

CARES Act Employee Retention Tax Credit Guide for Employers



CARES Act Employee Retention Tax Credit Guide for Employers

The Coronavirus Aid, Relief, and Economic Security (CARES) Act provides access to a tax credit for employers whose businesses have been impacted by COVID-19. Referred to as the Employee Retention Tax Credit (ERTC), the credit is available to businesses that either have had to partially or fully suspend their business operations in 2020 or have had a significant decline in gross receipts as compared with 2019. This guide outlines the general provisions in CARES regarding the ERTC tax credit, explains how businesses can claim the credit, sets out the limitations of using the ERTC when other relief has been claimed, and summarizes the seven pieces of ERTC guidance that have been released to date, all in a question and answer format.

For more information on any of these provisions, contact any of the Brownstein National Tax Policy Group attorneys listed on the last page.

As of the date of this Q&A Guide, the following guidance has been provided:

- [IRS FAQ](#)
- [IRS Notice 2020-22 \(Relief from Penalty for Failure to Deposit Employment Taxes\)](#)
- [IRS News Release IR-2020-62](#)
- [Department of Treasury Fact Sheet](#)
- [Department of Treasury Press Release](#)
- [U.S. Senate Committee on Finance FAQ](#)
- [IRS Coronavirus Tax Relief Homepage](#)

Table of Contents

I. General Rules of the Employee Retention Tax Credit (ERTC)

A. <u>What is the amount of the ERTC?</u>	3
B. <u>Who is eligible?</u>	3
C. <u>What constitutes fully or partially suspended operations?</u>	3
D. <u>What is a significant decline in gross receipts?</u>	4
E. <u>What are qualified wages?</u>	4
F. <u>What are qualified health plan expenses?</u>	5

II. Administration of the ERTC

G. <u>How are the credits refundable?</u>	6
H. <u>Can eligible employers claim the credit for qualified wages paid in March 2020?</u>	6
I. <u>How does an employer claim the credit?</u>	6
J. <u>How do I receive my credit?</u>	7
K. <u>With respect to the ERTC, what is Form 7200 and how does it work?</u>	7
L. <u>How does an employer report qualified wages paid in Q1?</u>	7
M. <u>With respect to the ERTC, when can an employer file Form 7200?</u>	8
N. <u>How do I fill out Part II of Form 7200?</u>	8
O. <u>May an employer reduce its federal employment tax deposit by the qualified wages that it has paid without incurring a failure to deposit penalty?</u>	9
P. <u>Can an employer paying qualified wages fund its payments of qualified wages before receiving the credits by reducing its federal employment tax deposits?</u>	9

III. Interaction of the ERTC With Other Provisions

Q. <u>May an employer receive both the tax credits for the qualified leave wages under the FFCRA and the ERTC under the CARES Act?</u>	9
R. <u>How does the ERTC interact with the deferral of payroll taxes (Section 2302 of CARES Act) and the Paycheck Protection Program loans (Section 1102 of CARES Act)?</u>	9
S. <u>Will there be additional guidance forthcoming?</u>	10

I. General Rules of the Employee Retention Tax Credit (ERTC)

A. What is the amount of the ERTC?

The CARES Act provides a refundable tax credit, capped at \$5,000 per employee, for 50% of qualified wages up to \$10,000 paid to employees from March 13, 2020, through Dec. 31, 2020.

Example: Employer pays \$10,000 in qualified wages to Employee A in Q2 2020. The ERTC available to Employer for the qualified wages paid to Employee A is \$5,000.

Example: Employer pays Employee B \$8,000 in qualified wages in Q2 2020 and \$8,000 in qualified wages in Q3 2020. The credit available to Employer for the qualified wages paid to Employee B is equal to \$4,000 in Q2 and \$1,000 in Q3 due to the overall limit of \$10,000 on qualified wages per employee for all calendar quarters.

B. Who is eligible?

Traditionally, employee retention credits have been available to businesses that were inoperable as a result of damage caused by a natural disaster (e.g., floods, hurricanes, fires) to encourage employers to keep employees on their payroll. Employee retention credits have also been available to businesses that continued to employ uniformed service members when such service members were called up to active duty (e.g., Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245).

