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Understanding the Employee Retention Credit



DISCLOSURE

These speakers have no relevant financial relationships to disclose.



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Overview of today's discussion

- Background on the retention credit
- Determining employer eligibility
- Calculating qualified wages
- Coordination of ERC with other programs and filings



Background

CARES Act to ARPA and
basics of the credit



How did we get here?

The CARES Act

- Initially created the ERC (among many COVID-19 programs)
- Effective dates: March 12, 2020 – Dec. 31, 2020

Consolidated Appropriations Act, 2021 (CAA)

- Modified and expanded the ERC
- Effective dates:
 - Some changes were retroactive.
(Effective for March 12, 2020 – Dec. 31, 2020)
 - Other changes were prospective.
(Effective for Jan. 1, 2021 – June 30, 2021, but may be extended again)

American Rescue Plan Act of 2021

- Modified and extended ERC through December 31, 2021
(Infrastructure Investment and Jobs Act may eliminate ability to take Q4 2021 credit)



Eligibility of Medical Care Facilities (MCF)

- CAA modified and expanded ERC to apply to a governmental entity whose principal purpose or function is to provide medical or hospital care
- May be able to claim ERC for Q1–Q4 of 2021 (ineligible for 2020 ERC)
- Treas. Reg. Section 1.170A-9(d)(1)
 - Definition of a hospital which can include a “skilled nursing facility”
 - Medical care includes the treatment of any physical or mental disability or condition, whether on an inpatient or outpatient basis, provided the costs are deductible by the person treated
- 42 U.S.C. 1395i-3(a)
 - Skilled nursing facilities - An institution which is primarily engaged in providing to residents skilled nursing care and related services for residents who require medical or nursing care, or rehabilitation services for the rehabilitation of injured, disable, or sick persons and is not primarily for the care and treatment of mental diseases.



What is the employee retention credit (ERC)?

Refundable payroll tax credit of up to:

- \$14,000 per employee in 2021 (70% of \$10,000 in qualified wages per quarter)

Key issues:

- Is a MCF an eligible employer for the credit?
- Did the MCF pay qualified wages?
- Must the MCF be aggregated with the county or other governmental entities when determining eligibility?
- Do any other programs overlap with the ERC?



Eligible employers

Eligibility is determined quarterly based on two tests:

Either:

- (1) Partial or full shutdown due to a government order, or
- (2) 20% or more gross receipts decline in that quarter (or the prior quarter) as compared to the corresponding quarter from 2019



Qualified wages

- The credit is based on the amount of qualified wages paid during employer eligibility.
- Different standards apply to employers that were above or below an employee threshold in 2019.
- **2021 Threshold: 500 employees in 2019**
 - **Eligible employers with 500 or fewer employees: all wages and health care costs paid to employees**
 - **Eligible employers with 500+ employees: only wages and healthcare costs paid to employees that are not providing services**



Aggregation considerations

Must consider aggregation for:

- Full or partial suspension of operations for the employer
- Significant decline in gross receipts
- Number of employees determination
- Allocation of credit to group members

Issues for MCFs

- No guidance from IRS – many questions
- Are MCFs standalone entities or should analysis include county/state activity
- Component unit consideration
- Board make up
- Encourage discussion with legal counsel



Fund vs Component Unit

What are the differences?

- **Fund** – used to account for activities within the primary government
- **Component unit** – legally separate entity that is related to the primary government enough that it is presented within the primary government's financial statements in a separate column.

Statement of Net Position

June 30, 2021

Primary Government

	Governmental Activities	Business-type Activities	Total	Component Unit
Assets				
Cash and cash equivalents	\$ 8,176,746	\$ 4,111,444	\$ 12,288,190	\$ 743,619
Receivables:				
Delinquent taxes	135,449	-	135,449	21,229

Fund within Primary Government (teal box) points to the Governmental Activities column.

Legally separate (teal box) points to the Component Unit column.



Summary of ERC

	2021
Maximum amount of credit per employee	<u>\$7,000</u> per employee <i>for each of Q1 and Q2 2021</i> (\$14,000 total) (<u>70% of \$10,000</u> of qualified wages per quarter)
Determination of employer eligibility (quarterly determination)	Either: (1) partial or full shutdown due to a government order (2) <u>20% or more</u> gross receipts decline in that quarter (<i>or the prior quarter</i>) as compared to the corresponding quarter <u>from 2019</u>
Impact of PPP loans	<u>Wage expenses supporting loan forgiveness cannot be counted as qualified wages</u>
Determination of qualified wages	Eligible employers with <u>500 or fewer employees</u> : all wages and healthcare costs paid to employees* Eligible employers with 500+ employees: only wages and healthcare costs paid to employees that are not providing services



