FAQs: Employee Retention Credit

The following questions and answers (Q&As) are based, in large part, on informal guidance provided by the IRS through May 8, 2020. As the IRS continues to update its guidance on various issues, the Q&As below have been revised, but they have not been renumbered. In certain instances, additional guidance on particular issues appears in other Q&As, which are cross-referenced for your convenience.

1. What is the Employee Retention Credit?

The Employee Retention Credit is a tax credit that an employer can take on its federal employment tax return when it meets certain conditions for retaining employees during the COVID-19 crisis. The tax credit is equal to 50 percent of "qualified wages" that "Eligible Employers" pay their employees. The maximum credit that an employer can claim for qualified wages paid to any individual employee is $5,000.

2. Am I an eligible employer?

You are eligible for the Employee Retention Credit if you carried on a trade or business during calendar year 2020 that either:

- Fully or partially suspends operation 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; or
- Experiences a significant decline in gross receipts during the calendar quarter.

3. Is the Employee Retention Credit available to large employers?

Yes. Employers of all sizes are eligible to claim the Employee Retention Credit if they otherwise satisfy the eligibility requirements in Q&A-2. The calculation of qualified wages, however, differs for employers with 100 or fewer employees and for larger employers.

4. If I have 500 or fewer employees, can I claim both the Employee Retention Credit and the paid leave credits under the Families First Coronavirus Relief Act ("FFCRA")?

The Employee Retention Credit is a tax credit that an employer can take on its federal employment tax return when it meets certain conditions for retaining employees during the COVID-19 crisis. The tax credit is equal to 50 percent of "qualified wages" that "Eligible Employers" pay their employees. The maximum credit that an employer can claim for qualified wages paid to any individual employee is $5,000.

5. Is my business partially suspended as a result of a government order?

Your trade or business may be partially suspended if you are permitted to remain open but government restrictions limiting business operations due to the COVID-19 crisis have reduced the normal capacity of your business. For example, if a government order to allow only curbside pickup or delivery, you are eligible for the Employee Retention Credit.

For more information, see the following Q&As:

- What types of governmental orders may result in a partial suspension of my business? (Q&A 18)
- Do government-ordered closures of my suppliers, wholesalers, or retailers result in a partial suspensions of my business? (Q&A 19)
- Is my business partially suspended if my employees can telework? (Q&A 20)
- What if my business is partially suspended in only some jurisdictions? (Q&A 21)

6. Did my business have a significant decline in gross receipts?

You can determine whether or not your business had a significant decline in gross receipts by comparing the same time periods in 2020 and 2019. Specifically, a significant decline in gross receipts (gross revenue reduced by returns and allowances) begins with the first quarter in which your 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 for your business ends with the first calendar quarter that follows the first calendar quarter for which the 2020 gross receipts for the quarter are more than 80 percent of its gross receipts for the same calendar quarter during 2019.

So, for example, if the gross receipts of your business were $150,000, $180,000, $165,000, and $200,000 in 2019, and $130,000, $65,000, $150,000, and $190,000 in 2020, you would be eligible for the Employee Retention Credit in the second and third quarters of 2020 because the second quarter was the first quarter in 2020 in which your gross receipts were less than 50% of the gross receipts in the same quarter of 2019 and the third quarter of 2020 was the first quarter in which your gross receipts were more than 80% of your gross receipts in the same quarter of 2019.

For purposes of the Employee Retention Credit, all employers who are required to be aggregated for purposes of the Work Opportunity Tax Credit (WOTC) or as part of an affiliated service group are treated as a single employer. Accordingly, you must consider the gross receipts for all businesses with which your business is required to be aggregated to determine if your business has experienced a significant decline in gross receipts. This may mean that your business has not experienced a significant decline in gross receipts even if your business alone met the threshold. Conversely, you may have experienced a significant decline in gross receipts as a result of a decline at a business with which your business must be aggregated even if your business alone did not have a significant decline.

7. What are "qualified wages" for purposes of the Employee Retention Credit?

Qualified wages are wages subject to Medicare taxes paid to employees after March 12, 2020, and before January 1, 2021. Qualified wages include the employer's qualified health plan expenses that are properly allocable to the wages. If you averaged 100 or fewer full-time employees in 2019, qualified wages are any wages paid to an employee during the period for which you are entitled to the Employee Retention Credit, including the payment of any pre-existing leave to the employee.

