

Employee Retention Credit May Provide Significant Benefits

In our December 22nd alert, we communicated good news from the Consolidated Appropriations Act of 2021 (signed by President Trump on December 27th), which included tax deductions for expenses paid with forgiven PPP funds, expanded categories for forgivable PPP costs, made the Employee Retention Credit (ERC) available to those with PPP loans (previously, borrowers who received a PPP loan were not permitted to also claim the ERC), and enhanced/ extended the ERC benefits through Quarters 1 and 2 of 2021. In case you missed that alert, this alert focuses on just the ERC.

The ERC allows certain employers whose operations were fully or partially suspended due to a COVID-19-related government order or who saw significant decreases in gross receipts a refundable federal payroll tax credit. There is no double dipping - the ERC may not be claimed on the same wages paid for with forgiven PPP funds. Over a month after the new law was signed, we are still waiting for guidance on the mechanics of claiming this payroll tax credit for those who also received PPP loans. For example, will reporting wages as payroll costs on a previously filed PPP forgiveness application impact the amount of ERC available, if those wages were not necessary for forgiveness? Many forgiveness applications were filed before this law change, and may have been completed differently if this credit were available to PPP borrowers at that time.

Before we get into the details, here is an example of how the ERC works.

- Assume a small S corporation employer has 10 employees now, and that its gross receipts back in Q1 2019 were \$250k but have now dropped in Q1 2021 to \$195k (reduction of 22%.) Regardless of whether or not operations were fully or partially suspended due to a COVID-19-related government order in Q1 2021, this company qualifies for the credit for Q1 2021 since its receipts dropped by more than the 20% threshold. Also assume this employer did not qualify for a PPP Second Draw loan for 2021.
- Assume wages and qualified health plan expenses of the 10 employees in Q1 2021 are as follows:

Employee #	Q1 2021 qualified		Total Q1 2021	Up to \$10k (A)	X credit %	Q1 2021 ERC
	Q1 2021 wages	health plan expenses				
1 (owner)	\$ 15,000	\$ -	\$ 15,000	\$ -	70%	\$ -
2	\$ 10,000	\$ 2,000	\$ 12,000	\$ 10,000	70%	\$ 7,000
3	\$ 10,000	\$ 2,000	\$ 12,000	\$ 10,000	70%	\$ 7,000
4	\$ 5,000	\$ 2,000	\$ 7,000	\$ 7,000	70%	\$ 4,900
5	\$ 5,000	\$ 2,000	\$ 7,000	\$ 7,000	70%	\$ 4,900
6	\$ 5,000	\$ 2,000	\$ 7,000	\$ 7,000	70%	\$ 4,900
7	\$ 5,000	\$ 2,000	\$ 7,000	\$ 7,000	70%	\$ 4,900
8	\$ 5,000	\$ -	\$ 5,000	\$ 5,000	70%	\$ 3,500
9	\$ 5,000	\$ -	\$ 5,000	\$ 5,000	70%	\$ 3,500
10	\$ 1,000	\$ -	\$ 1,000	\$ 1,000	70%	\$ 700
Q1 2021 employee retention credit, claimed on payroll tax filing (Form 941)						\$ 41,300
Addback on federal tax return (deductions must be reduced by amount of credit); assume 30% tax rate X \$41,300						\$ (12,390)
Net cash benefit						\$ 28,910

(A) Related parties are not eligible for the credit, so the owner's wages don't qualify.

An employer must qualify as an eligible employer in order to receive an ERC.

- For Quarters 2, 3, and/or 4 of 2020, an eligible employer is an employer that fully or partially suspended its operations due to a COVID-19-related governmental order OR had gross receipts for a quarter that were less than 50% of its gross receipts for the same quarter in 2019.
- For Quarters 1 and 2 of 2021, an eligible employer is an employer that fully or partially suspended its operations due to a COVID-19-related governmental order OR had gross receipts for a quarter that were less than 80% (i.e. a more than 20% reduction) of its gross receipts for the same quarter in 2019. Alternatively, an eligible employer may elect to look back at gross receipts of the immediately preceding quarter. For example, in Quarter 1 of 2021, the employer may compare gross receipts from Quarter 4 of 2020 to Quarter 4 of 2019.
- Certain businesses would generally not be considered to have a full or partial suspension:
 - Businesses considered to be essential, unless the suppliers to the business are unable to make deliveries of critical goods or materials due to a government order that causes the supplier to suspend its operations;
 - Businesses not considered to be essential, but who were able to continue at a comparable level of operations through telework.

The amount of credit available depends on the year in question.

- For 2020, an eligible employer can receive a credit equal to 50% of the first \$10,000 of qualified wages per employee in total for all quarters (with Quarter 2 including March 13-March 31), for a maximum credit of \$5,000 per employee.
- For Quarters 1 and 2 of 2021, an eligible employer can receive 70% of the first \$10,000 of qualified wages per employee for each quarter, for a maximum credit of \$14,000 per employee.

The size of the employer affects the amount of the credit available. For 2020, the delineation between a small employer and a large employer is 100 full-time employees; for 2021, the threshold is 500 full-time employees. Rules under IRC Sections 52 and 414 require aggregation of certain related businesses.

- For small employers, all wages and qualified health plan expenses are qualified wages (except wages paid to related parties).
- For large employers, only wages and qualified health plan expenses paid to employees for periods that the employee did not perform services for the employer are qualified wages (again, except for wages paid to related parties).

As mentioned above, an employer that received a PPP loan may also qualify for the ERC, but the same wages cannot be used for both PPP loan forgiveness and the ERC. While further IRS guidance is needed in this area, the ERC has the potential to provide certain businesses affected by COVID-19 with tax savings. Here is what you should consider:

- If you have not yet applied for PPP loan forgiveness, consider utilizing non-payroll expenses (such as interest, rent, utilities) to preserve more payroll expenses for potential ERC use.
- If you have already applied for PPP loan forgiveness, review your records to determine the amount of additional payroll expenses that are available for ERC use.

Additional information from the IRS is pending that will assist taxpayers in determining how

best to go about claiming any refunds. In the meantime, let us know if you have any questions.

About Us

GMS Surgent is a mid-sized, full service, certified public accounting and advisory firm serving business and individual clients located primarily in (but not limited to) the Greater Philadelphia area. We warmly invite you to click around our website to learn a little more about our firm, our clients and the ways in which our services could benefit you.

"Personal Attention – Valuable Results", is the principal component of our mission statement. It highlights the GMS Surgent commitment to forging strong relationships and ensuring constructive communication while earning consistently effective results for our clients. It plays an essential role throughout every aspect of our firm, guides our actions and acts as a benchmark for the services we provide.

This information is of a general nature. It may omit many details and special rules and is current only as of its published date. Please contact us for more information and how it pertains to your specific tax or financial situation.