As COVID-19 is unique from past situations, the eligibility for this credit has shifted from damaged/inoperable businesses and continued employment of active duty service members, to any employer carrying on a trade or business during calendar year 2020, which (i) was partially or fully suspended due to government orders related to COVID-19, or (ii) experienced a significant decline in gross receipts.

In addition to affected trades and businesses, organizations exempt from tax under section 501(c) are eligible, but (1) government and state entities and political subdivisions thereof and (2) businesses that receive a forgivable Paycheck Protection Program loan are not.

C. What constitutes fully or partially suspended operations?

The IRS's guidance is almost a recitation of the statute, and provides that the operation of a business may be suspended if an appropriate governmental authority imposes restrictions upon the business operations by limiting commerce, travel, or group meetings (for commercial, social, religious or other purposes) due to COVID-19 such that the operation can still continue to operate but not at its normal capacity.

Example: A state governor issues an order closing all restaurants in the state in order to reduce the spread of COVID-19. However, the order allows the restaurants to continue food sales to the public on a carry-out, drive-through or delivery basis. This results in a partial suspension of the operations of the trade or business due to an order of an appropriate governmental authority with respect to any restaurants in the state that provided full sit-down service, a dining room or other on-site eating facilities for customers prior to the order.

In recent history, employee retention credits have been available to businesses that were "inoperable as a result of damage sustained by reason of [disaster]" (e.g., California wildfire, and Hurricanes Harvey, Irma, Maria or Katrina). In an FAQ for hurricane victims, the IRS provided guidance that the "inoperable as a result of damage sustained by [disaster]" standard did not require damage to an employer's place of business. Instead, a business was inoperable if, for example, because of the disaster, the business is

physically inaccessible to employees, raw materials, utilities or customers. FAQs for Hurricane Victims—Employee Retention Credit, available [here](#).

D. What is a significant decline in gross receipts?

A significant decline in gross receipts means (i) any calendar quarter beginning Jan. 1, 2020, for which gross receipts are less than 50% of gross receipts for the same calendar quarter in 2019, and (ii) ending with the calendar quarter following the first calendar quarter beginning after a calendar quarter described in clause (i) for which gross receipts of such employer are greater than 80% of gross receipts for the same calendar quarter in the prior year.

Example:

	2020 Gross Receipts	2019 Gross Receipts	% of Prior Year
Q1	\$100,000	\$210,000	48%
Q2	\$190,000	\$230,000	83%
Q3	\$230,000	\$250,000	92%

Using the above table, the Employer had a significant decline in gross receipts commencing on Jan. 1, 2020 (the calendar quarter in which gross receipts were less than 50% of the same quarter in 2019), and ending on July 1, 2020 (the quarter following the quarter for which the gross receipts were more than 80% of the same quarter in 2019). Thus, the Employer is entitled to a retention credit with respect to the first and second calendar quarters of 2020.

E. What are qualified wages?

Greater Than 100 Employees. For businesses with an average of over 100 full-time equivalent employees during 2019, qualified wages means wages paid to an employee who is not providing services when (1) the business is suspended for government orders related to COVID-19, or (2) there is a significant decline in gross receipts. Note, the Senate’s Committee on Finance has released guidance that if an employee is performing services on a reduced schedule, wages paid to that employee are treated as qualified wages to the extent they exceed what the employee would have otherwise been paid for the services performed.

The term “qualified wages” does not include required paid sick leave or required paid family leave under the FFCRA, but does include qualified health plan expenses properly allocated to the qualified wages. Qualified wages for an employee may not exceed the amount such employee would have been paid for working an equivalent duration during the 30 days immediately prior to the period.

100 or Fewer Employees. For businesses with an average of 100 or less full-time equivalent employees during 2019, qualified wages means wages paid to an employee (whether or not providing services) when (1) the business is suspended under COVID-19 government orders, or (2) there is a significant decline in gross receipts. The term “qualified wages” does not include required paid sick leave or required paid family leave under the FFCRA, but does include qualified health plan expenses properly allocated to the qualified wages.