If you averaged more than 100 full-time employees (as determined for purposes of the Affordable Care Act) in 2019, qualified wages are the wages paid to an employee for time that the employee is not providing services due to either (1) a full or partial suspension of operations by order of a governmental authority due to COVID-19, or (2) a significant decline in gross receipts. For example, wages paid to a waiter who is not performing services because your dine-in service was suspended by government order are qualified wages; however, qualified

wages would not include wages paid to that same waiter for time spent preparing orders for pickup and delivery during the length of such suspension. Moreover, in contrast to the rule for small employers, the calculation of qualified wages for large employers does not include wages paid to employees pursuant to a pre-existing leave policy, because those amounts are considered to be benefits accrued during a prior period during which the employee provided services to the employer.

Recent IRS guidance has indicated that the IRS is focused on the amount of time that an employee spends working. So, wages paid to an employee who is working his or her normal schedule at home are not qualified wages even if the employee is less productive as a result of being required to telework. You may need to consider asking your employees who are not normally required to keep time records to record the amount of time that they are not working to support your claim for the Employee Retention Credit.

Further, if you averaged more than 100 full-time employees in 2019, the amount of qualified wages is limited to amounts that would have been paid for working in the 30 days prior to becoming eligible for the Employee Retention Credit. In other words, if you provided a raise to employees of $2 per hour for working during the crisis, the additional $2 per hour paid would not be qualified wages.

For additional information, see the following Q&As:

- How are qualified health plan expenses calculated? (Q&As 22-23)
- Do health plan expenses for health coverage provided to furloughed employees count as qualified wages? (Q&A 24)
- Are severance payments included in the calculated for qualified wages? (Q&A 25)

8. How do I determine how many full-time employees my business employs?

In general, the number of full-time employees includes each employee who worked an average of 30 hours per week during a month. For purposes of the Employee Retention Credit, all employers who are required to be aggregated as a single employer for purposes of the WOTC or as part of an affiliated service group are considered a single-employer when determining how many full-time employees your business employs.

9. What if my employees are paid by a third party?

The Employee Retention Credit belongs to the common-law employer of the individuals that are paid qualifying wages, regardless of whether the employer uses a third-party payer (such as a payroll service provider, professional employer organization (PEO), certified professional employer organization (CPEO), or an agent) to report and pay the employer's federal employment taxes. In other words, you, as the common law employer, are entitled to the Employer Retention Credit for qualified wages paid to your employees even if a third-party makes the wage payments or reports the wages and taxes on its federal employment tax returns. If this applies to you, you should discuss the situation with the third-party payer.

10. Is there a limit on the amount of qualified wages?

Qualified wages with respect to an individual employee are limited to $10,000. Thus, the maximum Employee Retention Credit is $5,000 per employee.

11. What tax does the credit apply against?

The Employee Retention Credit reduces the amount of the employer's share of Social Security tax that you are required to pay on wages. However, as discussed below, the IRS is permitting employers to receive the credit by reducing the total amount of employment taxes (i.e., the employer's share of Medicare taxes, the employees' shares of Social Security and Medicare taxes, and federal income tax withholdings) that they are required to deposit.

12. How do I receive the Employee Retention Credit?

You receive the Employee Retention Credit by reducing the amount of your employment tax deposits by the amount of the credit to which you are entitled based on qualified wages paid during the quarter prior to the required deposit.

13. Can I claim the Employee Retention Credit if I am deferring my employer share of Social Security tax deposits?

Yes. You are entitled to defer the deposit of the employer's share of Social Security taxes before you apply the employee retention credit. In other words, the credit for employee retention is applied after taking into consideration the deferred employer's share of Social Security taxes. Then the application of the employee retention credit will determine how much of your other employment tax deposits (employer's share of Medicare taxes, the employees' shares of Social Security and Medicare taxes, and federal income tax withholdings) may be retained, paid in advance, or refunded to you. As an example, if you are otherwise required to make a deposit of $9,000, including $2,000 of employer social security taxes and $7,000 of other employment taxes, you should first defer the deposit of $2,000 in employer social security taxes leaving a deposit liability of $7,000. If you are also entitled to an employee retention credit of $2,000, you should reduce the remaining deposit liability by $2,000 and deposit the remaining $5,000 of employment taxes on your standard deposit schedule. Of the $2,000 in deferred employer social security taxes, $1,000 must be deposited by December 31, 2021, and the remaining $1,000 must be deposited by December 31, 2022.