Employer eligibility



Full or partial suspension

Governmental orders

- An appropriate governmental authority must impose restrictions upon the business operations by limiting commerce, travel, or group meetings due to COVID-19.
 - Full suspension: All operations can't continue.
 - Partial suspension: Some, but not all, of typical operations can still continue.
- Federal, state, and local orders considered:
 - Must have jurisdiction over the employer's operations
 - Includes orders that limit hours of operation
 - Employers with multiple locations or group members are considered suspended if one is subject to a government order



Full or partial suspension

Governmental orders

- Essential businesses may be considered to have a partial suspension of operations if, under the facts and circumstances, more than a nominal portion of its business operations are suspended by a governmental order.
 - Nominal portion defined as
 - (i) the gross receipts from that portion of the business operations is not less than 10 percent of the total gross receipts (both determined using the gross receipts of the same calendar quarter in 2019), or
 - (ii) the hours of service performed by employees in that portion of the business is not less than 10 percent of the total number of hours of service performed by all employees in the employer's business (both determined using the number of hours of service performed by employees in the same calendar quarter in 2019).



Gross receipts decline

- Eligibility based on a gross receipts decline is determined quarterly
- Quarterly criteria: 20% or more gross receipts decline in that quarter as compared to the corresponding quarter from 2019
- Alternative test: 20% or more gross receipts decline in the preceding quarter as compared to the corresponding quarter from 2019
 - Example 1: To qualify for Q1 2021 ERC
 - Compare Q1 2021 to Q1 2019 or Q4 2020 to Q4 2019
 - Example 2 – To qualify for Q2 2021 ERC
 - Compare Q2 2021 to Q2 2019 or Q1 2021 to Q1 2019



What are gross receipts?

Has not been defined by the IRS for governmental entities

For profit and tax-exempt entities, include the following in gross receipts:

- Total sales, net of returns, and allowances
- Amounts received for services
- Investment income
- Rents, royalties, and annuities
- Gross proceeds from sales of assets and investments
- Contributions, grants and gifts
- Dues or assessments

Decline in gross receipts doesn't have to be COVID-19-related.



Qualified wages



ERC-eligible wages

Includes wages subject to FICA

- Typically, gross wages including tips, before deductions

Qualified health plan expenses

- Medical, dental, vision, FSA, HRA (but not HSA)
- Include both employer and employee portion
- Consider using COBRA rates – they are often higher!



ERC employee threshold

ERC credit year	<u>2019</u> Full time employees	*ERC-eligible wages (during shutdown or quarter of gross receipts decline)
2021	1-500	All 2021 wages paid to employees, whether working or not
2021	501+	Only 2021 wages paid to employees while NOT providing services

2019 is the measurement period for 2021:

- 2021 threshold – 500 full-time employees in 2019

*ERC-eligible wages = wages PLUS qualified healthcare expenses



Full-time employee count

Count full-time employees in 2019

- 2019 is the measurement period for 2021
- Not the same FTE calculation as used for PPP!

How to count?

- By month, count only employees who work on average:
 - 30 hours of service per week, OR
 - 130hrs/month
- Take the sum of the number of full-time employees in each calendar month in 2019 and divide that number by 12.



Coordination with other programs & filings



PPP & ERC

Paycheck Protection Program (PPP) loans were available in both 2020 and 2021.

PPP loans are forgiven if used to pay for payroll and other expenses during the covered period.

- ERC qualified wages can't be funded by forgiven PPP.

If the PPP loan IS NOT forgiven:

- Payroll can be included in ERC qualified wages.



PPP & ERC

If PPP loan IS forgiven:

- “Excess” payroll can be included in ERC qualified wages.