Example: Pursuant to a state order, all restaurants in the state are required to close in order to reduce the spread of COVID-19. However, the order allows restaurants to continue food sales to the public on a carry-out, drive-through or delivery basis. To comply with the state order, Employee A typically works inside a restaurant as a manager, but has since been required to work from home remotely. Assuming that there are no sick leave, required paid family leave wages paid, will wages paid to Employee A be qualified wages? If Employee A (who is now required to work from home) receives 100% of his wages, but has his hours cut so that he is only working 75% of the time, does that change anything?

- If Employee A's restaurant averaged more than 100 fulltime equivalent employees in 2019, wage payments to Employee A will not count as qualified wages, as he is still providing services. However, if Employee A's hours are reduced by 25% while his wages remain the same, 25% of the wages paid to Employee A will be considered qualified wages eligible toward the credit because Employee A is receiving 25% of his wages for not performing services while the restaurant's operations are partially suspended.
- If Employee A's restaurant averages 100 or less fulltime equivalent employees in 2019, wage payments to Employee A would count as qualified wages, regardless of whether he is providing services, as the restaurant's operations are partially suspended due to COVID-19 orders. Reducing Employee A's hours does not affect the ability of the restaurant to take the credit.

There are also restrictions that prohibit (1) employee wages from being eligible for the credit if the employer is allowed a Work Opportunity Tax Credit with respect to the employee, and (2) any wages taken into account for the credit being used to determine the Employer Credit for Paid Family and Medical Leave.

Documentation. While the CARES Act does not prescribe any particular form of documentation, taxpayers should develop a system to maintain records of the following information:

- Documentation to show how the taxpayer figured the amount of the ERTC for an individual employee or group of similarly situated employees;
- Documentation to show how the taxpayer figured the amount of qualified plan expenses that you allocated to wages; and
- Documentation to show the taxpayer's eligibility for the ERTC based on suspension of operations or a significant decline in gross receipts.

F. What are qualified health plan expenses?

Qualified health plan expenses are employer and pre-tax employee amounts paid or incurred by an eligible employer to provide and maintain a group health plan (as defined in §5000(b)(1) of the Code), but only to the extent such amounts are excluded from the employee's gross income by §106(a) of the Code.

Since qualified health plan expenses also increase the qualified sick and family leave credits under the FFCRA, such expenses must be properly allocated (so there is no double benefit) between qualified sick leave wages, qualified family leave wages, and qualified wages for purposes of the retention credit.

The IRS has provided that the allocation is proper if made on a pro rata basis among covered employees (for example, the average premium for all employees covered by a policy) and pro rata on the basis of period of coverage (relative to the time periods to which such wages relate). For employers who sponsor a fully insured or self-insured group health plan, the IRS has provided that any reasonable method is permitted to determine and allocate the plan expenses.

Example: An Employer sponsors a group health plan that covers 200 employees. Each employee is expected to work 250 days per year (five days a week for 50 weeks). The Employer and pre-tax employee amounts paid for the 200 employees are \$2 million. The average for all employees covered by the plan is \$2 million divided by 200, or \$10,000. For each employee expected to work 250 days a year, this results in a daily rate equal to \$40.

That \$40 is the amount of qualified health plan expenses, per employee, that can be allocated to each day of (1) paid sick leave, (2) paid family leave, and (3) qualified retention wages.

II. Administration of the ERTC

G. How are the credits refundable?

Pursuant to the text of the statute, the CARES Act provides that the credit is allowed against the employer's share of (1) old-age, survivors, and disability insurance (OASDI) taxes, and (2) Social Security and hospital insurance (Medicare) portions under the Railroad Retirement Tax Act (after taking into account any credits allowed for the employment of qualified veterans and for research expenditures of a qualified small business as well as the credits allowed for required paid sick or family leave under the FFCRA, and further reduced by the credits for (i) employment of qualified veterans, (ii) research expenditures of a qualified small business, and (iii) qualified sick and family leave under the FFCRA).

