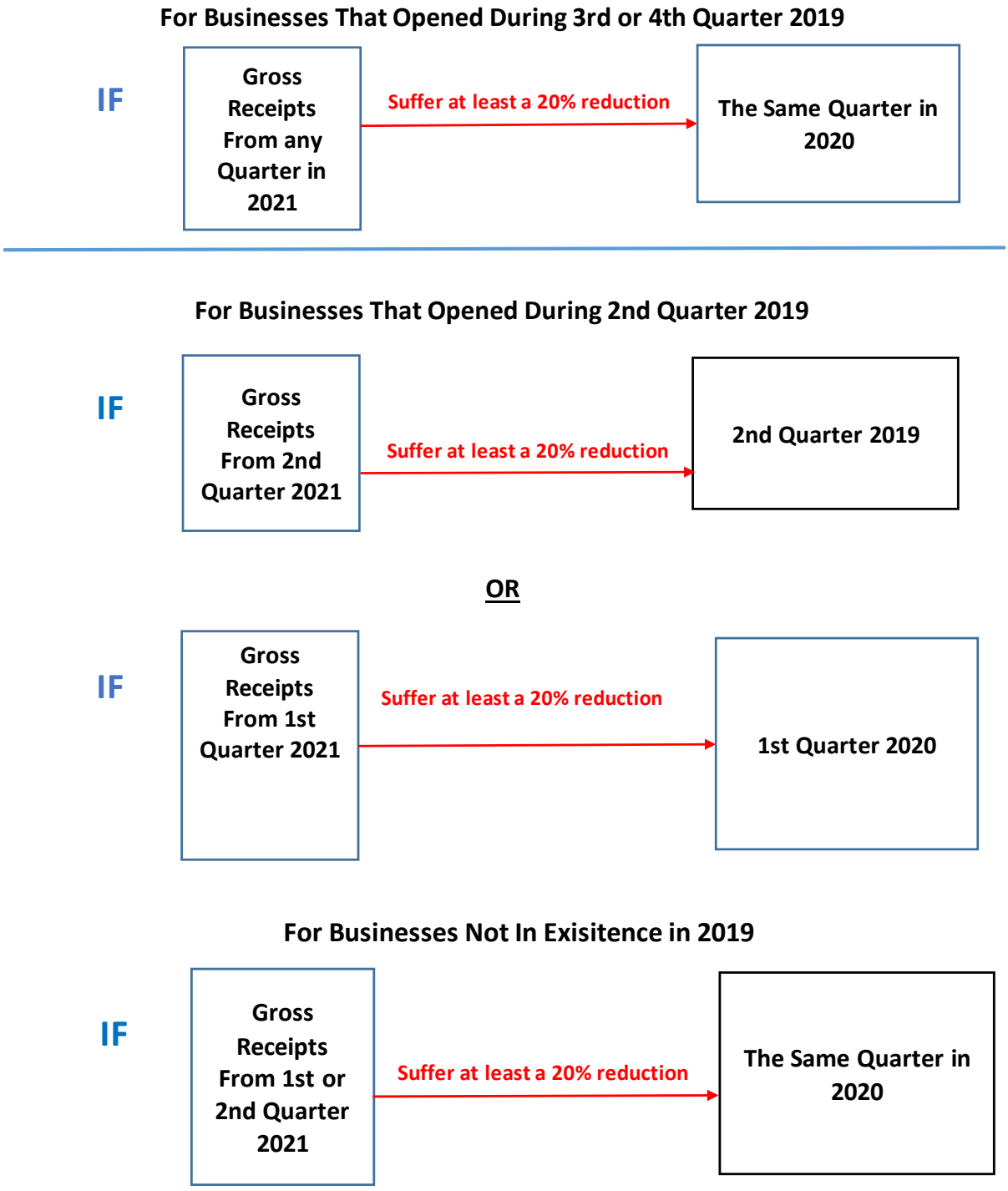
(1) DECREASE IN REDUCTION IN GROSS RECEIPTS NECESSARY TO QUALIFY AS ELIGIBLE EMPLOYER.—

(A) IN GENERAL.—Section 2301(c)(2)(A)(ii)(II) of the CARES Act is amended to read as follows: "(II) the gross receipts (within the meaning of section 448(c) of the Internal Revenue Code of 1986) of such employer for such calendar quarter are less than 80 percent of the gross receipts of such employer for the same calendar quarter in calendar year 2019.

