CERINI & ASSOCIATES LLP

CERTIFIED PUBLIC ACCOUNTANTS

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EMPLOYEE RETENTION TAX CREDIT GUIDE

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Originally passed as part of the CARES Act in March 2020, the **Employee Retention Tax Credit (ERTC)** was one of two programs designed to help employers keep employees on payroll during the widespread shutdowns in the spring of 2020, along with the **Paycheck Protection Program (PPP)** loans. Originally, borrowers were unable to claim both a PPP Loan and the ERTC thus overall limiting the appeal to borrowers for the ERTC, as generally the PPP would result in more funds for businesses and organizations.

Included in the 2021 appropriations & COVID-19 relief bill passed in late December 2020 was the **"Taxpayer Certainty and Disaster Relief Act of 2020" (TCDRA)**; normally this bill would have been a general non-item, continuing the passage of the extenders that happens every few years. However, buried in the bill was Section 206, which allowed for significant changes to the ERTC: ***the ability for a borrower that has taken a PPP loan to ALSO claim an ERTC!***

The TCDRA contained two separate provisions related to the ERTC – one which is more focused on 2020 changes on who can claim the credit in 2020 and another more focused on 2021 which incorporates this expanded eligibility and expands the calculation for the credit. It is crucial to note that some of the changes ONLY apply to 2020 (*increasing the eligibility for PPP borrowers*) retroactively while others apply ONLY to 2021 (*expanding the program to 2021, increasing the FTE "ceiling", change in gross receipt decline, the size of the credit*).

In order to claim an Employee Retention Tax Credit, an employer must first be what is considered a ***"qualified employer,"*** meaning they must meet one of the two following standards:

"Qualified Employer"

1. Fully or Partially Suspended as a result of a governmental order

2. Experiencing a "significant decline" in gross receipts

To date, there has still not been any formal, official guidance as to what fully or partially suspended as a result of a government order means from the IRS. They have only so far included **a few examples in their online FAQ**, which warns that it cannot be cited as *"legal authority."*