However, through Notice 2020-22 and the instructions to Form 7200 (Advance Payment of Employer Credits Due to COVID-19), the IRS expanded the credit to also allow it against (1) the employees' share of OASDI taxes, (2) the employees' share of Medicare, and (3) federal income taxes withheld from employees' wages.

The credit will be applied to offset any remaining tax liability on the employment tax return and the amount of any remaining excess will be reflected as an overpayment on the return. The overpayment will be subject to offset under section 6402(a) of the Code prior to being refunded to the employer.

Example: Employer pays \$10,000 in qualified wages to Employee A in Q2 2020, with the resulting tax obligations set forth in the below table:

ER Share OASDI	\$620
EE Share OASDI	\$620
ER Share HI	\$145
EE Share HI	\$145
EE Fed Income Tax WH	\$1,470
Total	\$3,000

In this case, if Employee A was the only employee, Employer would not send in any of these taxes. The ERTC available to Employer for the qualified wages paid to Employee A is \$5,000. This amount may be applied against the employer share of Social Security taxes that Employer is liable for with respect to all employee wages paid in Q2 2020, and then can be applied to the other employment taxes. Any excess over Employer's share of Social Security taxes is treated as an overpayment and refunded to Employer after offsetting the other tax liabilities in the table above and subject to any other offsets under section 6402(a) of the Code.

H. Can eligible employers claim the credit for qualified wages paid in March 2020?

Yes, an eligible employer can claim the credit for qualified wages paid as early as March 13, 2020. Credits claimed for March may be claimed on Form 941 (or other applicable employment tax return) for the second quarter of 2020 or through a request for advance payment on Form 7200.

I. How does an employer claim the credit?

Employers will report their total qualified wages and the related credits for each calendar quarter on their federal employment tax returns, usually quarterly on Form 941 (though §6302 of the Code generally requires deposits of employment taxes to be made on a monthly or biweekly basis).

Form 941 is used to report income and Social Security and Medicare taxes withheld by the employer from employee wages, as well as the employer's portion of Social Security and Medicare tax.

In anticipation of receiving the credits, employers can fund the credits with federal employment taxes, including withheld taxes, that are required to be deposited with the IRS or by requesting an advance of the credit from the IRS on Form 7200.

Practical Note: Employers should stop depositing employment taxes to the extent they will claim the credit.

J. How do I receive my credit?

Employers can be immediately reimbursed for the credit by reducing their required deposits of employment taxes that have been withheld from the employees' wages by the amount of the credit.

Eligible employers will report their total qualified wages and the related health insurance costs for each quarter on their (quarterly) employment tax returns beginning in the second quarter. If the employer's employment tax deposits are not sufficient to cover the credit, the employer may receive an advance payment from the IRS by submitting Form 7200, Advance Payment of Employer Credits Due to COVID-19.

K. With respect to the ERTC, what is Form 7200 and how does it work?

Form 7200, Advance Payment of Employer Credits Due to COVID-19, is used to request an advance payment of the ERTC that a taxpayer will claim on its quarterly (or annual) federal tax return.

When employers pay their employees, they are required to withhold federal income tax on the employees' share of Social Security and Medicare taxes. Employers are required to deposit those taxes, along with their employer share of Social Security and Medicare taxes, with the IRS and file employment tax returns (Forms 941, 943, 944 or CT-1, as applicable).

The employment taxes that are available for the credits include withheld federal income tax, the employee share of Social Security and Medicare taxes, and the employer share of Social Security and Medicare taxes with respect to all employees.

No employer is required to file Form 7200. Instead of filing Form 7200, an employer should first reduce its employment tax deposits to account for the credits. If there are not sufficient employment taxes to cover the amount of the ERTC, employers can file Form 7200 to request an advance payment from the IRS or can wait to get a refund when the employer claims its credits on the employment tax return. Please note, employers should not reduce their deposits and request advance credit payments for the same expected credit. Employers will need to reconcile any advance credit payments and reduced deposits on its employment tax returns filed for 2020.

Example: If an employer is entitled to an ERTC of \$5,000 and is otherwise required to deposit \$8,000 in employment taxes, the employer could reduce its federal employment tax deposits by \$5,000. The employer would only be required to deposit the remaining \$3,000 on its next regular deposit date.

