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In this article, the authors examine the employee retention tax credit provided by the Coronavirus Aid, Relief, and Economic Security Act.

The COVID-19 virus caught the world by surprise and led to an unprecedented rapid global economic decline. In response to the significant impact on American businesses and workers, several relief provisions have been enacted. One of these is the refundable employee retention tax credit (ERTC) in section 2301 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136).

The ERTC is available to employers regardless of size. It is a fully refundable tax credit designed to encourage employers to keep employees on the payroll amid widespread shutdowns and business slowdowns. The credit is equal to 50 percent of qualified wages, including allocable qualified health plan expenses, that a qualified employer pays to its employees after March 12, 2020, and before January 1, 2021. The maximum amount of qualified wages per employee is $10,000, making the maximum credit per employee equal to $5,000.

The credit is first used to offset the employer portion of Social Security taxes due for all employees. Any excess credit can then be used to offset remaining payroll taxes (both the employee and employer portions) and federal income tax withholding due. In some situations employers may claim an advance payment of the credit using IRS Form 7200. The availability of the credit isn't affected by an employer's deferral of payroll taxes under section 2302 of the CARES act, but it isn't available to employers that receive Paycheck Protection Program (PPP) loans.

Initially, the IRS provided 17 FAQs to assist taxpayers with fundamental questions about qualifying for and calculating the credit. The Joint Committee on Taxation also issued a technical explanation of the CARES Act[1] that provides insight into congressional intent. But many questions were left unanswered by this initial guidance. In response to requests for additional clarification, the IRS issued 94 updated FAQs, with corresponding examples.

Initial reactions to the FAQs were mixed. One positive was that the IRS reversed course on the

[1] JCT, "Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ('CARES') ACT," JCX-12-20 (Apr. 22, 2020).

critical issue of health plan expenses for furloughed employees after congressional pressure. The updated guidance also clarified aspects of the credit for employers whose circumstances directly correlate with the examples provided. However, several issues remain unclear for employers with unique circumstances not addressed in the examples. At this point it is unclear if the IRS will provide additional guidance and when it might do so. Meanwhile, employers have been forced to make significant personnel and financial decisions without clarity on the application of the credit.

I. Issues Facing Employers

A. Do 'Essential Businesses' Qualify?

An employer can qualify for the credit in two ways. The first, and likely the most relevant, is if the employer's trade or business is fully or partially suspended during a calendar quarter under orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) because of COVID-19.

Over the course of the past several months, state, city, and local governments have issued numerous shutdown orders. The orders vary considerably by location, specifically with how each defines "essential businesses." Depending on the order, an essential business may be subject to lesser restrictions or no restrictions at all.

The FAQs indicate that essential businesses, however defined, that can continue operations under a relevant government order will not be considered to have a full or partial suspension of operations. According to the FAQs, this is the case even if a business's customers are all "nonessential businesses" and are thus forced to shut down by the relevant government. The FAQs also provide that there is no suspension if the employer can continue operations comparable with its operations before the closure by requiring its employees to telework.

There are a few exceptions to this general rule. One FAQ states that the trade or business of an essential business will be deemed fully or partially suspended under a relevant government order if the order causes the supply of critical goods or materials to the business to be suspended. Further, if the relevant government order causes the essential business to close its workplace for some purposes (for example, the order requires closure of retail storefronts but allows online website orders and curbside pickup) or reduce its operating hours, the business will be deemed partially suspended under a relevant government order.

The FAQs leave many questions unanswered. For example, the FAQ indicating that an essential business whose suppliers are shut down by a relevant government order is eligible to claim the credit if essential goods and materials are unable to be delivered seems at odds with the FAQ that indicates that the very same essential business is ineligible for the credit if its customers are subject to a stay-at-home government order. The distinction is perplexing to say the least. In either situation, the essential business is operating at reduced capacity because of government orders that have interrupted supply chains, reduced demand, and caused related furloughs and possibly layoffs. The causal connection between the closure and the government order is unquestionable whether it affects the supply or demand side of its operations. The FAQs do not seem to align with legislative intent.