The following charts illustrate the testing periods applicable for 2021 in order to determine if the business has a significant decline in gross receipts:

For Businesses That Were Open All of 2019





Not only is it easier to qualify for the ERC now, but employers stand to receive larger amounts.

In 2020, employers were eligible to receive a credit equal to 50% of wages paid per employee up to $10,000 of wages paid for the year. Now in 2021, employers are

eligible to receive up to 70% of the first $10,000 of wages paid to each employee for each calendar quarter (70% x $10,000 = $7,000). This means that after receiving $7,000 for an employee in Quarter 1, an employer is still eligible to claim up to $7,000 of credits on that employee in Quarter 2. This is much more liberal than the 2020 rules, which provided that total cumulative credits per employee for the calendar year were limited to $5,000.

Question	2020	2021
If a business has eligible time periods, how much of paid qualified wages are eligible for credit?	Employers are eligible to receive a credit equal to 50% of wages paid per employee (including healthcare costs) up to $10,000 of wages paid for the year. After receiving $5,000, an employee is no longer eligible for ERC credit.	Employers are eligible to receive 70% of wages paid per employee (including healthcare costs) up to $10,000 for any quarter. After receiving $7,000 in a quarter, an employee is still eligible in the next quarter to receive ERC credit.

> *(b) INCREASE IN CREDIT PERCENTAGE.—Section 2301(a) of the CARES Act is amended by striking ''50 percent'' and inserting ''70 percent''.*

Further, as mentioned above, the FTE threshold whereby an employer with over 100 employees may only claim credits for wages paid to employees that are not working was increased from 100 employees in 2020 to 500 employees in 2021.

While employers are now permitted to receive both ERCs and PPP loans, an employer cannot use the same wages for both PPP forgiveness payments and ERC reimbursed wages.

For example, an employer that received a PPP loan on April 30 first qualified for the ERC only for Q3 of 2020 and has a covered period that goes from May 1 to October 15th, which is 24 weeks. The first $10,000 of wages in Q3 of 2020 that were used in the ERC calculation (which were paid from July 1st through September 30, 2020) cannot be considered to have been wages for purposes of the PPP forgiveness applications.

Question	2020	2021
Can ERC be taken in addition to PPP Loan?	Was not allowed under the CARES Act, but now applies retroactively for 2020.	Employers can qualify for both the ERC and the PPP loan, subject to the below.
How does a business navigate which payroll costs should be used for ERC credit and which should be reserved for PPP forgiveness?	If a business owner has ERC eligible time periods, the general rule is that ERC takes priority over PPP. However, employer can elect out of ERC credit to preserve use of wages and health care costs for PPP loan, and then "unelect" and qualify for credit if PPP forgiveness is not received.	Same as 2020.

> *(2) COORDINATION WITH PAYCHECK PROTECTION PROGRAM.— The Secretary, in consultation with the Administrator of the Small Business Administration, shall issue guidance providing that payroll costs paid during the covered period shall not fail to be treated as qualified wages under this section by reason of an election under paragraph (1) to the extent that a covered loan of the eligible employer is not forgiven by reason of a decision under section 7A(g) of the Small Business Act. Terms used in the preceding sentence which are also used in section 7A of the Small Business Act shall have the same meaning as when used in such section.*

The prohibition against applying ERCs and PPP funds to the same qualified wages (or payroll expenses) may create an interesting logistical problem for some Employers, who will need to be careful to assure that they have enough forgivable PPP expenses to qualify for forgiveness.

The IRS has not released guidance on the coordination of the ERC with PPP and this book will be updated once guidance is received. In the meantime, advisors should consult with clients that received PPP loans to make sure that wages are not being double counted, and should consider amending PPP Loan Forgiveness Applications to report more non-payroll costs forgivable expenses instead of payroll costs

(assuming that the requirement that at least 60% of the loan is spent on payroll costs is met) so that the ERC can be maximized.

IMPACT ON THE NECESSITY REQUIREMENT

Another consideration that employers that are permitted to receive PPP loans and ERCs is the "necessity requirement." PPP borrowers are required to certify that the loan amount was "necessary to support the ongoing operation" of the business. Employers now applying for their first or second draw PPP loan may not be able to certify in good faith that their loan amount meets the necessity requirement if they have or will receive significant ERC monies.