Example: If an employer is entitled to an ERTC of \$10,000 and was required to deposit \$8,000 in employment taxes, the employer could retain the entire \$8,000 of taxes as a portion of the refundable tax credit it is entitled to and file a request for an advance payment for the remaining \$2,000 using Form 7200.

L. How does an employer report qualified wages paid in Q1?

For employers that paid qualified wages between March 13, 2020, and March 31, 2020, such employers will include those wages together with the qualified wages paid during the second quarter of 2020 on their second quarter Form 941 to claim the ERTC. Do not include the credit on your first quarter Form 941.

M. With respect to the ERTC, when can an employer file Form 7200?

The ERTC for qualified wages applies to those wages paid between March 13, 2020, and Dec. 31, 2020.

An employer can file Form 7200 for an advance payment of the credits anticipated for a quarter at any time before the end of the month following the quarter in which it paid the qualified wages.

If necessary, an employer can file Form 7200 several times during each quarter. However, an employer should not file Form 7200 after it files Form 941 for the fourth quarter of 2020, and should not file Form 7200 to request an advance payment for any anticipated credit for which that employer has already reduced deposits.

N. How do I fill out Part II of Form 7200?

Line 1. Enter 50% of the amount of the qualified wages you paid to your employees so far in the current quarter. If you paid any qualified wages between March 13, 2020, and March 31, 2020, include 50% of those wages together with 50% of any qualified wages paid during the second quarter for the second-quarter total to enter on line 1.

Qualified wages don't include wages included on line 2 or line 3 for a credit for paid sick or paid family leave. Finally, you can't include wages paid to employees for whom you will take a work opportunity tax credit during this quarter.

Line 2. Enter the qualified sick leave wages you paid so far in the current quarter.

Line 3. Enter the qualified family leave wages you paid so far in the current quarter.

Line 4. Add lines 1, 2 and 3 and enter the result on line 4.

Line 5. Enter the amount by which you have already reduced your federal employment tax deposits for the credit for qualified leave wages (and certain health expenses and the employer's share of Medicare tax on the qualified leave wages) and the ERTC for this quarter.

Line 6. Enter the amount of any advances that you applied for on previous filings of this form for this quarter.

Line 7. Add lines 5 and 6 and enter the result on line 7.

Line 8. Subtract line 7 from line 4 and enter the amount on line 8. If the amount is zero or less, don't file this form; you're not eligible to receive an advance. You will need to report the amount of the advance that you request on your employment tax return for the return period, as well as the amounts that you requested on line 8.

The amounts entered on lines 1, 2, 3, 5 and 6 are cumulative totals for the quarter.

Example:

- Employer files Form 7200 on April 24, 2020, because it has a \$7,000 ERTC to report on line 1 and reduced deposits of \$4,000 (line 5).
- Employer also previously filed a Form 7200 on April 10, 2020, that reported \$5,000 on line 1 and reduced deposits of \$3,500 on line 5.
- The Form 7200 filed on April 24, 2020, will report \$12,000 on line 1, \$7,500 on line 5, and \$1,500 on line 6 (5,000 – 3,500 advance from Form 7200 filed April 10).
- The advance payment requested (line 8) on April 24 is \$3,000 (line 4–line 7).

O. May an employer reduce its federal employment tax deposit by the qualified wages that it has paid without incurring a failure to deposit penalty?

Yes, an eligible employer will not be subject to a penalty under section 6656 of the Code for failing to deposit federal employment taxes relating to qualified wages in a calendar quarter if:

- the employer paid qualified wages to its employees in the calendar quarter before the required deposit;
- the amount of federal employment taxes that the employer does not timely deposit, reduced by any amount of federal employment taxes not deposited in anticipation of the paid sick or family leave credits claimed under the FFCRA, is less than or equal to the amount of the employer’s anticipated ERTC for the qualified wages for the calendar quarter as of the time of the required deposit; and
- the employer did not seek payment of an advance credit by filing Form 7200, Advance Payment of Employer Credits Due to COVID-19, with respect to any portion of the anticipated credits it relied upon to reduce its deposits.