If your business deposited the employer share of Social Security taxes for some wages paid during the second quarter, the draft instructions to Form 941 suggest that you may need to reduce subsequent deposits during the quarter by the amount of employer Social Security tax deposited if you wish to defer those taxes. If your deposits during the quarter exceed your employment tax liabilities (reduced by the amount of any Employee Retention Credit), the amount must be applied to the employer share of Social Security tax and cannot be refunded.

14. What if my Employee Retention Credit exceeds my required tax deposits?

The Employee Retention Credits is fully refundable. That means you will get a refund if the amount of the credit is more than the employer portion of the Social Security tax on all wages paid to all employees. If you are entitled to an Employee Retention Credit exceeding the amount of your federal employment tax deposits, you can file a Form 7200, Advance Payment of Employer Credits Due to COVID-19, to claim an advance refund for the full amount of the anticipated credit that you were unable to claim by reducing your federal employment tax deposits. The IRS has indicated that advance payments will be made within two weeks of filing the Form 7200.

15. How do I claim a credit for qualified wages paid in March 2020?

Even though qualified wages paid in March 2020 were paid in the first calendar quarter, the IRS has indicated that you will be able to claim the Employee Retention Credit for qualified wages

paid in March 2020 on your quarterly employment tax return for the second calendar quarter. The IRS guidance to date suggests that you may not reduce your deposits during the second quarter or file Form 7200 to claim the Employee Retention Credit for qualified wages paid in March 2020.

16. Can I receive the Employee Retention Credit and Paycheck Protection Program ("PPP") loan?

No. Employers who receive a PPP loan from the Small Business Administration-approved lender are not eligible for the Employee Retention Credit. If you claim an Employee Retention Credit and later apply for and receive a PPP loan, you will be required to repay the credit. For purposes of the Employee Retention Credit, all employers who are required to be aggregated for purposes of WOTC or as part of an affiliated service group are treated as a single employer. So, if any employer with which your business is required to be aggregated received a PPP loan, you are ineligible for the Employee Retention Credit. If you received a PPP loan and repaid it during the safe harbor for repaying the loan (generally, before May 14), the IRS guidance indicates that you are eligible for the Employee Retention Credit.

17. Can I claim the Employee Retention Credit if I am self-employed?

You cannot claim the Employee Retention Credit on net-earnings from self-employment. However, if you have employees and file federal employment tax returns, you may claim an Employee Retention Credit with respect to qualified wages paid to your employees regardless of whether your business income is considered income from self-employment.

18. What types of governmental orders may result in a partial suspension of my business?

It is not always clear whether a particular government order will qualify as a partial suspension of your business, but the IRS recently issued guidance in the form of frequently asked questions on its website providing further information about the types of orders it considers to result in a partial suspension. Under the available guidance, an order that requires to you to close stores, reduce hours, or limits the ability of your employees to travel to and from work may result in a partial suspension of your business. This order must be a result of COVID-19 and not the result of some other factor, such as a health department ordered closure because of a failure to pass a health inspection. The guidance also indicates that the IRS does not consider an order to shelter-in-place or stay-at-home does not alone result in the partial suspension of an essential business that is permitted to operate without restriction even if it significantly reduces your business such that you voluntarily reduce hours or suspend operations.

19. Do government-ordered closures of my suppliers, wholesalers, or retailers result in a partial suspensions of my business?

Even if your business is essential and it may continue to operate, you may have a partial suspension of operations if a governmental order results in the suspension of a business in your supply chain and the facts and circumstances indicate that your business was partially suspended as a result of the disruption. Left unanswered by the IRS guidance is whether your business will be treated as being partially suspended as a result of a government order if the business disruption is indirect and results from a governmental order suspending the operations of the businesses to which you sell your goods or services. For example, if you sell products through third-party retailers and those third-party retailers are prohibited from operating by government order, which results in your having to idle your manufacturing employees, it is not clear that you are eligible for the Employee Retention Credit.

20. Is my business partially suspended if my employees can telework?

The guidance also indicates that the IRS may not consider your business to be partially suspended if you are able to "continue operations comparable to [your] operations prior to the closure by requiring employees to telework." It is uncertain when the IRS might consider a business's operations to be "comparable" to its prior operations. The example provided is a software developer whose employees historically worked from home one or two days per week. If your business has a culture of allowing employees to telework and does not generally involve meeting customers at your place of work, it is unclear whether a governmental order closing your office would be considered a partial suspension.

