COVID-19: CARES ACT EMPLOYER PAYROLL RETENTION TAX CREDIT

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The recently passed Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") provides a tax credit for eligible employers to encourage them to continue paying employees. The benefit allows a fully refundable tax credit equal to 50 percent of qualified wages (including allocable qualified health plan expenses). The credit is determined quarterly and is capped at $5,000 per eligible employee. The credit applies to qualified wages paid between March 12, 2020 and January 1, 2021.

ELIGIBLE EMPLOYERS

Suspension of Operations Due to Government Order

Eligible employers are those that carry on a trade or business or operate a tax-exempt organization during calendar year 2020 that satisfy one of two criteria. An employer can be an eligible employer if it fully or partially suspends operations during any calendar quarter in 2020 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. This allows many employers who were affected by state and local shutdown orders to qualify, including those whose operations are impacted by spacing restrictions or stay-at-home orders. For health care clients, orders restricting elective procedures will likely qualify under this test.

Significant Decline in Gross Receipts

Alternatively, if an employer did not fully or partially suspend operations due to a governmental order, the employer can still qualify if it experiences a significant decline in gross receipts during the calendar quarter. The significant decline in gross receipts test applies with the first quarter in which an employer's gross receipts for a calendar quarter in 2020 are less than 50 percent of its gross receipts for the same calendar quarter in 2019. The significant decline in gross receipts ends with the first calendar quarter that follows the first calendar quarter for which the employer's 2020 gross receipts for the quarter are greater than 80 percent of its gross receipts for the same calendar quarter during 2019. The Internal Revenue Service ("IRS") has provided the following example:[1]

	Q1	**Q2**	**Q3**
2019	$210,000	$230,000	$250,000
2020	$100,000	$190,000	$230,000
	48%	83%	92%

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	Entitled to Credit	*Entitled to Credit*	*Not Entitled to Credit*

QUALIFIED WAGES

Qualified wages are wages and compensation paid by an eligible employer to employees after March 12, 2020, and before January 1, 2021. Qualified wages include the eligible employer's qualified health plan expenses that are properly allocable to the wages. However, the definition of “qualified wages” is different based on the average number of full-time employees employed by the eligible employer during 2019.

More Than 100 Full-time Employees

If the eligible employer employed an average of more than 100 full-time employees in 2019, qualified wages are the wages paid to an employee *for time that the employee is not providing services* due to either government order or a significant decline in gross receipts. For example, if an employee is paid full salary or wages but is working only 75 percent of the time, 25 percent of wages and allocable health care costs are qualified wages. The employee also may be in furlough status. Qualified wages are capped at the wages the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period of economic hardship.

100 or Fewer Full-time Employees

If the eligible employer averaged 100 or fewer full-time employees in 2019, qualified wages are the full wages paid to any employee during any quarter of economic hardship, without regard to whether the employee was providing services.

HOW TO TAKE THE TAX CREDIT

The tax credit is allowed against the employer portion of social security (“FICA”) taxes. To the extent that the tax credit is more than the amount that the employer owes as the employer portion of FICA taxes, the credit is refundable. The refund is treated as an overpayment and is subject to IRS offsets against other tax liabilities before the refund. To facilitate cash flow for businesses, the IRS has issued guidance allowing employers to retain a corresponding amount of the employment taxes that otherwise would have been deposited, including federal income tax withholding, the employees' share of Social Security and Medicare taxes, and the employer's share of Social Security and Medicare taxes for all employees, up to the amount of the credit, without penalty. The IRS has also established procedures for obtaining an advance of the refundable tax credit using Form 7200.

An eligible employer can elect out of the tax credit for any calendar quarter. An employer taking the employee retention credit is also allowed to take advantage of the employer payroll tax deferral.

SPECIAL RULES

The CARES Act includes additional conditions to be eligible for the employee retention credit, including:

- The tax credit is not available to any eligible employer who receives a Small Business Interruption Loan under the Paycheck Protection Program.
- The credit does not apply to governmental employers.
- Aggregation rules to determine affiliated employers apply.

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- If an eligible employer has received a tax credit for qualified leave wages under the Families First Coronavirus Response Act ("FFCRA"), qualified wages for purposes of the employee retention credit do not include the amount of qualified sick and family leave wages for which the employer received tax credits under the FFCRA. Other rules apply to avoid "double dipping," including restrictions on eligibility of wages on which the work opportunity credit is taken.

LOOKING AHEAD

The employee retention credit has been popular with employers who do not qualify for Paycheck Protection Program loans. As Congress considers additional stimulus legislation, modifications to the employer retention credit may be contemplated. This could include expansion of eligibility to employers who are not directly affected by a governmental order but whose suppliers or customers are. It could also include an increase in the maximum amount of credit allowable.

WE CAN HELP

Please contact any of the authors of this alert for additional information regarding eligibility for the employee retention credit or to provide input as Congress considers possible revisions to the credit that could benefit your business or tax-exempt organization.

FOOTNOTES

[1] INTERNAL REVENUE SERV., FAQS: EMPLOYEE RETENTION CREDIT UNDER THE CARES ACT.

KEY CONTACTS



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