P. Can an employer paying qualified wages fund its payments of qualified wages before receiving the credits by reducing its federal employment tax deposits?

Pursuant to Notice 2020-22, an eligible employer may fund qualified wages by accessing federal employment taxes. An eligible employer that pays qualified wages to its employees in a calendar quarter before it is required to deposit federal employment taxes with the IRS for that quarter may reduce the amount of federal employment taxes it deposits for that quarter by half of the amount of the qualified wages paid in that calendar quarter (the credit amount). The eligible employer must account for the reduction in deposits on the Form 941, Employer’s Quarterly Federal Tax Return, for the quarter.

Example: Employer paid \$10,000 in qualified wages (including qualified health plan expenses) and is therefore entitled to a \$5,000 credit, and is otherwise required to deposit \$8,000 in federal employment taxes for wage payments made during the same quarter as the \$10,000 in qualified wages. Employer has no paid sick or family leave credits under the FFCRA. Employer may keep up to \$5,000 of the \$8,000 of taxes Employer was going to deposit, and it will not owe a penalty for keeping the \$5,000. Employer is required to deposit only the remaining \$3,000 on its required deposit date. Employer will later account for the \$5,000 it retained when it files Form 941, Employer’s Quarterly Federal Tax Return, for the quarter.

III. Interaction of the ERTC With Other Provisions

Q. May an employer receive both the tax credits for the qualified leave wages under the FFCRA and the ERTC under the CARES Act?

Yes, but not for the same wages. The amount of qualified wages for which an eligible employer may claim the ERTC does not include the amount of qualified sick and family leave wages for which the employer received tax credits under the FFCRA. This is because the FFCRA credits are refundable against employment taxes as well, and a double benefit is not permitted.

R. How does the ERTC interact with the deferral of payroll taxes (Section 2302 of CARES Act) and the Paycheck Protection Program loans (Section 1102 of CARES Act)?

Section 2302 of the CARES Act provides that the payment and deposit of an employer’s share of the Social Security portion of FICA tax and the employer’s share of the Social Security portion of the Railroad Retirement Tax Act for deposits that are due to be made from March 27, 2020, through Dec. 31, 2020, is not due before Dec. 31, 2021 (for the first 50% of the liability), and Dec. 31, 2022 (for the remaining 50% of the liability).

A taxpayer who receives a loan under the Paycheck Protection Program described in Section 1102 of the CARES Act is not eligible for the ERTC. However, unless and until a taxpayer is approved for a Paycheck Protection Program loan, it can claim the ERTC. If a taxpayer claims the ERTC and later receives a Paycheck Protection Program loan, the ERTC will be recaptured.

S. Will there be additional guidance forthcoming?

Additional guidance is expected. At a minimum, the CARES Act requires the Secretary of the Treasury to issue instructions or guidance necessary (1) to provide for the recapture of the credit if such credit is allowed to a taxpayer who received a Paycheck Protection Program Loan in a subsequent quarter, and (2) for the application of “significant decline in gross receipts” in the case of any employer that was not carrying on a trade or business for all or part of the same calendar quarter in 2019.

Authors:

Russell Sullivan
Shareholder
rsullivan@bhfs.com
202.383.4423

Rosemary Becchi
Strategic Advisor and Counsel
rbecchi@bhfs.com
202.383.4421

Harold Hancock
Shareholder
hhancock@bhfs.com
202.383.4422

Gregory Janssen
Associate
gjanssen@bhfs.com
303.223.1288

Lori Harju
Policy Director
lhharju@bhfs.com
202.747.0519

Nancy Strelau
Shareholder
nstrelau@bhfs.com
303.223.1151

Charlie Iovino
Senior Policy Advisor and Counsel
ciovino@bhfs.com
202.383.4424

Radha Mohan
Policy Advisor and Associate
rmohan@bhfs.com
202.383.4425

Daniel Joseph
Policy Advisor
djoseph@bhfs.com
202.216.4864

Anne Starke
Policy Advisor and Associate
astarke@bhfs.com
202.872.5297