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Employee Retention Tax Credit (ERTC) for Closely Held Businesses

Closely Held Businesses Committee

May 14, 2022

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Employee Retention Tax Credit (ERTC) for Closely Held Businesses

ABA Tax Section Conference
Washington, DC
May 14, 2022

Benjamin L. Grosz
Harrison B. Richards

Christopher N. Moran
Danchai Mekadenaumporn

Learning Objectives

- After attending the session, the participant will be able to:
 - Understand the mechanics of the employee retention tax credit (the “ERTC”)
 - Describe which businesses are eligible for the ERTC
 - Explain how to calculate and apply for the ERTC

Disclaimer

Materials prepared by: Benjamin L. Grosz and Charlotte P. Hopson with the assistance of Jonathan L. Holbrook. These materials were prepared without input or review from the government speaker. They reflect the views of the authors only.

Agenda

Background

Eligibility for ERTC

Mechanics of the Credit

Other Considerations

Questions?

Benjamin L. Grosz



Ben is a partner at Ivins, Phillips & Barker, Chtd., where he counsels corporate, nonprofit and individual clients, concentrating on Employee Benefits, Trusts & Estates, and Tax matters. He regularly advises clients regarding their fiduciary duties and compliance with IRS and ERISA rules with respect to retirement plans, trusts, businesses, nonprofits, investments, and equity comp.

Before going into law, Ben's professional experiences in the financial services industry included: working for a Fortune 200 bank and credit card company, award-winning financial education volunteering, leading a 50+ person pro bono tax project, and authoring a financial advice column for two newspapers.

Ben earned his B.A. from the University of Virginia (*magna cum laude* and elected Phi Beta Kappa), an Executive Certificate in Financial Planning from Georgetown University, and his J.D. from the University of Virginia School of Law. He has been frequently quoted in national publications and the trade press (including *Forbes*, *US News & World Report*, CNBC, and *PlanSponsor*) on benefits and tax matters, and he has spoken to the American Bar Association, the D.C. Bar, The Plan Sponsor University, the Tax Executives Institute, and the PlanSponsor National Conference.

Danchai Mekadenaumporn



Danchai is a Senior Technician Reviewer in Employment Tax Branch 1 of the IRS Office of Chief Counsel, where he has also served as Assistant to the Branch Chief. Danchai works on developing and drafting regulations; providing recommendations on legislation; reviewing and preparing private letter rulings, revenue rulings, and other advice; and performing field service activities (including legal assistance, document review, appellate recommendations and litigation support) on federal employment tax matters.

Before joining the IRS, Danchai worked for over six years in the national office of a Big Four accounting firm, where his practice focused on compensation, benefits, and employment tax matters. He performed due diligence and identified key tax risks of executive compensation arrangements, qualified retirement plans, health and welfare plans, fringe benefits, payroll reporting, and golden parachute payments in M&A transactions; researched and drafted tax opinions; and provided technical tax advice and guidance on all aspects of his specialty areas.

Danchai earned his S.B. from the Massachusetts Institute of Technology (MIT), and his J.D. from William & Mary Law School (where he served on the William and Mary Journal of Women and the Law and the Lewis B. Puller, Jr. Veterans Benefits Clinic).

Charlotte P. Hopson



Charlotte is an associate at Ivins, Phillips & Barker, Chtd. Her practice focuses on a range of federal income, estate and gift tax planning matters, and employee benefits issues. Prior to joining IPB, Charlotte practiced in the Financial Services group in the Washington, DC office of an AmLaw 100 Firm.

Charlotte earned her J.D., *cum laude*, from the Georgetown University Law Center and received a B.S.B.A., *cum laude*, from Georgetown University. During law school, she interned at the Securities and Exchange Commission and the Department of Justice, Tax Division.

Prior to law school, Charlotte worked as a CPA at a Big Four accounting firm.

Harrison B. Richards



Harrison is an associate at Ivins, Phillips & Barker, Chtd. His practice focuses on a range of federal income, estate and gift tax planning matters, and employee benefits issues.

Harrison earned his J.D., *magna cum laude* and Order of the Coif, from the Northwestern Pritzker School of Law and received a B.S. in Economics, *magna cum laude*, from Brigham Young University. As a student, Harrison interned with the Commercial Law Development Program at the U.S. Department of Commerce, working on commercial-law reform in the Middle East. Prior to law school, Harrison worked at a leading economic consulting firm where he applied economic analysis to the law in high-stakes litigation disputes across finance, antitrust, and employment issues.

Christopher N. Moran



Chris is an associate at Venable in Baltimore. His practice focuses primarily on nonprofit law, tax planning, and tax controversy. Chris assists clients with planning significant charitable gifts and setting up new charitable entities. He also has extensive experience with state and local tax compliance, federal and state income tax planning, and tax controversies.

In his work with nonprofit organizations, Chris has advised clients on the standards for managing endowments and complying with gift restrictions, and the corporate and tax consequences of joint ventures, mergers, and restructurings. Chris also has experience in counseling U.S. charities on tax and financial issues related to their activities in foreign countries.

