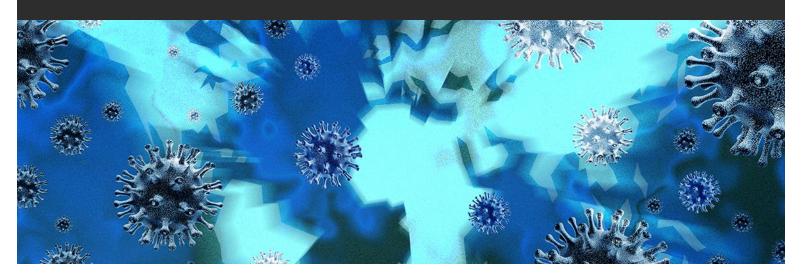


### **Alert** | Health Emergency Preparedness Task Force: Coronavirus Disease 2019/COVID-19 Economic Stimulus



April 6, 2020

## **Employee Retention Tax Credit for Employers under the CARES Act**

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), which was signed into law on March 27, 2020, contains a tax credit to encourage companies to continue paying employees if the business has been closed, or there has been a significant decline in sales due to Coronavirus Disease 2019 (COVID-19). This tax credit is available to a business of any size, although the rules for a business with no more than 100 employees are more flexible. Importantly, the credit is refundable and can be monetized quickly after the payroll is paid.

This provision allows a 50% refundable tax credit for wages paid to employees of businesses that have been closed due to governmental order or that have encountered a significant decline in gross receipts. The tax credit is capped at \$5,000 for each employee, so there would be no credit allowed after the first \$10,000 in wages eligible for the credit have been paid. The eligibility rules vary depending on the number of workers. The credit may be applied to a company that conducts a trade or business for wages paid after March 12, 2020, and before Jan. 1, 2021, if the requirements are satisfied.

#### Requirements

The first requirement is that (i) the employer's business has either been fully or partially closed due to a COVID-19-related governmental order, or (ii) the business's gross receipts for the calendar quarter are less than 50% of the gross receipts for the same quarter in the prior year, and continuing for subsequent calendar quarters until the gross receipts climb to more than 80% of the respective prior year calendar

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quarter. Because the COVID-19 crisis in the United States did not hit businesses hard until mid-March, the "significant decline in gross receipts test" might not apply to some companies for wages paid between March 13 and March 31, because the 50% decline in gross receipts is tested on a calendar quarter, and some businesses did not suffer a significant decline in sales until mid-March. Therefore, the availability of this credit for wages paid in the second half of March may be limited for some businesses, unless the business was closed due to a governmental order (since the credit is available for wages paid when a business is closed due to COVID-19).

The second requirement is that the employer may not receive a small business interruption loan under the CARES Act's Paycheck Protection Program (PPP) (which itself is limited to companies with less than 500 employees). If an employer takes this credit, and later obtains a small business interruption loan, the tax credit is recaptured and must be repaid to the IRS. This may be a difficult choice for businesses with up to 500 employees, since the economics of taking out a PPP loan for 2.5 times the average monthly payroll is favorable, because the loan can be forgiven. However, in order to have a PPP loan forgiven, a company may not reduce its workforce or wages – a requirement not present for the employee retention tax credit. Accordingly, if a reduction in workforce or pay rates is a possibility, a company might want to consider taking the tax credit rather than the PPP loan.

The third requirement applies only to companies with more than 100 employees. For a company with more than 100 employees, to receive the tax credit for wages paid to any specific employee, such employee may not be providing any services to the employer. This means that if an employee is working from home because the business is closed due to a COVID-19-related governmental order, the wages paid would not be eligible for the credit. On the other hand, a company with 100 employees or less would be eligible to receive the tax credit, even if all its employees are working, whether from home or at the workplace. There is a broad aggregation rule that would treat entities controlled by a common owner as a single employer for purposes of this 100-employee rule. For example, if a common owner owns 10 businesses, each operated by a separate legal entity, and each business has 15 employees, all 150 employees would be aggregated, so that each business would be treated as having more than 100 employees.

The 50% tax credit is allowed for wages plus amounts paid or incurred to maintain the employee's group health plan on a pro rata basis during the time the employee is receiving retention pay. In order to include the pro rata share of health insurance benefits, the benefits must be tax-free to the employee (as most employer-provided health benefit plans are). For example, assume an employee is paid \$1,000 per week and receives tax-free group health insurance benefits that are continued by the employer, and the cost to provide the health insurance is \$100 per week. In such a case, the amount eligible for the 50% credit would be \$1,100 (for a \$550 tax credit). However, the maximum credit per employee would still be limited to \$5,000.

A special rule prohibits application of the credit for wages paid to an employee that exceed the amount the employee would have been paid for working the same amount of time during the prior 30- day period. This may cause issues for employees who work on commissions, and such situations may need to be addressed by future guidance from the IRS.

In order to avoid a double tax benefit, the CARES Act provides that the deduction for wages paid shall be reduced by the amount of the tax credits received. Furthermore, the credit will not be available for wages paid to owners of a business or their relatives.

If an employer uses a Professional Employer Organization (PEO) to provide staffing, the tax credit belongs to the employer, not to the PEO. The PEO is required to provide information to the employer so that the employer can use the information to claim the credit.



The tax credit is taken against the social security component of payroll taxes. If the amount of the credit exceeds the social security component of payroll taxes, the excess amount will be refunded. The IRS announced in Release IR-2020-62 that an employer can be immediately reimbursed for the credit by reducing their required deposits of payroll taxes that have been withheld from employees' wages by the amount of the credit. In other words, an employer can retain the amount of taxes withheld from its employees in order to be reimbursed for the credit. If the employer's tax deposits are not sufficient to cover the credit, the employer may receive an advance payment of the credit from the IRS by submitting Form 7200, Advance Payment of Employer Credits Due to COVID-19. This will allow the employer to receive the refund prior to the filing date for the quarterly Form 940 payroll tax return.

For more information and updates on the developing situation, visit GT's Health Emergency Preparedness Task Force: Coronavirus Disease 2019 or GT's COVID-19 Economic Stimulus Team.

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