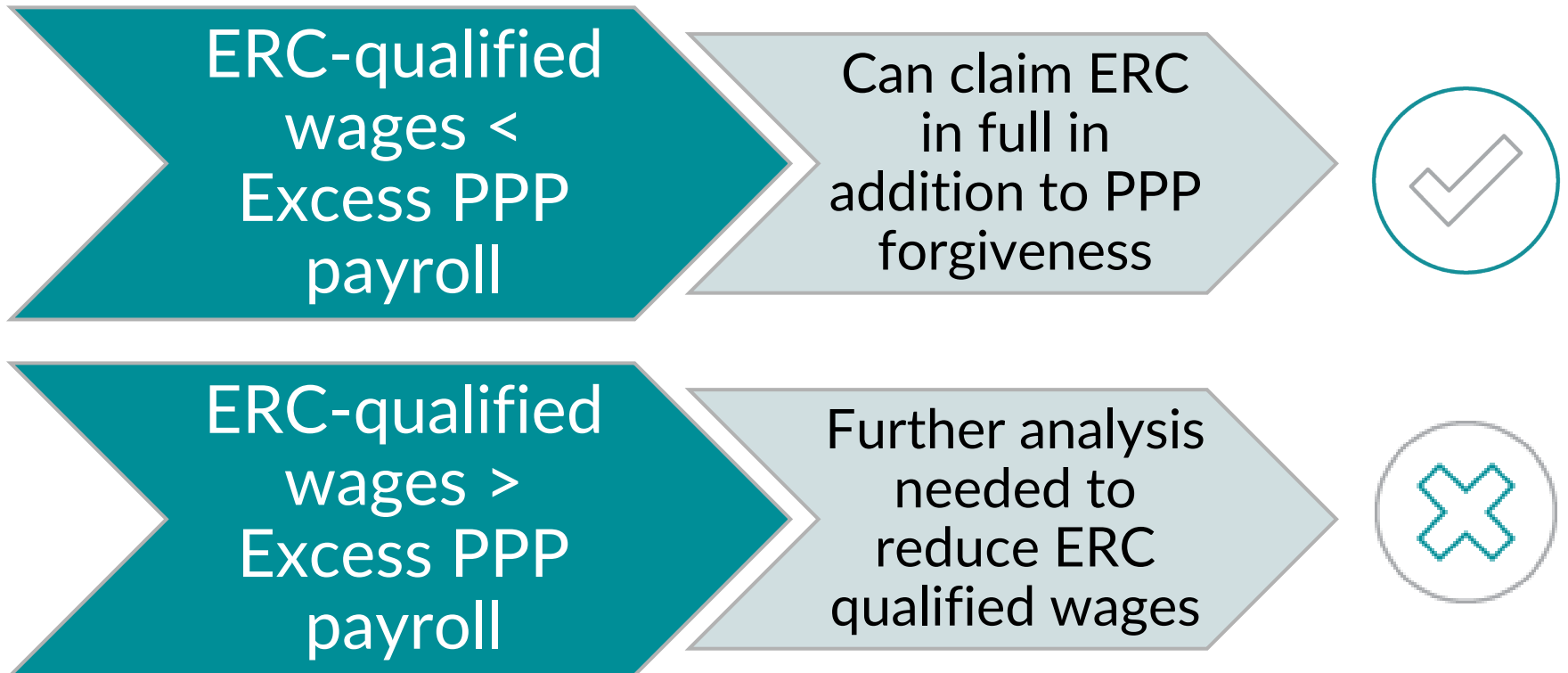
$$\begin{array}{l} \text{PPP-eligible payroll} \\ - \text{PPP-forgiven payroll} \\ \hline \text{Excess PPP payroll} \end{array}$$

- Amounts reported on forgiveness application aren't necessarily the same amounts for this analysis.
 - Consider PPP-eligible nonpayroll expenses that may not have been reported on forgiveness application.
 - All amounts that *could have* been reported on the forgiveness application should be considered.



PPP & ERC

If PPP loan IS forgiven:





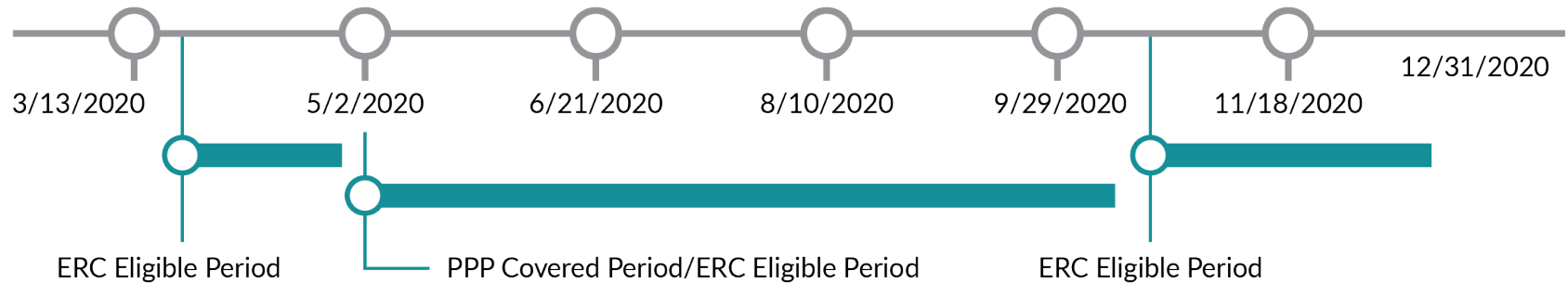
PPP & ERC: Optimization

Strategy to optimize PPP and ERC

1. Identify qualified ERC wages outside the covered period.
2. Determine “excess PPP payroll” in the covered period.
3. Identify qualified ERC Wages inside the covered period.
4. Analyze wages in the covered period.