It should also be noted that because of the limited use of the gross receipts test, as discussed more below, most employers will rely on the government shutdown orders as the basis to claim the credit. Thus, a strict and limited interpretation of government-ordered shutdowns could result in the loss of credits for many employers that have continued to pay their employees (consistent with congressional intent) in reliance on the credit.

B. How Does an Employer Determine Eligibility Under the Gross Receipts Test?

If a business does not qualify for the credit because of a full or partial suspension under a governmental order, an employer may nonetheless qualify if it experiences a significant decline (greater than 50 percent) in gross receipts during a calendar quarter in 2020 compared with the same calendar quarter in 2019.

The gross receipts test is perplexing considering the urgency and intent that drove the passage of the CARES Act through Congress. If the goal was to supplement wages paid by employers, it is odd that qualification for the credit would depend on a test that remains indeterminable until after the end of a quarter. Employers are making real-time decisions and need to know with some degree of certainty whether they qualify for the credit.

If employers must wait until the end of the quarter to determine whether they are eligible to claim the credit, the test is largely unworkable. The FAQs do not address whether an employer will be subject to penalties if it determines in good faith during the quarter that it qualifies for the credit but later learns that it is ineligible because gross receipts exceeded expectations toward the end of the quarter. The JCT explanation indicates that Treasury should provide some relief in such cases, but the IRS hasn't indicated its intent to do so thus far. Requiring employers to wait until the end of a given quarter does not seem to align with the purpose of the legislation.

As discussed below, broad aggregation rules apply to related groups of companies. The updated guidance clarifies that the aggregation rule should be applied to determine whether an employer has a significant decline in gross receipts. Under the FAQs, if an aggregated group of companies does not satisfy the gross receipts test on an aggregated basis, the credit is unavailable even though several of the entities in the group, by themselves, satisfy the test. This further reduces the usefulness of this prong of the credit.

The FAQs do provide a mechanism to account for newly formed businesses, or changes in a company's business or structure, between calendar years 2019 and 2020. For example, an employer that started a business in the third quarter of 2019 should use that quarter as the base period to determine whether it experienced a significant decline in gross receipts for the first three quarters in 2020, and should use the fourth quarter of 2019 for comparison with the fourth quarter of 2020 to determine whether it experienced a significant decline in gross receipts in that quarter. If the employer commenced business in the middle of a quarter in 2019, the employer should estimate the gross receipts it would have had for the entire quarter based on the gross receipts for the portion of the quarter that the business was in operation.

An employer that acquired (either in an asset purchase, stock purchase, or any other form of acquisition) a trade or business during the 2020 calendar year must include the gross receipts from the acquired business in its gross receipts computation for each calendar quarter that it owns and operates the acquired business. However, solely for purposes of the ERTC, when an employer compares its gross receipts for a 2020 calendar quarter of an acquired business with its gross receipts for the same calendar quarter in 2019 when it did not own the acquired business, the employer may, to the extent the information is available, include the gross receipts of the acquired business in its gross receipts for the 2019 calendar quarter. Under this safe harbor approach, the employer may include these gross receipts even though the employer did not own the acquired business during that 2019 calendar quarter.

Further, an employer that acquires a trade or business in the middle of a calendar quarter in 2020 and that chooses to use this safe harbor approach must estimate the gross receipts it would have had from the acquired business for the entire quarter based on the gross receipts for the portion of the quarter that it owned and operated the acquired business. However, an employer that does not use this safe harbor approach is required to include only the gross receipts from the acquired business for the portion of the quarter that it owned and operated the acquired business.

The FAQs do not address employers that make a disposition in calendar year 2020. Depending on the size and magnitude of the disposition, the employer may be more likely to qualify for the credit.