21. What if my business is partially suspended in only some jurisdictions?

More helpfully, the IRS has indicated that if your business operates in multiple jurisdictions a partial suspension of your business in one jurisdiction is treated as a partial suspension nationwide. As a result, you may be eligible to claim the Employee Retention Credit nationwide if you implement a consistent policy across all jurisdictions—such as only providing carryout or delivery service—even if a governmental orders require those restrictions only in certain locations.

22. How do I calculate health plan expenses?

Health plan expenses include both costs paid by the employer and costs paid by the employee with pre-tax salary reduction contributions. IRS guidance indicates that an eligible Employer who sponsors a fully-insured group health plan may use any reasonable method to determine and allocate the plan expenses, including (1) the COBRA applicable premium for the employee typically available from the insurer, (2) one average premium rate for all employees, or (3) a substantially similar method that takes into account the average premium rate determined separately for employees with self-only and other than self-only coverage. If you choose to use one premium rate for all employees, you could calculate the allocable amount by adjusting to a daily premium based on the employee's average number of work days during the year. Days of paid leave may be counted as work days for this purpose, so a full-time, year-round employee who works five days per week would be treated as having 260 work days during the year. You may use a reasonable method to determine average work days for part-time and seasonal employees.

Similarly, an eligible employer who sponsors a self-insured group health plan may use any reasonable method to determine and allocate the health plan expenses, including (1) the COBRA applicable premium for the employee typically available from the administrator, or (2) any reasonable actuarial method to determine the estimated annual expenses of the plan. If you choose to use a reasonable actuarial method, daily health plan expenses would be determined in a manner similar to that used for insured premiums.

Although contributions to health savings accounts, qualified small employer health reimbursement arrangements, and Archer medical savings accounts are not qualified health plan expenses, contributions to health reimbursement arrangements (including an individual coverage HRA) or health flexible spending arrangements are qualified health plan expenses.

23. How do I allocate health plan expenses to qualified wages?

For employers that averaged 100 or fewer full-time employees in 2019, all health plan expenses paid or incurred after March 12, 2020, and before January 1, 2021, may be treated as qualified health plan expenses during any period in a calendar quarter during which the employer's

business operations are fully or partially suspended due to a governmental order or during a calendar quarter in which the employer experiences a significant decline in gross receipts.

If your business had more than 100 full-time employees in 2019, health plan expenses paid or incurred during the time period for which the employer may claim the employee retention credit must be allocated to time employees are not working. With respect to employees who are working a reduced schedule, the reduction in work time determines the proportion of health plan expenses that may be allocated to qualified health plan expenses. For example, if your employee is working 50 percent fewer hours but your business is continuing to pay the same amount of health plan expenses for the employee's health coverage, 50 percent of the your business's health plan expenses for the employee's coverage are allocable to qualified health plan expenses.

For all employers, regardless of the average number of full-time employees in 2019, health plan expenses paid for furloughed employees are treated as qualified health plan expenses.

24. Do health plan expenses for health coverage provided to furloughed employees count as qualified wages?

Yes. Although the IRS originally took the position that such expenses did not count as qualified wages, the IRS reversed course on May 7. In its revised guidance, the IRS confirms that health plan expenses paid or incurred by an employer to provide health benefits to furloughed employees who were/are not paid other wages are qualified wages for purposes of the Employee Retention Credit.

25. Does severance pay count as qualified wages?

The IRS has taken the position that qualified wages do not include payments made to a former employee, such as severance payments The IRS's position is that payments are considered to be qualified wages for purposes of the Employee Retention Credit only if the payment is made to an employee who continues to be employed. This rule with respect to severance is in contrast to the rule for furloughed employees—if an eligible employer continues to pay furloughed employees for a period of time and then terminates the employment relationship, qualified wages would include amounts paid during the length of the furlough. It appears that the IRS has based its position on the same analysis that it used to preclude large employees from treating pre-existing leave accruals as payments for qualified wages, i.e., the severance payments are made for services previously performed by the employee. This logic, however, may not support the IRS's narrow view on severance payments when the employer gratuitously implemented a severance program in response to the pandemic and the governmental orders that it triggered. For example, if an employer has no standard severance policy and does not routinely provide severance, the IRS's argument that the employees earned the severance for prior service could be challenged.

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