Chris participates in a variety pro bono matters, particularly with low-income taxpayers and incarcerated persons. He earned his J.D. from Washington University School of Law in 2015, and received a B.A., *cum laude*, from Wheaton College, where he also played varsity baseball.

Agenda

Background

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Mechanics of the Credit

Other Considerations

What is the ERTC?



- Eligible employers may claim a refundable credit against applicable employment taxes for a portion of qualified wages

Why Does It Matter?

A Case Study



Who Should Care?

- Businesses which struggled during the pandemic
- Businesses which suspended or altered operations due to government orders during applicable quarters
- The advisors that work with these businesses (i.e., accountants, lawyers, etc.)

A Brief History of the ERTC

March 13, 2020:
the President
declared a
nationwide
emergency

March 27, 2020:
the President
signed the
CARES Act into
law

December 27,
2020: the
President signed
the Relief Act
into law

March 11, 2021:
the President
signed ARPA into
law

Statutory History

- **2020:** the CARES Act introduced the ERTC via Section 2301
- **2020:** the Relief Act amended the ERTC and extended it to Q1 and Q2 of 2021 via Sections 206 and 207
- **2021:** ARPA enacted Section 3134 of Code, which extended the ERTC to Q3 (and Q4 in limited form) of 2021 via Section 9651



Reference Materials: Regulatory History

- IRS FAQs:
 - <https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act>
- IRS Notices:
 - Notice 2021-20 in March 2021
 - The Notice provides guidance on the ERTC under section 2301 of the CARES Act, as amended by section 206 of the Relief Act
 - Notice 2021-23 in April 2021
 - The Notice provides guidance on the ERTC under section 2301 of the CARES Act, as amended by section 207 of the Relief Act
 - Notice 2021-49 in August 2021
 - The Notice provides guidance on the ERTC available under section 3134 of the Code
 - Notice 2021-65 in December 2021
 - The Notice provides guidance on the ERTC after September 30, 2021
- IRS Revenue Procedure 2021-33

Reference Materials: Applicable Rules by Quarter

- **2020:** Section 2301 of the CARES Act, as amended by section 206 of the Relief Act; Notice 2021-20; Notice 2021-49
- **Q1 and Q2 of 2021:** Section 2301 of the CARES Act, as amended by sections 206 and 207 of the Relief Act; Notice 2021-20; Notice 2021-23; Notice 2021-49
- **Q3 of 2021:** Code Section 3134, as enacted by section 9651 of ARPA; Notice 2021-20; Notice 2021-23; Notice 2021-49
- **Q4 of 2021:** Code Section 3134, as enacted by section 9651 of the ARPA; Notice 2021-20; Notice 2021-23; Notice 2021-49; Notice 2021-65

Agenda

Background

Eligibility for ERTC

- General Eligibility
- The Gross Receipts Test
- The Partial Suspension Test
- The Recovery Startup Test

Mechanics of the Credit

Other Considerations

General Eligibility

Requirements to be an Eligible Employer

- To claim the ERTC, an employer must be an eligible employer
- An employer is an eligible employer if it:
 - Carries on a trade or business in the applicable quarter; and
 - Satisfies one of the following tests:
 1. A **gross receipts test**;
 2. A **partial suspension test**; or
 3. In certain quarters, a **recovery startup business test**
- The number of employees can determine the size of the credit

Carrying on a Trade or Business: Standard Meaning

- “Trade or business” has the same meaning as when used in section 162 of the Code
 - An activity does not qualify as a trade or business unless:
 - Primary purpose is to make a profit, and
 - Carried on with regularity and continuity
 - This is a facts and circumstances test

