

Alert | Restaurant Industry/Tax



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Restaurant Businesses Entitled to Favorable Employee Retention Credit Treatment

This GT Alert covers the following:

- Restaurants may be eligible to file refund claims for the employee retention credit because of late-published IRS guidance on PPP loan forgiveness, part-time workers, and tip income.

Restaurant businesses have a new opportunity to take advantage of the employee retention tax credit under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, even though Congress terminated the credit Sept. 30, 2021, three months earlier than scheduled. Certain restaurant businesses that thought they were ineligible for this tax credit may be entitled to take advantage of it for wages paid up until this COVID-19 economic incentive ended. Such potential opportunity is a result of IRS guidance that was published in August 2021, the month before the credit ended.

The employee retention credit initially allowed a 50% credit for wages paid for the second through fourth quarters of 2020, and then a 70% credit for wages paid for the first through third quarters of 2021, if the business either had its operations suspended due to COVID-19-related government orders or had a significant decline in gross receipts. Wages paid with a loan under the Paycheck Protection Program were not eligible for the credit. The credit was limited to a maximum of \$5,000 per employee for 2020, but this cap was increased to \$7,000 per employee per quarter for the first through third quarters of 2021 (total maximum credit of \$21,000 per employee for 2021). The credit is applied against the employer's share of

payroll taxes, and to the extent the credit exceeded the employer's share of payroll taxes, the IRS refunds the difference to the employer.

Impact of PPP Loans and Restaurant Revitalization Grants on Gross Receipts

For 2020, a business satisfied the significant decline in gross receipts requirement for credit eligibility if it experienced a greater than 50% reduction in gross receipts compared to the same quarter in 2019. This test was eased for 2021 quarters to include reductions in gross receipts greater than 20%. When the IRS published its initial guidance, it said gross receipts included tax-exempt income. The assumption was that a PPP loan forgiven or a grant under the Restaurant Revitalization Fund (RRF), both treated as tax-exempt revenue, would nevertheless be treated as gross receipts for determining whether a restaurant business had a significant decline in gross receipts for credit eligibility. Therefore, it would have been understandable if a restaurant owner who had a PPP loan forgiven or received an RRF grant assumed that the amount of the forgiven loan or grant needed to be included in the restaurant's gross receipts calculation, which may have resulted in not satisfying the decline in gross receipts test. However, the IRS published Revenue Procedure 2021-33 in August 2021, which provides that for purposes of determining whether a business has had a significant decline in gross receipts for a quarter, the business may exclude forgiven PPP loans and RRF grants from its gross receipts. This will increase the likelihood that a restaurant business can pass the decline in gross receipts test to allow the business to claim the credit. Even though this credit ended in September 2021, a company can still claim the credit for prior quarters by filing an amended payroll tax return.

Part-Time Employees

Another important factor in claiming the credit deals with the number of average full-time employees a company had in 2019. The critical thresholds to qualify as a "Small Employer" are 100 or fewer average full-time employees in 2019 for determining the credit for 2020 quarters, and 500 or fewer average full-time employees for 2021 quarters. If the conditions to claim the credit are satisfied – either because business operations were suspended by a government order or the company had a decline in gross receipts – a Small Employer gets the credit for wages paid even though the business is open and the employees are working. On the other hand, larger businesses that surpassed these 100- or 500-employee thresholds could take the credit only if it paid its employees even though they were not working. Note that these 100/500 employee thresholds are determined on a company-wide basis, not on a per-location basis that tested eligibility for PPP loan rules.

In August 2021, the IRS published Notice 2021-49, which states full-time equivalents in 2019 are not counted in determining this 100/500 employee threshold. Some restaurant businesses may have thought they were not eligible to claim the credit because their part-time workers, when aggregated into full-time equivalents, caused the businesses to exceed the 100/500 average full-time employee threshold. However, as a result of this IRS notice, they now may be eligible to file an amended quarterly payroll tax returns to claim the credit.

Better yet, Notice 2021-49 states that wages paid to part-time employees are eligible for the credit – even though part-time employees are not counted toward the 100/500 employee threshold. Some restaurant businesses may have assumed the wages paid to part-time workers were not eligible for the credit, and may be able to file amended payroll tax returns to claim the credit for part-time worker wages.

Cash Tips

Finally, Notice 2021-49 also states that an employee's cash tips of more than \$20 per month are wages eligible for the credit. Some restaurant businesses may have assumed that tips paid by customers were not eligible for the credit, and did not include tips in their claim for the credit. If so, they could file amended payroll tax returns to claim the credit. Of course, to claim the credit for cash tips received by employees, a restaurant business must report the tips as income on the employee's Form W-2.

In summary, restaurant businesses should revisit their employee retention credit analysis with their legal and tax advisors in light of Notice 2021-49. The benefits could be substantial.

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