

In general, what is the employee retention credit?

- The employee retention credit is a refundable tax credit for **eligible employers** of any size, which carry on a trade or business in 2020, including tax-exempt organizations, and which, during a calendar quarter in 2020, either (a) **fully or partially suspend operation due to a governmental order relating to COVID-19** or (b) experience a “**significant decline in gross receipts**” in a calendar quarter.
- The credit is equal to **50% of the qualified wages** paid with respect to each employee of the employer.
- The amount of qualified wages (inclusive of allocable health care costs) depends on the average number of full-time employees employed during 2019 and is limited to \$10,000 for each employee all calendar quarters during 2020. Thus, the **maximum credit amount per employee is \$5,000**.
- **The credit is fully refundable.** The credit first offsets the employer’s payroll taxes otherwise payable by the employer. If the amount of the credit exceeds such taxes, then the excess is paid as a refund to the employer by the Treasury. The IRS is directed to issue guidance to allow the credit to be payable to eligible employers on an advance basis, with subsequent reconciliation.
- The credit applies to qualifying wages paid after March 12, 2020 and before January 1, 2021.
- Eligible employers are not required to claim the credit. Note that employers cannot both claim this credit and receive a Paycheck Protection Program (PPP) loan.
- Governmental employers are not eligible for the credit. Further, self-employed individuals are not eligible for the credit for their self-employment services or earnings.
- As discussed below, there are many other details that need to be clarified in future guidance. The IRS has [published FAQs](#) on the credit, which may be updated from time to time. Regulations may also be issued at some point.

What is a “full or partial reduction in operations”?

A full or partial suspension of operations qualifies an employer for the credit if the suspension is due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19.

The operation of a trade or business may be partially suspended if an appropriate governmental authority imposes restrictions on the business operations by limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19 such that the business can continue to operate but not at its normal capacity. Thus, whether there is a partial suspension will depend on the details of the relevant order. For example, an order that limits restaurants, bars and similar establishments in a state to carry-out, drive-through or delivery food and beverage sales would be considered a partial suspension of business operations for such establishments that previously provided

full sit-down service, a dining room or other on-premises eating or drinking facilities. As another example, orders that limit business hours or numbers of customers may be considered a partial suspension depending on the specifics of the order. Further guidance on this issue from the IRS would be helpful.

What is a significant decline in gross receipts?

A significant decline in gross receipts:

- begins with the first calendar quarter in 2020 in which the employer's gross receipts are less than 50% of the gross receipts for the same calendar quarter in 2019, and
- ends with the first calendar following the first calendar quarter in 2020 for which gross receipts are greater than 80% of the gross receipts for the same calendar quarter in 2019.

Gross receipts are defined for this purpose as under Code section 448(c), which provides generally that gross receipts means gross receipts for any taxable year reduced by returns and allowances made during such year.

Treasury is directed to issue guidance for employers who were not carrying on a trade or business for all or part of the same calendar quarter in 2019.

For example, suppose that:

- in first quarter 2020, an employer's gross receipts were 60% of gross receipts for first quarter 2019;
- in second quarter 2020 the employer's gross receipts are 48% of gross receipts in second quarter of 2019; and
- in third quarter 2020, the employer's gross receipts are 83% of gross receipts for third quarter 2019. The employer would cease to qualify under the gross receipts reduction test for the quarter beginning October 1, 2020.

In this example, the employer is entitled to a credit for the second and third quarters of 2020.

What are "qualified wages?"

In general, "qualified wages" are wages as defined for social security tax purposes (Code sec. 3121(a)) and that are paid after March 12, 2020 and before January 1, 2021. Qualified wages also include the employer's "qualified health plan expenses" that are properly allocable to qualified wages. Qualified paid sick and family leave wages for which the employer receives a tax credit under the provisions of the Families First Coronavirus Response Act (FFCRA) may not be taken into account under the employee retention credit. The FFCRA paid leave credits apply to employers with fewer than 500 employees.

The definition of "qualified wages" also depends on the eligible employer's average number of full-time employees during calendar year 2019.

If the average number of the employer's full-time employees during 2019 was **more than 100**, IRS FAQs (as of March 31, 2020) highlight that qualified wages are wages paid by the eligible employer with respect to an employee who is **"not providing services"** due to a full or partial suspension of operations or significant decline in gross receipts as described above. The amount of wages taken into account under the credit for an employee who is not performing services may not exceed what the employee would have been paid for working an equivalent period during the 30 days immediately preceding the period of economic hardship that qualifies the employer for the credit.

Observation: There have been some questions and controversy regarding the wording of the IRS FAQs for these employers and the possible interpretation that the credit does not apply with respect to an employee that is working on a reduced schedule due to COVID-19. Congressional tax writers have indicated that the intent was to allow the credit in such cases. The IRS has not provided up-dated guidance on this point, and further clarification is expected, hopefully soon, so that employers can have certainty on this key issue.

If the average number of full-time employees employed by such employer during 2019 was **100 or less**, qualified wages are wages paid to any employee during the period of the full or partial suspension or significant decline in gross receipts, as described above. Thus, these employers may receive the credit for wages paid to all employees regardless of whether such employees are performing services or not.

How does an employer determine its "average number of full-time employees" for 2019?

An employer's average number of full-time employees is determined under the rules in Code section 4980H (employer's shared responsibility requirements regarding health coverage). To determine its average number of full-time employees for 2019, an employer adds its total number of full-time employees for each month of calendar year 2019 to the total number of full-time equivalent employees for each month of calendar year 2019 and divides by 12.