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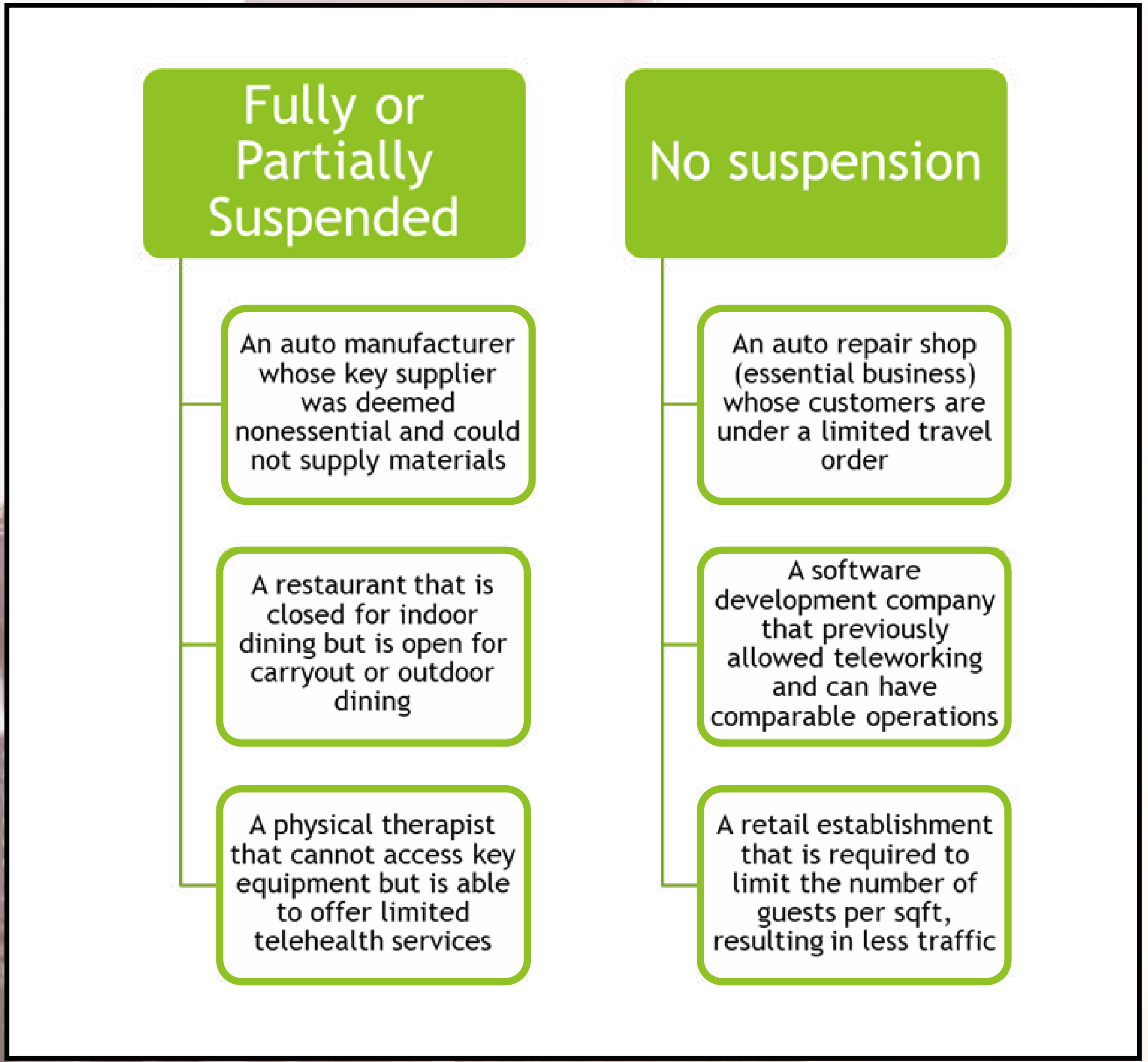
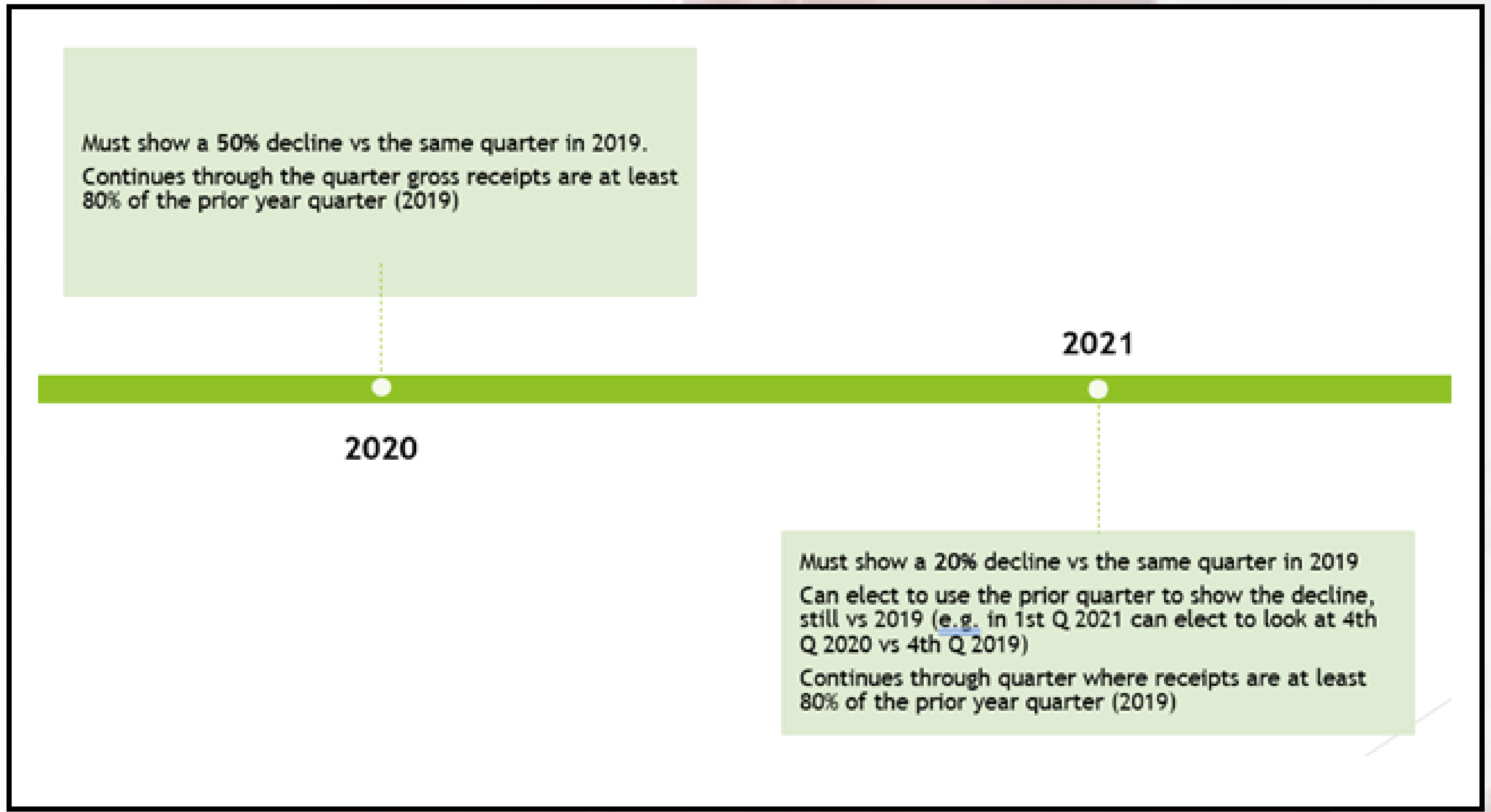
ELIGIBILITY AND QUALIFIED WAGES

