

March 26, 2021

CLIENT ALERT – CORONAVIRUS (COVID-19)
EMPLOYEE RETENTION TAX CREDIT

Dear Clients and Friends:

The Employee Retention Tax Credit (“ERTC”) was part of the COVID-19 relief provided by the CARES Act back in March 2020. Our original Client Alert discussing the ERTC can be accessed [here](#). The ERTC was then expanded by the Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act passed in December 2020. Our prior Client Alert discussing the expansion of the ERTC, is available [here](#).

The ERTC was further expanded by the American Rescue Plan passed on March 11, 2021. In addition, on March 1, 2021, between the passage of the two most recent stimulus packages, the Internal Revenue Service (IRS) issued Notice 2021-20 (the “Notice”) providing comprehensive guidance related to the 2020 ERTC.

In light of these changes and the ERTC attribution rules, employers who had previously determined that they were not eligible for the ERTC should take another look.

This Client Alert highlights certain things that businesses should be aware of regarding the ERTC, including the ERTC attribution rules, the changes to the ERTC made by the two most recent stimulus packages and the IRS guidance. This information is not legal advice and may not be suitable for all client situations. As always, if you would like specific legal assistance with respect to this programs or any other matters, please do not hesitate to contact your HH&K attorney.

What is the ERTC?

The ERTC is a refundable payroll tax credit on certain “qualified wages” (including certain health plan expenses) paid to employees during applicable covered periods, subject to caps and limitations. The calculation methodology and restrictions are different for the 2020 ERTC and the 2021 ERTC and the IRS has not yet issued guidance on the 2021 ERTC. Both the 2020 ERTC and the 2021 ERTC are reduced by any credits received by the employer for sick leave and family leave under the Families First Coronavirus Relief Act (“FFCRA”).

2020 ERTC

The 2020 ERTC is equal to 50% of the qualified wages paid to employees beginning March 13, 2020 through December 31, 2020 with a cap of \$10,000 per employee for all quarters, for a maximum of credit of \$5,000 per employee in 2020.

For 2020, companies with more than 100 employees may only claim the ERTC for employees on the payroll who were not working due to the pandemic, while companies with less than 100 may claim the credit for all employee wages.

2021 ERTC

The 2021 ERTC is equal to 70% of the qualified wages of the employer with a cap of \$10,000 per employee per quarter, for a maximum of credit of \$7,000 per employee per quarter. Under the Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act, the 2021 ERTC was only available for the first two quarters of 2021. The American Rescue Plan extends the credit through December 31, 2021.

The Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act increased the 100 employee threshold to 500 employees so that in 2021, companies with more than 500 employees may only claim the ERTC for employees on the payroll who were not working due to the pandemic, while companies with less than 500 employees may claim the credit for all qualifying wages.

Qualifying for the ERTC

There are two ways that businesses can qualify for the ERTC: (1) by experiencing a significant decline in gross receipts; or (2) by being subject to a full or partial suspension of business activities.

Significant Decline in Gross Receipts

2020 ERTC

In 2020, employers are eligible for the ERTC in any quarter in which it has a reduction of gross receipts greater than 50% as compared to the same quarter in 2019. The employer continues to be eligible for the credit in subsequent quarters if it has a reduction in gross receipts of more than 80% as compared to the same quarter in 2019.

2021 ERTC

Beginning January 1, 2021, an employer qualifies for the ERTC for the period that begins in a calendar quarter in which gross receipts are less than 80% of gross receipts for the same calendar quarter of 2019 and ending on the last day of the first quarter in which gross receipts are more than 80% for the same calendar quarter of 2019.

Employers may elect to apply this test in 2021 based on gross receipts from the immediately preceding calendar quarter to determine their eligibility for the credit. In other words, an employer who cannot meet this test in the first quarter of 2021 may elect to compare gross receipts in the 4th quarter of 2020 to the 4th quarter of 2019 and if there is a decline of at least 20% between the two, the 1st quarter of 2021 will be an eligible quarter.

Full or Partial Suspension of Business Activities

Businesses that do not meet the decline in gross receipts test can still qualify for the ERTC if business operations were fully or partially suspended during the applicable time period due to a government order limiting commerce, travel or group meetings due to COVID-19. For those employers who were allowed to continue to operate (even if subject to some restrictions), they may be considered to have a partial suspension of operations if, under the facts and circumstances, more than a “nominal” portion of their business operations are suspended by a governmental order

Examples of such government orders include:

- orders requiring non-essential businesses to close;
- orders imposing a curfew on residents that impact the operating hours of a business;
- orders mandating workplace closure for cleansing or disinfecting; and
- orders significantly restricting business operations (e.g. take out/curbside pickup only; outdoor seating only; limitations on indoor capacity that have more than a “nominal” effect, etc.).

