

# New Employee Retention Credit Guidance Issued by IRS

## *Important Clarifications Impacting Application of ERC*

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On March 1, 2021, the IRS issued [Notice 2021-20](#), which provides retroactive guidance on the Employee Retention Credit (ERC) for applicable wages paid during 2020. The notice addresses changes to the credit that were enacted in the Consolidated Appropriations Act in December

2020, affirms certain guidance previously issued in “Q&A” form, and provides additional clarifications impacting eligibility. Notably, **the notice does NOT address qualified wages paid in 2021**, but states that the IRS will address that in future guidance.

## **Background**

To aid small businesses in retaining employees and continuing to pay wages during the challenging economic climate resulting from the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) enacted on March 27, 2020, provided for an employee retention credit. This legislation was subsequently amended by the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Relief Act), included in the Consolidated Appropriations Act enacted on December 27, 2020. Among other guidance, Notice 2021-20 seeks to provide clarity regarding how entities who received forgivable loans under the Paycheck Protection Program (PPP) can also utilize the ERC.

Guidance included in the notice includes clarity regarding the following:

- Who are eligible employers,
- What constitutes an eligible suspension of business operations,
- What is considered a significant decline in gross receipts,
- What are qualified wages,
- What is the maximum amount of the credit, and
- How the ERC interacts with PPP Loans.



## ***Eligible Employers***

The notice defines an eligible employer as any employer carrying on a trade or business during calendar year 2020, for which in any calendar quarter:

- Business operations were “fully or partially suspended due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings...due to COVID-19,” or
- The business experienced a “significant decline in gross receipts.”

The ERC does not apply to Federal or State governments or any political subdivision or agency thereof.

## ***Eligible Suspension of Operations***

For the purpose of the ERC, the business disruption must be the direct result of governmental orders to suspend all or part of business operations. This includes “orders, proclamations, or decrees from the Federal government or any State or local government,” but only invoke an eligible suspension if they “limit commerce, travel, or group meetings (for commercial, social, religious, or other purposes)” due to COVID-19. State or local orders must have jurisdiction over the employer’s operations for the order to qualify.

The notice clarifies that governmental orders that could result in an eligible suspension include the following:

- Orders for all non-essential businesses to close for a specified period;
- Orders for residents, other than residents who are employees of an essential business, to shelter in place for a specified period;
- Orders impacting the operating hours of a business for a specified period; and
- Orders mandating workplace closure for cleaning.

A full or partial suspension of trade or business operations occurs when “more than a nominal portion of its business operations are suspended by a government order.” The notice explains that, for the purpose of the ERC, the suspension constitutes more than a nominal portion of business operations if either:

- Gross receipts from the suspended portion of the business operations is at least 10% of total gross receipts (calculated using gross receipts for the corresponding quarter in 2019); or
- The hours of service provided by employees in that portion of the business are at least 10% of the total number of hours of service provided by all employees of the business (calculated using hours of service for the corresponding quarter in 2019).

An essential business could still be considered to have a partial suspension under certain circumstances, including having its operating hours impacted by government orders or having a suspension of a non-essential component of the business that is more than a nominal portion of the business.

Importantly, the notice emphasizes that a business that suspends some or all of its business operations due to a reduced demand by customers for its products or services due to stay-at-home orders or other circumstances do NOT constitute an eligible suspension. However, the business could still qualify as an eligible employer if it meets the “significant decline in gross receipts” provision.

Similarly, if an employer is required to close its workplace but the business is able to “continue operations comparable to its operations prior to the closure” by allowing employees to work remotely, it does not qualify as a full or partial suspension for purposes of the ERC, other than limited circumstances in which there was more than a two-week delay in transitioning to facilitate telework operations.



Business with operations in multiple locations are considered to have a partial suspension if some, but not all, of the jurisdictions in which it operates are subject to applicable government orders.

## Eligible Decline in Gross Receipts

There are two measurements that come into play with regard to determining when a business has experienced a significant decline in gross receipts for the purpose of eligibility for the ERC.

- The period of decline **begins** with the first calendar quarter beginning after December 31, 2019, in which gross receipts for the quarter are less than **50%** of gross receipts for the corresponding calendar quarter in 2019.
- The period of decline **ends** with earlier of:
  - the calendar quarter following the first subsequent calendar quarter in which gross receipts are greater than **80%** of gross receipts in the corresponding quarter of 2019, or
  - January 1, 2021.

For the purpose of this calculation, gross receipts includes total sales (net of returns and allowances) and all amounts received for services, plus any income from investments or other outside sources. Gross receipts are generally not reduced by cost of goods sold, but are adjusted by the adjusted basis in certain assets sold. For tax-exempt entities, gross receipts is defined as the gross amount received by the organization from all sources, without reduction for any costs or expenses.

Special rules apply for businesses that began operations during 2019 or acquired a trade or business during 2020.

## Qualified Wages

Qualified wages include wages and compensation, without regard to the social security wage base, paid by an employer to its employees after March 12, 2020, and before January 1, 2021. Additionally, wages include amounts paid by the employer to provide group health coverage, so long as such amounts are excluded from the gross income of employees.

