

EMPLOYEE RETENTION CREDIT EXTENDED AND EXPANDED CONSOLIDATED APPROPRIATIONS ACT OF 2021 (CAA 2021)

February 3, 2021



Agenda for Today



Introduction



CARES Act Employee Retention Credit (ERC)



How to Claim the ERC



CAA21 Changes

- Retroactive for 2020
- Prospective for Q1 & Q2 2021



Interplay Between ERC and Paycheck Protection Program (PPP)



Questions

With You Today



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Overview

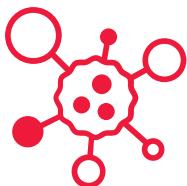
The Employee Retention Credit (ERC) was part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, enacted on March 27, 2020

- ▶ Refundable credit against employer Social Security tax (IRS Form 941).
- ▶ Payroll tax credit, not income tax credit.
- ▶ Applied to certain wages and allocable health plan costs paid to employees between March 13, 2020 and December 31, 2020.
- ▶ Credit equal to 50% of qualified wages up to \$10,000 in qualified wages per employee, for a maximum credit per employee of \$5,000.

To take advantage of the ERC, employers must satisfy one of two “eligibility” tests AND must have “qualified wages”.

Eligibility

To be eligible for the ERC, an employer must meet at least one of the following “eligibility” tests:



The employer’s operations were fully or partially suspended due to a governmental order related to COVID-19; or



The employer incurred a decline in gross receipts of greater than 50% during a 2020 calendar quarter compared to the same calendar quarter during 2019.

Which industries are claiming the ERC?



Which industries are we seeing taking advantage of the new 2020 and 2021 ERC rules?

- ▶ Retail
- ▶ Gaming and Hospitality
- ▶ Healthcare & Hospitals
- ▶ Non-essential Manufacturing
- ▶ Restaurants, Breweries and Bars
- ▶ Not for Profits, which include: Schools, Museums, Performing Arts Centers, Churches, etc.
- ▶ Any other industry significantly impacted from COVID-19



Can essential businesses qualify as eligible employers?

- ▶ Yes! Essential businesses may still qualify under the gross receipts test or under the governmental order test if they have a partial shutdown.
- ▶ Essential business may be considered partially shut down if a governmental order requires the employer to close its workplace for certain non-essential purposes but not others and/or if a governmental order requires an employer to reduce its operating hours.

Employer Aggregation Rules



How are aggregated groups determined and what is the impact on ERC?

- ▶ All entities that are treated as a single employer under IRC § 52(a) or (b) controlled group rules or are otherwise aggregated under IRC § 414(m) and (o) are considered one employer for the ERC.
- ▶ This applies to the determination of eligibility, the number of average employees, and the calculation of qualified wages.
- ▶ The amount of the ERC calculated must be apportioned to members of the aggregated group based on the qualified wages generated by each member.



How is the governmental order test applied to aggregated groups and/or employers operating across multiple jurisdictions?

- ▶ For aggregated groups, if the operations of one member of the group are suspended by a governmental order, then all members of the aggregated group may be considered to have their operations partially suspended.
- ▶ If an employer establishes a policy to comply with the local governmental orders that constitutes a full or partial shutdown and applies this policy across jurisdictions in order to operate in a consistent manner, the employer would be considered an eligible employer with respect to all locations in which the policy is enacted; this applies to both essential and non-essential businesses.

Gross Receipts Rules



Is the gross receipts test calculated on the cash or accrual method?

- ▶ If the employer is entitled to the small business exclusion that allows them to use the cash method for the tax return under IRC § 448(c), then they can also use the cash method for calculating gross receipts.
- ▶ Otherwise, this test is calculated under the accrual method.



How are gross receipts calculated?

- ▶ In general, gross receipts includes total sales, net of returns and allowances, and all amounts received for services, income from investments, and from incidental or outside sources (interest, dividends, rent, royalties, and other income).
- ▶ Gross receipts from foreign affiliates are included.

Overview of Qualified Wages

The definition of “qualified wages” for ERC purposes varies depending upon the employer’s average headcount in 2019.

- ▶ **100 or fewer full-time employees:** Qualified wages are all wages paid to all employees during the period of eligibility.
- ▶ **Greater than 100 full-time employees:** Qualified wages are only wages paid to employees who are not performing services due to COVID-19 during the period of eligibility.

Additional provisions:

- ▶ Allocable health plan expenses are eligible for the ERC (subject to the \$10,000 qualified wage limitation).
- ▶ The ERC was not available to employers that received a Paycheck Protection Program (PPP) loan.
- ▶ Wages are not eligible for the ERC if they were the basis for other tax credits, such as the Families First Coronavirus Relief Act (FFCRA) mandatory federal paid leave credit and the Work Opportunity Tax Credit (WOTC).

Common Questions on Qualified Wages



How is the average number of full-time employees determined?

- ▶ A full-time employee is an employee who had an average of at least 30 hours per week or 130 hours per month during 2019. (Using ACA rules.)
- ▶ The average is determined by taking the sum of the number of full-time employees in each calendar month in 2019 and dividing by the number of full calendar months the employer operated its business in 2019.