In general, for this purpose, an employer determines its number of full-time employees for a month by counting individuals employed on average for at least 30 hours of service per week during the month or at least 130 hours of service during the month. An employer determines its number of full-time equivalent employees for a month by combining the number of hours of service of all non-full-time employees for the month (but not including more than 120 hours of service per employee), and dividing the total by 120. For example, an employer that employs 40 full-time employees and 20 employees each with 60 hours of service in a month has the equivalent of 50 full-time employees in the month (40 full-time employees plus 10 full-time equivalent employees (20 X 60 = 1200, and 1200/120 = 10)).

What are "qualified health plan expenses"?

Qualified wages also include the employer's qualified health plan expenses that are properly allocable to qualified wages. Qualified health plan expenses are amounts paid or incurred by the eligible employer to provide and maintain a group health plan (as defined in Code section 5000(b)(1)) to the extent excluded from the gross income of employees. Unless provided otherwise in IRS guidance, an allocation will be

treated as properly made if it is 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).

Note that the overall limitation on qualified wages of \$10,000 per employee includes qualified health plan expenses.

The IRS has not yet provided detail on how qualified health plan expenses is defined for purposes of the retention credit. However, the definition here is the same as the definition for purposes of the payroll credit for required sick leave under section 7001 of the FFCRA and the payroll credit for required paid family leave in section 7003 of FFCRA. The [IRS has provided guidance](#) under those provisions, which may be instructive until the IRS issues further guidance under this provision.

What employer aggregation rules are included in the statute?

The CARES Act expressly provides **specific aggregation rules** with regards to the credit based on Section 52(a) and (b) and Section 414(m) and (o) of the Internal Revenue Code. However, it is not clear how these aggregation rules apply to the various aspects of the credit.

Under the referenced aggregation rules, generally speaking, all employees of all corporations which are members of the same controlled group of corporations shall be treated as employed by a single employer for purposes of the credit. A controlled group of corporations generally means one or more chains of corporations connected through stock ownership with a common parent corporation if:

- (A) stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned by one or more of the other corporations; and
- (B) the common parent corporation owns stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

For partnerships or sole proprietorships, generally, all employees of trades or business (whether or not incorporated) which are under common control shall be treated as employed by a single employer for purposes of the credit. These aggregation rules can be complex and will depend on the specific circumstances of a given employer.

How do the aggregation rules apply to the specific provisions of the credit?

Determining qualification for the tax credit is complicated and the aggregation rule arguably makes the determination more complicated. The language of the statute states that if the aggregation rule applies and multiple persons are treated as a single employer, then those purposes shall be treated as “one employer for purposes of this section.” This raises several complex issues of application for which there is currently no guidance from the IRS, including:

- Does the aggregation rule apply to determine whether there has been a full or partial suspension of operations?
- If so, how does business suspension for one group member impact other group members whose businesses may not be interrupted?
- Does the aggregation rule apply to determine the gross receipts reduction test?
- If so, do unaffected group members artificially inflate the gross receipts of other impacted group members?

For now, we are awaiting guidance from Treasury on how to apply the aggregation rule and work through many of these complex questions.

Are employers who receive a small business Paycheck Protection Program (PPP) loan pursuant to Section 1102 of the Act eligible for the credit?

No, an employer who receives a PPP loan is not eligible for the credit. Any credit claimed by an employer that also receives PPP loan is subject to recapture under rules to be issued by the IRS.

Deciding whether a qualifying employer would be better off taking a PPP loan or the retention credit involves a number of different factors and can be difficult. One issue to consider is the potential amount of the PPP loan that would be available (and forgivable), compared to the maximum \$5,000 per employee amount of the credit. Another potentially complicating factor is that the affiliation rules that apply for determining PPP loan eligibility may be different than the aggregation rules that apply under the retention credit, making it difficult to determine which parts of a consolidated business qualify for which or potentially both programs. Further complicating the employer's decision is the fact that the PPP loan total authorization is limited to \$350 billion. Although this seems like a large amount, loans are available on a first-come first-served basis and the demand for the loans is expected to be substantial. Once the fund is exhausted, no further loans will be made. If this happens, it is possible that future relief legislation could extend the loan program; however, nothing is certain at this time.

Another tax relief provision also has an interaction with PPP loans. Section 2303 of the CARES Act allows employers of any size to defer payment of the employer's portion of Social Security taxes (6.2% of covered wages) through the end of 2020. The payments are due in two equal installments on December 31, 2021 and December 31, 2022. Employers who receive forgiveness of a PPP loan are not eligible for this deferral.

What if an employer furloughs employees after claiming the credit?

The statute does not contain any requirement that employees be retained for a specific period during 2020. It appears that employers may still have options available to them even after claiming the credit.

What is the process for an employer to claim the credit, including an advance refund, and what if any documentation requirements are necessary?

The IRS issued guidance in Notice 2020-22, which indicated that the refundable tax credit is reported on the employer's tax return for reporting its liability for payroll taxes (generally, the quarterly IRS Form 941). We expect further guidance to be issued regarding the specifics of these reporting requirements. An employer may also claim an advance payment of the refundable tax credit for Qualified Wages by filing IRS Form 7200, Advance Payment of Employer Credits Due to COVID-19.

At this point, the IRS has not provided specific guidance related to documentation requirements to obtain the credit, but we expect the requirements to be similarly robust to the documentation requirements to obtaining tax credits for Paid Sick Leave and Emergency Family Medical Leave under the FFCRA. The [IRS has provided guidance](#) under the provisions in an FAQ.



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