PPP and ERC

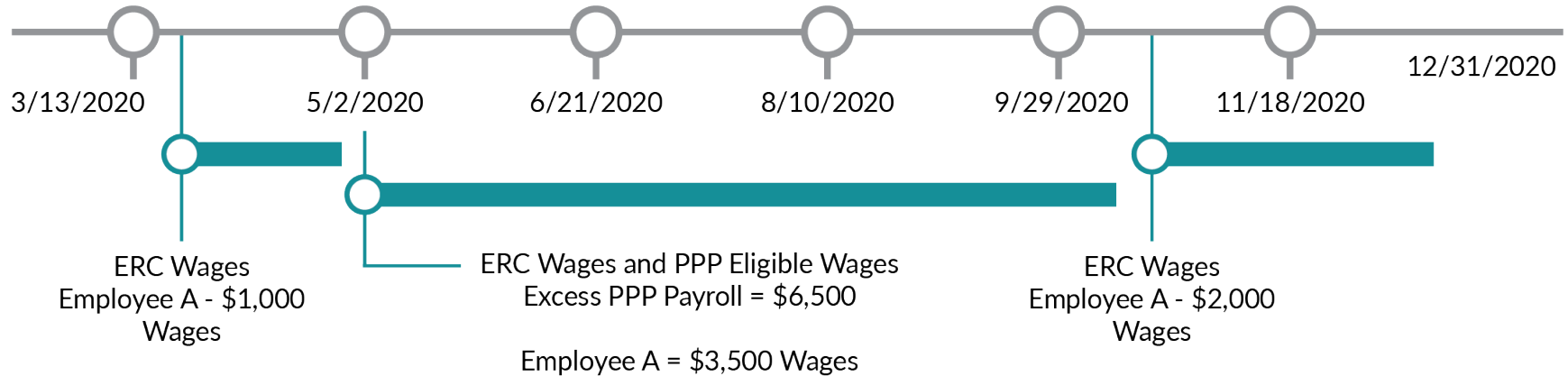


Example:

- 50 employees
- Suspended operations March 18, 2020
- 50% decline in receipts Q2
- 30% decline in receipts Q3
- No decline in receipts in Q4
- PPP loan disbursement May 1, 2020
- 24-week covered period



PPP & ERC: PPP not limiting ERC



Example:

1. ERC payroll outside the covered period = $\$1,000 + \$2,000 = \$3,000$
2. Excess PPP payroll = $\$6,500$
3. ERC payroll inside the covered period = $\$3,500$
4. Total ERC qualified wages = $\$3,000 + \$3,500 = \$6,500$



2021 PPP2 & ERC strategies

To maximize the benefit between PPP2 and ERC, strategy is important.

- Understand which quarters will qualify for ERC.
- Extend covered period to the full 24 weeks.
- Maximize nonpayroll PPP expenses.
- Consider some expenses eligible for ERC and not PPP:
 - Wages of >100,000 annualized
 - Employee portion of health insurance



Filing considerations

Q1 – Q3 2021 ERC must be claimed by filing 941X

- 941X is paper-filed return
- Patience may be required for refunds
- Q4 2021 ERC is in limbo



What to do now?



What to do now?

Document the nature of shutdown

- Obtain copy of specific governmental order that resulted in partial or complete shutdown
- Identify segment of business unable to operate due to order

Calculate gross receipts for each calendar quarter of 2019 and 2021

- If books weren't closed quarterly, or if fiscal-year quarters don't align with calendar quarters, may require additional work
- Make sure to consider if aggregation is applicable
- Don't forget alternative lookback method



What to do now?

Consider procedural matters

- Evaluate and substantiate employer eligibility and wage calculations.

Coordinate ERC and PPP filings. Revisit employee count from 2019

- Carefully review to determine impact on credits
- Be careful to distinguish this employee count from others
- Pay attention to aggregation rules



Evaluating 2021 opportunities

ERC (2021)

Was business “fully or partially” suspended* due to a governmental order during either of the first 2 quarters of 2021?

YES

NO

Were wages and/or health insurance premiums paid for any employees during period of business suspension?

Were gross receipts in either of the first 2 quarters of 2021 less than 80% of the same quarter of 2019?***

NO

YES

YES

NO

Some amount of Employee Retention Credit is available but is subject to overlap rules with PPP forgiveness.

NO

Were average monthly FTEs in 2019 greater than 500?****

YES

During qualifying period,**** were employees paid to not work?

NO

During qualifying period,**** were health insurance premiums paid for furloughed employees?

NO

Employee Retention Credit isn't available.



Q&A