What costs are potentially includable/excludable as qualified wages?

- ▶ Qualified wages are defined as wages under IRC 3121(a).
- ▶ If an eligible employer averaged more than 100 full-time employees in 2019, the employer may generally not treat as qualified wages amounts paid to employees for paid time off for vacations, holidays, sick days and other off days.
- ▶ Payments, including severance, made to a former employee following termination of employment are not considered qualified wages.
- ▶ Wages paid to related individuals, such as employees who are children or other family members, are not qualified wages.

Common Questions on Qualified Wages



What is the definition of allocable qualified health plan expenses?

- ▶ The amount of qualified health plan expenses taken into account in determining the credit generally includes both the portion of the cost paid by the employer and the portion of the cost paid by the employee with pre-tax salary reduction contributions. (Does not include any employee after-tax contributions.)
- ▶ For fully-insured group health plan, employers may use any reasonable method to determine and allocate the plan expenses, including:
 - The COBRA premium for the employee.
 - One average premium rate for all employees.
 - A substantially similar method that takes into account the average premium rate determined separately for employees with self-only and other than self-only coverage.
- ▶ For self-insured group health plan, employers may use any reasonable method to determine and allocate the plan expenses, including:
 - The COBRA premium for the employee.
 - Any reasonable actuarial method to determine the estimated annual expenses of the plan.

How to Claim the Credit

Reduction of Federal Employment Tax Deposits

- ▶ In anticipation of receiving the tax credits, employers can fund qualified wages by offsetting the federal income and employment that would otherwise be required to be deposited with the IRS.
 - In other words, employers can retain the federal income tax withheld from employees, the employees' share of Social Security and Medicare taxes, and the employer's share of Social Security and Medicare taxes, with respect to all wages paid to all employees.
 - This will provide immediate funding of the tax credit unless the credit is larger than the total payroll tax deposit for the period.

“Rapid” Refund

- ▶ In 2020, if there were not sufficient employment taxes to cover the credit, employers could file IRS Form 7200 to request an advance payment from the IRS.
- ▶ In 2021, Form 7200 advanced refund method is not available for large employers.

Federal Employment Tax Return

- ▶ An employer may also claim the credit directly on its quarterly federal employment tax return (IRS Form 941) or amended quarterly federal employment tax return (Form 941-X).
- ▶ Regardless of the credit recovery method utilized, employers will need to report the qualified wages and health plan expenses and reconcile any advanced credit payments and reduced deposits on their quarterly IRS Form 941.

Retroactive Changes Under Sec. 206 of CAA21

The following changes apply to the ERC as if they were enacted originally as part of the CARES Act:

PPP LOAN ELIGIBILITY		TREATMENT OF HEALTH PLAN EXPENSES	
OLD RULE	An employer that receives a PPP loan is not eligible to claim the ERC.	OLD RULE	Although eligible for the ERC, allocable health plan expenses were considered separate from qualified wages for purposes of the credit.
NEW RULE	Employers that receive a PPP loan may claim the ERC in 2020 and 2021.	NEW RULE	The definition of qualified wages has been expanded to include allocable health plan expenses, thereby aligning the law with IRS guidance that allocable health plan expenses qualify for the ERC even if no other qualified wages are paid.

Retroactive Changes Under Sec. 206 of CAA21

The following changes apply to the ERC as if they were enacted originally as part of the CARES Act:

DEFINITION OF GROSS RECEIPTS FOR TAX-EXEMPT ORGANIZATIONS		APPLICABLE QUARTER TO CLAIM THE ERC	
OLD RULE	The original CARES Act did not define gross receipts for tax-exempt organizations, so it was unclear how they could satisfy that prong of the gateway test.	OLD RULE	ERC was claimed in the quarter the qualified wages or health plan costs were paid on Form 941.
NEW RULE	CAA21 clarifies that the definition of gross receipts follows IRC § 6033 (i.e., all receipts, same as for Form 990 reporting).	NEW RULE	Old rule still applies to most employers. But certain employers who paid qualified wages before Q4 2020 and who did not take such wages into account for claiming the ERC, could elect to treat such wages as paid in Q4 2020 and claim the credit on the Q4 Form 941.

Prospective Changes Under Sec. 207 of CAA21

The following changes apply from **January 1 to June 30, 2021**:

CREDIT AVAILABILITY		CREDIT PERCENTAGE AMOUNT	
OLD RULE	ERC is only available for qualified wages paid between March 13 and December 31, 2020.	OLD RULE	2020 ERC = 50% of qualified wages and allocable health plan expenses.
NEW RULE	Expanded ERC is available to qualified wages paid from January 1 to June 30, 2021.	NEW RULE	2021 ERC = 70% of qualified wages and allocable health plan expenses.