Generally, the standard is "under the facts and circumstances, more than a nominal portion of its business operations are suspended by a governmental order". The FAQ includes the following examples and datapoints:



A *"significant decline"* in gross receipts can now depend on the period when the credit is claimed (*2020 or 2021*).



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Gross receipts are defined as receipts under Section 448(c), meaning net sales and other amounts received for services for a business using whichever method you use to file your tax return, including interest, dividends, rents, royalties or sales tax. For exempt organizations, receipts are now defined as receipts under Section 6033, which is meant to be gross receipts from operations as reported on Form 990.

		Number of FTEs		
Year		1-99	100-499	500+
2020	*Qualified Wages*	All Wages are Qualified	Only wages paid to employees not providing services are qualified	Only wages paid to employees not providing services are qualified
	Qualified Health Insurance Costs	All Employer Portion are Qualified (even if Furloughed)	Only for employees not providing service, including furloughed employees	Only for employees not providing service, including furloughed employees
	Wage Cap	$10,000 per Employee per Year	$10,000 per Employee per Year	$10,000 per Employee per Year
	Rate	50%	50%	50%
	Max Credit Per Quarter	$5,000	$5,000	$5,000
	Max Credit Per Year	$5,000	$5,000	$5,000
2021	*Qualified Wages*	All Wages are Qualified	All Wages are Qualified	Only wages paid to employees not providing services are qualified
	Qualified Health Insurance Costs	All Employer Portion are Qualified (even if Furloughed)	All Employer Portion are Qualified (even if Furloughed)	Only for employees not providing service, including furloughed employees
	Wage Cap	$10,000 per Employee per Quarter	$10,000 per Employee per Quarter	$10,000 per Employee per Quarter
	Rate	70%	70%	70%
	Max Credit Per Quarter	$7,000	$7,000	$7,000
	Max Credit Per Year	$14,000	$14,000	$14,000

ELIGIBILITY AND QUALIFIED WAGES

The amount of the credit and what constitutes qualified wages depends on the year of the credit claim. For wages to initially count, first an employer needs to be considered a qualified employer (*above*); second, the wages must be paid either during the shut down period (*if the qualification is related to the shutdown*) or during the quarters with the significant decline in gross receipts.

For credits claimed for wages paid in 2nd, 3rd, or 4th Q 2020 employers will be limited to $10,000 in wages at a 50% credit rate, for a max annual credit of $5,000 per employee. For employers with less than 100 full-time equivalent employees, all wages and health insurance costs are qualified (*assuming they are qualified employers*) regardless if the employee was providing services or not. For employers with over 100 full-time equivalent employees, the credit was limited to qualified wages and health insurance costs paid for employees who were not providing services.