TAX TREATMENT

The tax treatment of the ERC credit is unique and has an impact on planning and tax liability.

First, it is important to know that the ERC reduces the expenses that an Eligible Employer can otherwise deduct on its federal income tax return by the amount of the credit.

For example, if an employer spends $65,000 on payroll expenses and receives $20,000 in credits, then the employer can only deduct $45,000, and will therefore pay income tax on an additional amount of $20,000, if the employer has positive taxable income**.**

The above reduction occurs because Section 2301(e) of the CARES Act provides that rules similar to section 280C(a) of the Internal Revenue Code (the "Code") will apply for purposes of applying the Employee Retention Credit. Section 280C(a) of the Code generally disallows a deduction for the portion of wages paid equal to the sum of certain credits determined for the taxable year. Accordingly, a similar deduction disallowance would apply under the Employee Retention Credit, so that an employer's aggregate deductions would be reduced by the amount of the credit as a result of this disallowance rule.

Employers are not required to include ERC credit amounts received in their gross income, but the reduction of the deduction described above has the equivalent effect. Neither the portion of the credit that reduces the employer's applicable employment taxes, nor the refundable portion of the credit, is included in the employer's gross income.

HOW TO RETROACTIVELY CLAIM THE ERC FOR 2020

Employers who were ineligible in 2020 can now retroactively claim their eligible 2020 ERCs by filing a Form 941-X. This will allow them to amend their previously submitted quarterly employment tax returns, thereby claiming the ERCs they would have been eligible for. Keep in mind, however, that computational changes taking effect in 2021 will not apply to 2020. The rules for 2020 (discussed in the 2020 section above) will largely stay the same, except for the fact that PPP borrowers may now go back in time to claim those applicable credits.

Section 206(e)(2) of the Economic Aid Act is the provision that allows employers to retroactively claiming credits for wages paid in past quarters if they filed their payroll tax return before December 27th, 2020. The provision, in relevant part, states the following:

> *Section 206(e)(2)(A): For purposes of section 2301 of the CARES Act, an employer who has filed a return of tax with respect to applicable employment taxes . . . before the date of the enactment of this Act may elect . . . to treat any applicable amount as an amount paid in the calendar quarter which includes the date of the enactment of this Act.*

This provision does create some possible issues for those contemplating whether or not to retroactively claim ERCs. The problem is how Sec. 206(e)(2)(B) defines "Applicable Amount"

> *Under Section 206(e)(2)(B) of the Act, the the term ''Applicable Amount'' means the amount of wages which—*
>
> *(i) are—*
>
> *(I) described in section 2301(c)(5)(B) of the CARES Act, as added by the amendments made by subsection (b), or*
>
> *(II) permitted to be treated as qualified wages under guidance issued pursuant to section 2301(g)(2) of the CARES Act (as added by subsection (c)) . . . .*

The amended CARES Act Section of 2301(c)(5)(B) is where Congress moved the definition of "health care costs" for ERC purposes and stated that they could be included as part of "wages." The amended Section 2301(g)(2) of the CARES Act is the section where Congress provided that wages that were paid with PPP funds that were subsequently not forgiven can be counted towards ERCs retroactively.

Essentially, what Congress is saying here is that employers can either (a) retroactively claim wage credits attributable to healthcare costs, **or** (b) retroactively claim wage credits attributable to qualified wages that were initially paid using PPP loans that were not subsequently forgiven, but not both.

This issue was highlighted by Tony Nitti in his recent article entitled "Breaking Down Changes To The Employee Retention Tax Credit In The New Covid Relief Bill" that can be found on his Forbes Blog. We greatly appreciate Tony for his leadership and expertise in this area.

Why would Congress require employers to choose between healthcare costs OR wages paid with PPP loans that were not forgiven? Why can't an employer claim all of the wage credits they retroactively became eligible to receive? It is very possible that this was a simple drafting error. It is also possible that this was Congress' way of ensuring that employers could not retroactively claim credits on wages that they paid with forgivable PPP loans. Hopefully this will be clarified in a Technical Corrections Act or potentially by updated IRS guidance.