

Practice Update

# Updated: IRS Provides Extensive New Guidance on the Employee Retention Credit

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Shortly after the passage of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) in late March, the IRS quickly released guidance in the form of frequently asked questions to assist employers in determining eligibility and application procedures for the Employee Retention Credit.

While this initial guidance was helpful, it covered only the general applicability of the credit and answered only basic questions regarding operation of the credit. The IRS expanded this guidance in the form of [95 Frequently Asked Questions](#), which provided much needed insight for employers seeking to understand eligibility requirements and application procedures regarding the credit. Even with all of this additional guidance, there are still many technical questions not yet answered. Additionally, in some ways, the new guidance is inconsistent with prior guidance, and creates uncertainty for employers, which will have to be addressed by the IRS in the near future.

Additionally, in some ways, the new guidance is inconsistent with prior guidance. For example, the IRS faced significant pushback from Congress and the public on some of the positions it has taken with respect to the credit, and, on May 7, 2020, it revised two of the recently issued FAQs (FAQs 64 and 65 on

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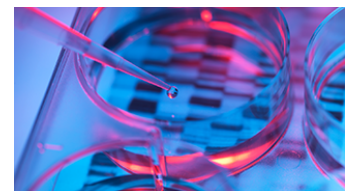
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the treatment of health plan expenses) to better align with congressional intent and one (FAQ 79 on the return of PPP funds) to answer an open question. It is likely that the IRS will continue to update the FAQs as issues arise. This understandably creates uncertainty for employers in determining whether they can rely on the guidance as issued. Thus, this is a work in progress. Expect more guidance and refinement in the near future.

As new rules continue to be released on the Paycheck Protection Program (PPP), employers who have decided to not apply for a PPP loan, or those who have decided to return the funds may want to give the Employee Retention Credit a second look, particularly in light of this new extensive guidance.

### What's New

In addition to the general FAQs that were issued in March, the IRS's website now provides detailed guidance on determining:

- Which employers are eligible to claim the credit
- Which entities are considered a single employer under the aggregation rules
- What types of government orders may be taken into account for purposes of the credit
- When an employer's trade or business operations are considered fully or partially suspended due to a governmental order
- When an employer is considered to have a significant decline in gross receipts
- What are qualified wages
- The amount of allocable qualified health plan expenses
- How to claim the credit

The IRS also added FAQs covering special issues for employers, including clarifying that the credit is not includible in the employer's income, but does reduce

the amount of deductible expenses the employer may claim on its tax return.

Finally, the IRS added a discussion on how to claim the credit through a third party payer (importantly allowing a third party payer to complete and submit IRS Form 7200 on the employer's behalf to request the advance credit).

### Key Areas of Expanded Guidance

This new guidance clarifies pertinent details surrounding the credit, including what constitutes a "trade or business," the availability of the credit for specified groups (such as tribes, self-employed individuals, household employers, and employers in US territories), what constitutes a "partial or full suspension of operations" or "reduction of gross receipts," and what is included as "qualified wages or qualified health plan expenses."

The IRS also provides important guidance regarding how related employers are aggregated for purposes of the credit. All aggregated entities are considered a single employer for purposes of the credit, and must be aggregated for the purpose of determining whether:

1. The employer has a trade or business that was fully or partially suspended for purposes of the credit;
2. The employer had a significant decline in gross receipts;
3. The employer has more than 100 full-time employees; and
4. The employer is precluded from claiming the credit because a member of the aggregated group received a Paycheck Protection Program loan under the Small Business Act. Since the aggregation rules impact whether an employer is eligible for the credit, this guidance is critical for related entities.

## Who is an Eligible Employer?

Generally, the Employee Retention Credit is available only to “Eligible Employers,” defined as those who carry on a trade or business during calendar year 2020 that either (1) fully or partially suspends operation during any quarter in 2020 due to an order from a governmental order relating to COVID-19; or (2) experiences a significant decline in gross receipts during the calendar quarter.

The IRS also clarifies the requisite relationship between a governmental order and an employer’s suspension of business operations. For instance, if a governmental order requires non-essential businesses to suspend operations but allows essential businesses to continue operations, the essential business generally is not considered to have a full or partial suspension of operations, even if the order has an impact on the employer’s operations. A stay-at-home order impacting the employer’s customers also will not constitute suspension of its business operations. However, in those cases, the employer may be eligible for the credit on account of a significant decline in gross receipts. The employer may also be considered to have a suspension of operations if the governmental order causes the employer’s suppliers to suspend operations and the business is unable to receive critical goods or materials on account of the governmental order.

To determine whether the employer has experienced a significant decline in gross receipts, the guidance confirms that a recently acquired business should apply the 2019 gross receipts from the acquired business to determine whether it has had a significant decline in 2020. The IRS also indicated that it would issue future guidance on how tax-exempt organizations can determine if they experienced a significant decline in gross receipts.

## What are Qualified Wages?

Employers are eligible for the Employee Retention Credit based on “qualified wages” it pays to employees. The updated guidance addresses how to determine whether an employer has qualified wages. The determination depends upon whether an employer has more than 100 employees (in which case qualified wages include only wages paid for employees that are not providing services) or 100 or fewer employees (in which case qualified wages are wages paid to any employee). The IRS provides extensive guidance for computing the credit in both cases.

### Resolving Conflicts with Prior Guidance

In some ways, the IRS guidance conflicts with the interpretation of the Joint Committee on Taxation (JCT), which creates confusion for employers since neither JCT interpretations nor IRS FAQs are binding on the IRS. For instance, the JCT had previously stated that in determining whether an employer has 100 employees, both full-time and full-time equivalent employees should be considered. However, the IRS guidance discusses only full-time employees.

Initially, the IRS also deviated from JCT in asserting that employers cannot claim the credit for health care expenses they continue to pay employees if they are not paying any other wages. The JCT had previously suggested the opposite position on this issue, and congressional leaders claimed that the impetus for treating health care expenses as wages was to encourage employers to maintain health coverage during this time, and that the IRS’s position was against public policy. In response to significant pushback on this position, the IRS agreed to reconsider its position, and on May 7, 2020, revised FAQs 64 and 65, to confirm that health plan expenses paid or incurred after March 12, 2020 and allocable to the time that the employees are not providing services may be treated as qualified wages

The IRS has generally stated that these FAQs represent its position, and while they do not constitute formal guidance, they are indicative as to how the IRS views the issues. Nonetheless, until formal guidance is issued, these inconsistencies create confusion for employers. Further, while the IRS's willingness to update the FAQs is helpful for employers, it also adds to uncertainty as to how much weight to give this informal guidance.

### Will Further Guidance Be Issued?

In addition to resolving conflicts, even with this comprehensive new guidance, there are still issues that remain unaddressed. The IRS appears committed to updating this guidance to answer these open questions. For instance, the IRS updated FAQ 79 on May 7<sup>th</sup> to confirm that an employer who repays its PPP loan by May 14, 2020 will be treated as though the employer had never received the loan and therefore be eligible to claim the Employee Retention Credit. The IRS has also indicated that it will provide guidance to clarify how a nonprofit organization should determine eligibility under the gross receipts test.

Based on the IRS's willingness to update this guidance, in response to pressure or to provide further clarity on open issues, it is likely that it will continue to do so as questions arise.

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