

NOW & NEXT

Coronavirus Stimulus & Relief Alert

NOVEMBER 15, 2022

Employee Retention Credit then and now: What you need to know

By Patrick "Rick" Cox

Businesses must understand changes to the Employee Retention Credit (ERC) that could affect eligibility—and likelihood of an audit.



What's the impact?

- / Companies that have already obtained ERC relief or are thinking of seeking an ERC refund must proceed with caution when conducting tax planning around ERC1 and ERC2
- / Eligibility standards regarding revenue decline and timing have been updated

The ERC was introduced in March 2020 by the CARES Act, amended by sections 206 and 207 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, enacted as Division EE of the Consolidated Appropriations Act of 2021 (Dec. 27, 2020), extended by section 9651 of the American Rescue Plan Act of 2021 (Mar. 11, 2021), and further amended by the Infrastructure Investment and Jobs Act (Nov. 15, 2021). We discussed the original iteration (ERC1) in two prior alerts. When the dust settled, we were left with ERC1 and ERC2, the latter relating to payroll periods in the first three quarters of 2021, while ERC1 only applies to payroll periods in 2020.

While the ERC was codified (IRC Section 3134), to this date we do not have any Treasury regulations or revenue rulings detailing how all the rules work. No significant guidance has been

issued recently, and thus, we are left with the Internal Revenue Service (IRS) Frequently Asked Questions (FAQs), which were converted into numerous IRS notices (Notices 2021-20, -23, -49, -65) and one significant revenue procedure (Rev. Proc. 2021-33). Thus it continues to be important to proceed with caution when conducting tax planning around ERC1 and ERC2.

It does not help that many concepts in ERC1 apply to ERC2, and some ERC2 guidance directs ERC1 planning. The evolution of the ERC has left the landscape muddy with old “google guidance,” and things are not improved by the “pop-up advisors” seeking contingency fees for ERC representation. The IRS has warned about these advisors and the consequences of the ERC (IR-2022-183, Oct. 19, 2022).

The following will provide a very high-level comparison between ERC1 and ERC2 and also general considerations for companies who may have already obtained ERC relief or are thinking of seeking an ERC refund or even engaging in a merger or acquisition transaction where the ERC is involved. It is important to keep in mind that the below is not a substitute for consultation with experienced tax counsel.

ERC—THEN

ERC1 was made available by the CARES Act to employers whose businesses either were:

- / fully or partially suspended or
- / had significant reductions in gross receipts.

ERC1 can be up to \$5,000 per employee for qualified wages paid during the period from March 12, 2020, through the end of 2020. The ERC1 can still be obtained for qualifying businesses by filing amended Forms 941-X. The taxpayer has three years from the date Form 941 was filed (or two years from the date the amount reported on Form 941 was paid, if later) to file a Form 941-X.

ERC—NOW

ERC2 applies for wages paid beginning January 1, 2021, and ending September 30, 2021:

- / The applicable credit percentage is increased from 50% to 70% of qualified wages
- / The limit on per-employee qualifying wages is increased from \$10,000 for the year to \$10,000 per quarter; together with the previous bullet, the maximum credit for 2021 is, therefore, \$21,000 per employee
- / The eligibility threshold tied to revenue decline is decreased from 50% to 20%, and employers may now calculate that by comparing the quarter affected by the pandemic to the same calendar quarter of 2019
- / Moreover, a beneficial rule provides that the taxpayer can qualify for ERC2 in a given 2021 quarter if the taxpayer qualified in the immediately preceding 2021 quarterⁱ
- / The “large employer” threshold is increased to over 500 employees from over 100 employees under the CARES Act

ERC—WHAT TO LOOK FOR

While application of the ERC rules is highly fact sensitive and can be extremely complicated, taxpayers wondering whether they qualify for the ERC (or whether a target company qualifies or qualified) should generally ask whether there was a decline in gross receipts during the relevant quarter in 2020 or 2021 or whether there was a “full or partial suspension” of business operations for one or more affiliates or lines of business caused by an executive order or some other governmental authority. Of course, there are layers upon layers of complicating issues, like “How to aggregate related parties?” or “What constitutes gross receipts?”—but these are the details that can be worked through with an advisor.

If there has been no reduction in gross receipts for any line of business or if the taxpayer has not been directly or indirectly (supply chain) impacted by a government order, there is little likelihood that the taxpayer would qualify for ERC1 or ERC2.

ERC—OTHER CONSIDERATIONS

Because of the extension of the statute of limitations, as mentioned above, and because the IRS and the executive branch, in general, have taken a keen interest in fighting COVID-19-related fraud, it is prudent to adhere to a best practices protocol that will better situate the taxpayer in the event of an audit or in the case where the taxpayer is a party to a merger or acquisition transaction in which ERC is a material item. Specifically, we recommend:

- / keeping detailed operational and financial records substantiating the basis for qualifying for the ERC, including internal communications demonstrating the reaction the taxpayer had to any governmental restrictions impacting the business.
- / memorializing the legal basis (or bases) for ERC qualification and including all possible rationales, especially since the statute (Sec. 3134(m)) does provide reference to regulations whose promulgation could alter current interpretations of the rules.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

Patrick “Rick” Cox
212.940.3066
pcox@nixonpeabody.com