For credits claimed for wages paid in the 1st or 2nd Quarter of 2021 employers are still limited to the $10,000 base, but now it is applied per quarter rather than per year. Further, the rate has increased to 70%, making the maximum credit now $7,000 per quarter (*$14,000 per year, as the program is set to expire June 30, 2021*). The full-time equivalent "ceiling" to allow all wages paid as eligible for employers with less than 500 employees, a significant increase from 100.

The ERTC is a payroll focused credit and reduces an employer's payroll tax obligations. The credits would be claimed on Form 941, filed quarterly and received by employers by reducing their tax deposits. Employers are also able to claim advance payments of the credit on Form 7200 if their remaining deposits are insufficient to cover their credit.

For 2020 claims previously not done (*as a result of a PPP Loan*), employers would have the option of either amending their 2nd and 3rd Q 2020 941 (*to note: any 1st Q 2020 eligible wages paid between March 12th and March 31st*) are claimed on the 2nd Q return. As part of the TCDRA, the expanded 2020 ERTC also allows for taxpayers to claim an "*applicable amount*" catch-up credit for taxpayers who already filed 2nd and 3rd Q 2020 payroll tax returns in lieu of amending. The credit would be (*as written at least*) only for qualified health care expenses or for where PPP forgiveness was denied; there is belief this may be a technical drafting error and it would apply for all wages that are ERTC eligible.

Additionally, the TCDRA instructed the IRS to make available a program to allow for advance payments for small employers (*less than 500 full-time equivalents*) on these credits, not to exceed 70% of the average quarterly wages the employer paid in 2019. The precise mechanism of this claim is still largely a mystery and potentially may be for some time. Any employers that receive this credit will be required to reconcile the amount advanced versus the actual credit.

When claiming an ERTC, taxpayers should keep certain underlying documentation available per the IRS instructions. We recommend that taxpayers have the following available:

	ERTC Documenation Recommendations
	Organizational Level
1	Organizational Background, including information on key revenue or support streams, payroll processes and operational departments and functions
2	Environmental, political and economic summary of timeperiod
	Eligiblity Criteria
1a	Identification (and COPY!) of full or partial governmental order, if applicable.
1b	Analysis of how governmental order impacts organization.
	OR
1	Calculation of 2019 gross receipts by quarter, with comparison to 2020 or 2021 receipts for the same quarter.
	Employee Data
1	Per payroll data sheet including employees Name Title Department Gross Pay (If applicable) Services provided to Organization (if applicable) Why unable to provide services
2	Calculation of Qualified Wages
3	Caluclation of Qualified Health Plan Expenses
4	Payroll Journals for claimed periods
5	Health invoices for claimed periods

Finally, any employer who wishes to claim an ERTC is encouraged to contact their payroll provider at the start of the process as to best understand their procedures. Many providers will not allow you to amend returns outside of their system or otherwise make these claims without working through their process.

Prior to this change, employers were unable to claim an ERTC if they had at any point claimed a PPP Loan. These changes may allow for a few scenarios that did not exist prior, such as a PPP Loan borrower did not receive funding until July or August 2020 to claim for 2nd Q 2020 (*if otherwise eligible*) or to claim for expenses paid after the 10 weeks of PPP Funding had been exhausted.

It is important to note that any wages (*including health insurance costs*) which are used for the ERTC will NOT count as PPP eligible payroll costs. This is to prevent a clear situation of *"double dipping,"* but its important to note that the disallowance is on the PPP side which means the ERTC in theory has priority over the PPP in determining eligible wages. Therefore, a borrower that claims an ERTC will not be able to use these wages in calculating eligible PPP forgiveness costs.

For many PPP Loan borrowers, it is important to note that the passage of this act has increased both potential PPP expenses (*to include covered operational expenses*) and allows for a potential second draw. While borrowers may be able to do both, there now runs the potential for *"optimization"* to allow for borrowers who are facing significant financial difficulties to maximize these sources.

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