Don’t overlook the employee retention credit

By Randy CrabtreeApril 23, 2021

The CARES Act included sweeping measures designed to incentivize companies — particularly small businesses — not to lay off workers.

While the Paycheck Protection Program gets most of the attention, the Employee Retention Credit also provides employers with a generous tax credit for retaining workers.

Why didn’t companies try to qualify for both programs during the darkest days of the pandemic? In most cases you couldn’t qualify for the ERC if you had already received a PPP loan. However, that restriction was removed when the Consolidated Appropriations Act was signed into law on Dec. 27, 2020. Thanks to further enhancements in the CAA, and the introduction of the American Rescue Plan Act, which was signed into law on March 11, 2021, employers can now receive $33,000 in credits per employee.

I’ve worked with scores of practitioners and companies, and it seems the confusion about the various employment-incentive programs stems from how the credits are actually credited. PPP loans are potentially forgivable while ERCs are refundable. That led many to believe the programs were mutually exclusive. They’re not anymore.

Best of both worlds

The CAA also extended the ERC through June 30, 2021 and then the ARPA extended it further through Dec. 31, 2021 to give COVID-impacted businesses more time to get back on their feet. Further, as of Jan. 2021, employers have been able to capture an ERC of up to 70 percent of each employee’s qualified wages (up to $10,000 per quarter). That’s up from 50 percent of qualified wages per year under the original plan. Thus, employers can now earn up to $7,000 in credits per employee per quarter in 2021 — up from $5,000 per employee per year in 2020.

Example: A small business with 10 employees can now earn a credit of up to $330,000 between 2020 and 2021.

Credit calculated	**50% of up to $10,000 of wages per employee per year**	**70% of up to $10,000 of wages per employee per quarter**
Wages/health costs capped	**Annually**	**Quarterly**
Maximum credit per employee	**$5,000**	**$28,000**

Source: Tri-Merit, LLC 2021

Two methods for qualifying for ERC

I realize the ERC can be confusing to businesses and their advisors. To break it down, I like to start with two different methods for determining whether a business can qualify for ERC.*Note: An employer only needs to meet one of the two criteria to qualify.*

1. Use astrictly numbers-based approach. If a business can show a significant (more than 50 percent) drop in quarterly revenue from one quarter in 2019 to the comparable quarter in 2020, then the business can qualify for ERC. For 2021 ERC, the quarterly revenue decline just needs to be more than 20 percent when compared to the same quarter in 2019.

2. Show that the business has been directly or indirectly impacted by a government shutdown. If you have clients owning restaurants, hotels, theaters and gyms, it's pretty clear the government-ordered shutdowns significantly impacted their businesses during the pandemic. But for other businesses, such as dental offices, manufacturers and nonprofits, you need to dig into the particular facts and circumstances of each enterprise. Start by asking yourself diagnostic questions such as these:

- Did a shutdown affect your client's ability to travel or to hold group meetings?
- Was their supply chain affected?
- Was your client's business impacted by reduced capacity at their location?
- Did they need to suspend operations in order to disinfect the place of work?

IRS Notice 2021-20 provides further guidance for determining whether a business qualifies for ERC based on full or partial shutdowns:

1. Does the business have telework capabilities for employees?
2. Is the work portable?
3. Do employees need to be physically present to perform their work?
4. Was there a transition period to telework?

Keep in mind:

- An “eligible” business is considered to be any private-sector business or tax-exempt organization that conducts a trade or business.
- Government employers are not eligible, with some exceptions beginning in 2021.
- The number of employees in a company does not affect its ability to claim the credit, but it can affect the calculation method
- The credit is refundable. This means the amount of the credit can be immediately monetized as an offset to payroll taxes owed and a refund of any excess credit.
- Essential businesses can qualify.

Final considerations

There is a lot of interplay between the ERC and other wage-based credits. Determining how those credits work together can be confusing, to say the least. Also keep in mind the impact of the ERC on tax filings. Make sure your clients segregate all the wages they used to qualify for ERC, PPP forgiveness and other credits. Also remember the difference between a full and a partial suspension of business, and which workers count as 2019 full-time employees. That definition will affect the credit calculation. Finally, there is always the potential for fraud when we’re talking about extremely generous government programs during a time of great anxiety and confusion.

Some companies may try to apply for the ERC even though they know they don’t qualify. Others may inflate their payroll to increase their refundable credit. To reduce payroll fraud, the IRS extended the statute of limitations to five years from three years on 941 filings that claim the ERC.

While the latest tax bill extended the ERC through year-end 2021, most tax experts don’t expect the credit to be extended further. Now is the time for you and your business clients to take advantage of both the PPP2 and the ERC. Thanks to you, we can keep hard-working people on the job and help their families and communities get back on track. As with so many things in life, take the time to do it right and don’t be a do-it-yourselfer when so much is on the line. Qualification, quantification and documentation go a long way toward ensuring a successful result and toward helping clients thrive — not just survive — as we work our way back to recovery.

Your clients and their employees are counting on you.