Prospective Changes Under Sec. 207 of CAA21

The following changes apply from **January 1 to June 30, 2021**:

 QUALIFIED WAGES & ALLOCABLE HEALTH PLAN EXPENSE LIMITATIONS		 FULL-TIME EMPLOYEE THRESHOLD	
OLD RULE	2020 qualified wages and allocable health plan expenses may not exceed \$10,000 per year.	OLD RULE	For 2020, if 100 or fewer full-time employees on average in 2019, then qualified wages means all wages paid to all employees. But if more than 100 full-time employees on average in 2019, qualified wages means only wages paid to employees who are not performing services due to COVID-19
NEW RULE	2021 qualified wages and allocable health plan expenses may not exceed \$10,000 per quarter for Q1 and Q2 2021.	NEW RULE	For 2021, replace “100 employees” (above) with “500 employees”

Prospective Changes Under Sec. 207 of CAA21

The following changes apply from **January 1 to June 30, 2021**:



EMPLOYER ELIGIBILITY UNDER GROSS RECEIPTS TEST

OLD RULE

The employer must incur a decline in gross receipts of greater than 50% during a 2020 calendar quarter when compared to the same calendar quarter during 2019.

NEW RULE

The employer must incur a decline in gross receipts of greater than 20% during a 2021 calendar quarter when compared to the same calendar quarter during 2019. The employer may elect to instead compare the preceding calendar quarter's gross receipts against the gross receipts for the corresponding calendar quarter in 2019, for purposes of determining eligibility under this test for Q1 and Q2 2021.

- For example, if the employer had a 20% or greater decrease in gross receipts for Q4 2020 compared to Q4 2019 but did not have a 20% or greater decrease for Q1 2021 compared to Q1 2019, the employer could elect to qualify for the ERC for Q1 2021 based on the Q4 2020 comparison to Q4 2019.

Prospective Changes Under Sec. 207 of CAA21

The following changes apply from **January 1 to June 30, 2021**:



PAY RATE INCREASES

OLD RULE

For 2020, qualified wages paid to an employee cannot exceed what the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the operational suspension or the first day of the quarter in which the employer experienced a significant decline in gross receipts.

NEW RULE

For 2021, this limitation was removed so employers can give “hazard pay” increases or bonuses, etc.



ADVANCE PAYMENTS

OLD RULE

For 2020, any eligible employer could file Form 7200 to claim an advanced refund of the ERC.

NEW RULE

For 2021, IRS will draft guidance to allow advanced payment of the credit for employers with 500 or fewer employees, with certain limitations.

Prospective Changes Under Sec. 207 of CAA21

The following changes apply from **January 1 to June 30, 2021:**



ELIGIBILITY OF GOVERNMENTAL ENTITIES

OLD RULE

For 2020, governmental entities could not claim the ERC.

NEW RULE

For 2021, exceptions were created for organizations described in IRC § 501(c)(1), colleges, universities, and entities whose principal purpose is providing medical or hospital care.

Interplay of ERC and PPP

LIMITATIONS

- ▶ Payroll costs funded by forgiven PPP loans are not eligible for the ERC.
- ▶ ERC qualified wages cannot be considered payroll costs that are eligible for PPP forgiveness

CONSIDERATIONS

- ▶ Due to CAA21 changes, an employer can support the PPP loan using any period of time within the PPP period (April 1 - December 31, 2020), not just 8 or 24 weeks.
- ▶ Most borrowers received PPP funds in April (Round 1) or May (Round 2), while the most government shut-down orders were issued starting mid-March through May; so, there may be a period of time when operations were partially/fully shut down before the PPP loan “covered period”.
- ▶ If total wages are significantly higher than the PPP loan amount, there is likely still an ERC benefit during the PPP timeframe.
- ▶ Pending guidance, if an employer designates certain wages for PPP forgiveness and those payroll costs are not forgiven, then the employer may still treat those amounts as qualified wages for ERC purposes.

Interplay of ERC and PPP



BEST PRACTICES

- ▶ If a borrower has not yet applied for PPP loan forgiveness, borrowers may want to allocate the maximum permissible amount of non-payroll costs for PPP loan forgiveness. Up to 40% of PPP funds can be used for non-payroll costs. By allocating 40% of PPP loan proceeds to nonpayroll costs, borrowers can increase the pool of potentially eligible ERC qualified wages.
- ▶ Consider the forgiveness period (8 weeks vs. 24 weeks or anything in between) and the impact on eligible ERC wages.
- ▶ Documentation is needed to show that a company is not using the same wages for both PPP forgiveness and the ERC.
- ▶ Connect with a local BDO PPP expert to optimize the PPP process for both 2020 and/or 2021.



BDO Thought Leadership

2021 ERC

- ▶ [New Stimulus Package Extends and Expands Employee Retention Credit](#)
- ▶ [Significant Enhancements to the Employee Retention Tax Credit \(ERTC\): Maximizing the ERTC in 2020 and 2021](#)
- ▶ [New Stimulus Package Passed December 21, 2020](#)

2020 ERC

- ▶ [Have You Considered the Employee Retention Credit?](#)
- ▶ [As Governors Lift COVID-19 Restrictions, What Happens to the Cares Act Employee Retention Credit?](#)
- ▶ [IRS Updates FAQs on Cares Act Employee Retention Credits and Payroll Tax Deferrals](#)
- ▶ [IRS Updates FAQs on Employee Retention Credits for Acquisitions of PPP Borrowers](#)



Questions?



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