It is also notable that the Health and Economic Recovery Omnibus Emergency Solutions Act (H.R. 6800), which was recently passed by the House of Representatives, proposes significant changes to the gross receipts test, including phasing in the credit for employers that have experienced a 10 percent decline in gross receipts for a calendar quarter as opposed to a greater than 50 percent decline. While the outlook for enactment of the legislation as currently drafted is murky, it demonstrates that Congress is at least contemplating enhancements to the ERTC, which many would welcome. Such changes could significantly increase employer eligibility and the value of the credit.

C. What Constitutes 'Qualified Wages' for a Large Employer?

The amount of the credit is based on qualified wages. If an employer averaged more than 100 full-time employees in 2019, qualified wages are wages paid to an employee for time that the employee is "not providing services" because there was either (1) a full or partial suspension of operations by order of a governmental authority due to the COVID-19 virus, or (2) a significant decline in gross receipts.

Many employers are paying employees full time even though they are working only part time because of reduced demand. The updated guidance confirms that wages paid to employees working reduced schedules constitute qualified wages to the extent the employer is paying wages for the time the employees are not providing services. For example, if an employer's employees are working half time but getting paid full time, half of the employees' wages would qualify for the credit.

According to the FAQs, employers may use any reasonable method to determine the number of hours that a salaried employee is not providing services, but for which the employee receives wages either at the employee's normal wage rate or at a reduced wage rate. The FAQs also indicate that it is not reasonable for the employer to treat an employee's hours as having been reduced based on an assessment of the employee's productivity levels during the hours the employee is working.

Unfortunately, the generic language used in the FAQs is not very helpful for employers trying to determine qualified wages for salaried employees who don't usually keep track of their hours and who may work irregular schedules. It is still unclear how employers are supposed to differentiate between when a salaried employee is not providing services because of a government order and when a salaried employee is merely being less productive.

One option employers may consider, but only if workable, is having its salaried employees work on only some days of the week to clearly delineate the days and time that those employees are not providing services.

Another issue that employers are facing is the interconnectedness of operations and whether an employee is not providing services because of a government order. Large employers have operational support groups throughout the country, making it more difficult to determine whether a support function in a state that is perhaps not subject to a shutdown order would be eligible for the credit. If the employees of that support function assist business units that are shut down because of a government order, are the wages paid to the employees of that support function also eligible for the credit?

D. 'Qualified Health Plan Expenses' on Behalf of Furloughed Employees?

Qualified wages also include the employer's qualified health plan expenses that are properly allocable to the wages. Initially, the IRS resisted treating qualified health plan expenses paid for by the employer on behalf of furloughed employees (who are not receiving wages) as qualified wages. But a bipartisan effort by congressional taxwriters led the IRS to change course. The most recent FAQs confirm that qualified wages include the costs of health plan expenses paid for furloughed employees who are not performing services or receiving any wages but who remain eligible for the employer's health plan.

E. How Broad Is the Aggregation Rule?

The credit includes a broad aggregation rule that applies for purposes of the section. According to this rule, multiple persons are treated as a single employer. Initially, it was unclear how broadly the IRS would apply the rule. Hopes were that its application would be more limited, but ultimately the IRS adopted a broad interpretation of this provision.

The FAQs indicate that the aggregation rule should be applied to determine whether an employer has a trade or business that was fully or partially suspended under orders related to COVID-19 from an appropriate governmental authority. Thus, the FAQs indicate that employers that operate a trade or business in multiple locations and are subject to state and local governmental orders limiting operations in some, but not all, jurisdictions are considered to have a partial suspension of operations and be an eligible employer.

If the operations of a trade or business of one member of an aggregated group are suspended by a government order, the operations of that trade or business of the other members of the aggregated group are considered to be fully or partially suspended. While the aggregated group will be considered an eligible employer, only those qualified wages that can be adequately linked to the relevant government shutdown order will qualify for the credit.

Also, as noted, the aggregation rule should be applied to determine whether an employer has a significant decline in gross receipts. Thus, an eligible employer may fail the gross receipts test on an aggregate basis even though several of the entities in the group, by themselves, satisfy the test.