The specific determination regarding qualified wages depends on the average number of full-time employees of the business in 2019. Full time employees are defined as any employee who had at least 30 hours of service per week or 130 hours of service per month during 2019. Average full-time employees for 2019 are calculated as the sum of the number of full-time employees in each calendar month of 2019, divided by twelve. Special rules apply for business that started during 2019.

- **Large Eligible Employer** (>100 employees): Wages paid to an employee for time the employee is not providing services due to full or partial suspension of business operations due to a government order or significant decline in gross receipts.
- **Small Eligible Employer** (up to 100 employees): Wages paid to an employee during any period in the calendar quarter in which the business operations are fully or partially suspended or any calendar quarter in which the business experiences a significant decline in gross revenues.

A large employer may not consider wages paid for pre-existing vacation, holidays, sick time, or other personal leave to be qualified wages, as such amounts represent amounts accrued during a period in which the employees provided services. However, a small employer may treat all wages paid during an eligible suspension of operations or quarter in which it has a significant decline in gross receipts, unless the wages are taken into account under the Families First Coronavirus Relief Act (FFCRA).



## Maximum Amount of Credit

The ERC is calculated as 50% of qualified wages (including qualified health plan expenses) paid during a calendar quarter. The maximum amount of qualified wages (including allocable qualified health plan expenses) for all eligible quarters for each employee is \$10,000. Accordingly, the maximum credit for 2020, per employee is \$5,000.

## Interaction of ERC and PPP

In the original CARES Act legislation, a business receiving a PPP loan was ineligible for the ERC. The Relief Act retroactively reversed this, allowing eligible employers to utilize both programs. However, the qualified wages claimed for the ERC cannot include any payroll costs paid during the covered period of the PPP that are used to qualify for loan forgiveness. Specifically, an employer is deemed to have made the election not to include in ERC qualified wages “the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven.” However, if the employer fails to receive forgiveness of all or part of the PPP loan amount, then only the portion of qualified wages, if any, supporting the forgiven amount must be excluded from qualified wages for the purposes of an ERC claim.

Because of this dynamic, it is strongly suggested that businesses report all eligible expenses on their PPP Loan Forgiveness Applications, even if they have adequate payroll expenses to achieve full forgiveness of the loan amount. Since payroll expenses are only required to be 60% of total eligible expenses to qualify for full forgiveness, it is advantageous to report the non-payroll eligible expenses as this may reduce the amount of wages precluded from being considered qualified wages for purpose of the ERC. To illustrate this, the notice included the following example (emphasis added):

*Employer C received a PPP loan of \$200,000. Employer C is an eligible employer and paid \$200,000 of qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. Employer C also paid other eligible expenses of \$70,000. In order to receive forgiveness of the PPP loan in its entirety, Employer C was required, under the SBA rules, to report a total of \$200,000 of payroll costs and other eligible expenses (and a minimum of \$120,000 of payroll costs). Employer C submitted a PPP Loan Forgiveness Application and reported the \$200,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan, **but did not report the other eligible expenses of \$70,000.** Employer C received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000.*

*Employer C is deemed to have made an election not to take into account \$200,000 of qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. Although Employer C could have reported \$70,000 of eligible expenses (other than payroll costs) and \$130,000 of payroll costs, Employer C reported \$200,000 of qualified wages as payroll costs on the PPP Loan Forgiveness Application. As a result, no portion of those qualified wages reported as payroll costs may be treated as qualified wages for purposes of the employee retention credit. **Employer C cannot reduce the deemed election by the amount of the other eligible expenses that it could have reported on its PPP Loan Forgiveness Application.***



## How We Can Help

In order to ensure your business maximizes the ERC opportunity, contact your JTaylor tax advisor to discuss your specific circumstances. The retroactive provisions of the guidance create complexities, particularly for businesses that received a PPP loan. If the PPP Loan Forgiveness Application has not yet been submitted, we advise that you consult with us before doing so, as the information submitted on that application will impact the amount of wages that might be considered qualified wages for the purposes of determining the ERC.

We can work with you to determine whether you are an eligible employer, and if so, assist you in determining the amount of qualified wages you may be able to claim each quarter for the ERC.

JTaylor professionals will continue monitoring new developments impacting the ERC, including anticipated guidance with regard to the ERC for 2021. In addition, we are closely following the proposed COVID-19 relief legislation widely anticipated to be passed in the coming days to see whether any provisions therein may extend the ERC for wages beyond June 30, 2021.

*JTaylor is a certified public accounting firm. Our professionals are not attorneys, and the information contained herein does not constitute legal advice. Our goal is to provide guidance to our clients as they make decisions with regard to their businesses, using the best information available at this time. This is an area that continues to evolve, and we reserve the right to update any information contained herein as new information or guidance becomes available.*

*Because the facts and circumstances of each situation can be unique, particularly as applied to these new, complex provisions of federal legislation and associated interpretive guidance, we recommend seeking professional guidance before undertaking any action in regard to these provisions.*