The Notice provides guidance on what constitutes a “nominal” portion of an employer’s business for purposes of qualifying for the credit. In addition to providing some specific examples of restrictions that would constitute “partial suspensions”, the Notice states that the following will be deemed partial suspensions that have a “more than nominal” effect on an employer’s business:

- A governmental order that results in a reduction in an employer’s ability to provide goods or services in the normal course of the employer’s business of not less than 10% percent; and
- A governmental order that shuts down a portion of the employer’s business where:

- the gross receipts from that portion of the business operations is at least 10% of the total gross receipts (determined using the gross receipts of the same calendar quarter in 2019); or
- the hours of service performed by employees in that portion of the business is at least 10% of the total number of hours of service performed by all employees in the employer's business (again determined using the number of hours of service performed by employees in the same calendar quarter in 2019)

Prior IRS guidance on the ERTC has also stated that no “partial suspension” is deemed to occur if an employer's workplace is closed by a governmental order but the employer is able to continue operations “comparable” to its prior operations by requiring employees to telework. The Notice includes some examples of what is considered “comparable” operations, but also identifies three (3) factors that the employer must consider to properly determine comparability: (a) portability of employees’ work; (b) the need for presence in the employee’s physical workspace; and (c) ability to transition to telework operations.

Aggregation Rules

For purposes of the ERTC, all entities subject to the aggregation rules in Section 52(a) and (b) and Section 414(m) or (o) of the Internal Revenue Code of 1986, as amended (the “Code”) are considered a single employer including when:

1. determining whether the employer has a trade or business in operation that was fully or partially suspended due to a qualifying government order limiting commerce, travel, or group meetings due to COVID-19;
2. determining whether the employer has experienced a significant decline in gross receipts; and
3. determining whether the employer meets the full-time employee requirement.

Members of an aggregated group are required to apportion the ERTC based on each group member's proportionate share of the Qualified Wages considered when computing the amount of the credit. In addition, all members of an “aggregated group” are eligible for the ERTC if one member of the group has business operations fully or partially suspended due to government order. Employers who thought that they may not be eligible for the ERTC because only a portion of their business was suspended or partially suspended should take another look.

The ERTC and the Paycheck Protection Program (“PPP”)

When the CARES Act was initially passed, employers that received a PPP loan were ineligible for the ERTC. One of the recent changes is that recipients of PPP loans may take advantage of both the PPP and the ERTC so long as the wages for which the employer receives the ERTC are not also forgiven payroll costs for purposes of the PPP. Thus, PPP borrowers who previously discounted the ERTC as an option should take another look at their payroll records to determine whether they paid any wages that were not forgiven under the PPP that would now qualify for the ERTC under the new rules.

The Notice includes some additional guidance on the interaction of the ERTC with PPP by providing general rules and seven new examples showing how to determine the portion of ERTC-eligible wages based on the amount claimed as payroll costs on the PPP loan forgiveness application.

Documentation Requirements

The IRS Notice specifies the records that employers should keep to show their eligibility for the ERTC and mandates that such records be maintained for at least four (4) years. The records are:

- The relevant governmental order(s);
- Any records the employer used to analyze whether a sufficient portion of the business was suspended or whether the impact on the business was sufficient to suspend operations;
- Records used to establish a gross receipts decline;
- Records of qualified wages;
- Documentation of qualified health plan expenses;
- Documentation of aggregated group analysis;
- Copies of Forms 7200; and
- Copies of the employer's federal employment tax returns.

Other Income Tax Implications of the ERTC

The IRS Notice requires employers to reduce their deduction for qualified wages, including qualified health plan expenses, by the ERTC amount and confirms that the deduction for the employer's share of Social Security and Medicare taxes is not reduced by any portion of the ERTC.

Contact Your HH&K Attorney for Legal Guidance

This information is not legal advice and may not be suitable for all client situations. This Client Alert provides general information regarding the ERTC and does not outline all of the important considerations related thereto. This Client Alert is not a substitute for legal guidance regarding ERTC details and how those may be applicable to your business. As always, if we can be of assistance during this difficult time, please do not hesitate to contact your HH&K attorney.



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