Lastly, the aggregation rule should be applied to determine whether an employer has an average of more than 100 full-time employees for 2019 and whether an employer is precluded from claiming the ERTC if any member of the aggregated group receives a PPP loan. If one member of the aggregated group receives a PPP loan, the other members in the aggregated group, which are not benefiting from the loan proceeds, lose the ability to claim the credit. For employers that remain eligible for PPP loans, this interpretation is unfortunate because any double-dipping could easily be avoided, particularly if one affiliate receives the PPP loan and another affiliate does not.

The broad reach of this aggregation rule is likely to diminish the utility and benefit of the ERTC for large, diverse aggregated groups such as private equity funds and many others.

F. How Should an Employer Document Credits Claimed?

The IRS has previously issued detailed documentation guidelines for the employee sick pay and emergency family leave pay tax credits claimed under the Families First Coronavirus Response Act (P.L. 116-127). It was anticipated that the IRS would provide substantially similar documentation guidelines for the ERTC. Unfortunately, it is still unclear how employers should document employee retention credits claimed. For example, how should a large employer document that it is paying wages to salaried employees who are not providing services (or are providing reduced services)? The FAQs indicate that an employer may use any reasonable method to determine the number of hours for which an employee is not providing services. The FAQs, however, are silent on how to document the qualified wages.

Employers have already started to take reasonable action to substantiate their expected claims. But more detailed documentation requirements would be helpful so employers can properly substantiate the credits claimed.

G. PPP Loan Claims and the ERTC

Can an employer that receives a PPP loan claim the ERTC for wages paid that are not funded with loan proceeds? No, according to the FAQs. An employer that receives a PPP loan is not eligible for the ERTC. PPP loans are generally available to small employers. However, there is an exception from the affiliation rules for some large employers, such as those in the hospitality industry. Such large employers have payroll obligations that are significantly larger than the PPP loan proceeds received. Before the updated FAQs, an initial question was whether those employers would still be eligible for the ERTC for wages paid that are not funded by the PPP loan proceeds. As long as they are not double-dipping with the PPP loans, allowing them to qualify for the ERTC seems consistent with legislative intent.

However, the IRS clarified that an employer is precluded from claiming the ERTC if any member of the aggregated group receives a PPP loan. This may give members of large aggregated groups pause before taking out PPP loans if it is determined that the ERTC available to the aggregated group will be more valuable than the loan. Further, if an employer repaid a PPP loan by May 18, the employer will be treated as if it never received a PPP loan and will be eligible for the ERTC.

H. Are the FAQs Binding Guidance?

It is noteworthy that the following notification is printed at the top of each page of the FAQs:

> This FAQ is not included in the Internal Revenue Bulletin, and therefore may not be relied upon as legal authority. This means that the information cannot be used to support a legal argument in a court case.

The IRS highlights the fact that these FAQs are merely informative and are not binding guidance. Previously, the IRS has indicated that FAQs and other items posted on IRS.gov that have not been published in the Internal Revenue Bulletin are not legal authority and thus should not be used to sustain a position unless the FAQs explicitly indicate otherwise or the IRS indicates otherwise by news release or by notice or announcement published in the IRB.

For employers with unique circumstances that are not directly addressed by the FAQs, and whose qualification for the ERTC is unclear, there may be an inclination to pursue the credits based on a reasonable interpretation of the statute. Employers may even be willing to take positions that conflict with the FAQs if they feel that such position is supported by the statutory language. Even though the FAQs are not binding, taking a contrary position will likely increase the risk of IRS challenge.

II. Conclusion

While the FAQs provide helpful guidance for employers whose circumstances directly correlate with the examples provided, employers with unique circumstances may still be unable to determine with certainty whether they qualify for the credit. Those employers are, or soon will be, faced with a decision whether to continue paying their employees with the threat of not receiving the tax credit, implementing further cost-saving measures (such as layoffs or furloughs), or taking a tax position that may be contrary to or not addressed by the FAQs.

More layoffs may be forthcoming, so some liberalization of these provisions would be helpful to companies and their workers. We hope that additional IRS guidance or congressional action will come soon so that employers will be better informed to make these difficult decisions. ■