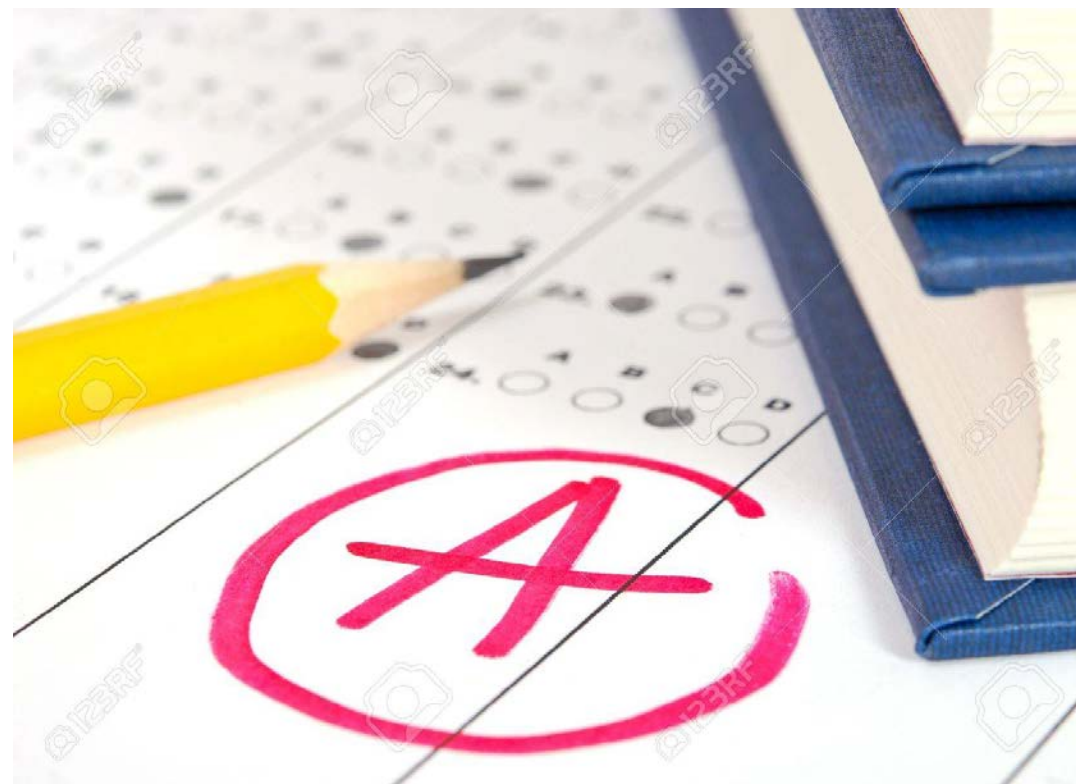
The Aggregation Rules: A Remix

- The ERTC aggregation rules combine rules seen elsewhere in the Code:
 - Section 52(a) and (b) control groups
 - Section 414(m) and (o) affiliated service groups
- Businesses must apply the rules for purposes of:
 - Calculating the number of employees;
 - Calculating gross receipts; and
 - Analyzing whether there is a partial suspension

The Gross Receipts Test

What Is the Gross Receipts Test?

- Eligible employer must experience a significant decline in gross receipts in applicable quarter
 - Gross receipts are on an entity's tax return
 - This includes gross receipts from all operations (not only from activities that constitute related trades or businesses)
- Gross receipts = total sales and all amounts received for services
 - Also includes any income from investments or from incidental or outside sources



How is a Significant Decline in Gross Receipts Calculated?

- Employer generally must compare a quarter's gross receipts to the gross receipts of the same quarter in 2019
- Test depends on calendar quarter



2020 Decline in Gross Receipts

- Begins with a 2020 calendar quarter (if any) in which employer's gross receipts are less than 50% of its gross receipts for the same calendar quarter in 2019
- Ends with a quarter in which gross receipts of the employer are greater than 80% of gross receipts for the same calendar quarter in 2019
- Quarter-by-quarter test

2021 Decline in Gross Receipts

- A calendar quarter in 2021 (if any) in which an employer's gross receipts are less than 80% of its gross receipts for the same calendar quarter in 2019
 - Only applicable to the first three quarters (*not Q4 2021*)
- Quarter-by-quarter test

Gross Receipts Calculation for New Businesses

- If an employer started business in 2019, it should use the first quarter in which it was in business for determining a significant decline in gross receipts in 2020
 - For example, if the business is claiming the ERTC for the second quarter of 2020, but it opened in the third quarter of 2019, it would compare the second quarter 2020 gross receipts to the third quarter 2019 gross receipts
- If an employer was not in existence in the comparable quarter in 2019, the employer generally compares 2021 gross receipts to the applicable 2020 quarter
- An employer that started business in the middle of a quarter in 2019 must estimate the gross receipts it would have had for the entire quarter

Election to Calculate Based on an Alternative Quarter

- An employer may elect to use an alternative quarter to calculate gross receipts in 2021
- This election allows an employer to use the prior quarter in determining gross receipts



Safe Harbor for Newly Acquired Businesses



- Employer that acquires a business in 2020 may include the gross receipts of the acquired business in its gross receipts for 2019 in determining whether there was a significant decline in gross receipts

The Partial Suspension Test

What Is the Partial Suspension Test?

1. The employer must have a full or partial suspension of its trade or business;
2. The suspension must be due to government orders;
3. The governmental orders must be from an “appropriate governmental authority”; and
4. The governmental orders must limit “commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to...COVID-19”

What Is a Full or Partial Suspension?

- A “more than nominal” portion of the business must be partially suspended (or fully suspended)
- The IRS deems a reduction in an employer’s ability to provide goods or services of at least 10% as more than nominal
- This is a facts and circumstances test
 - An essential business is not considered to have a suspension of operations if the governmental order allows the business to remain open
 - A business may have a partial suspension if a supplier’s business is partially suspended, but not if a government order simply requires its customers to stay home
 - A business which voluntarily suspends business is not eligible for the ERTC



What Is a Governmental Order?

- Order must be from “an appropriate governmental authority”
 - Orders, proclamations, or decrees from the Federal government or any state or local government are “orders from an appropriate governmental authority”
 - Statements from a governmental official, however, including comments made during press conferences or in interviews with the media, do not rise to the level of a governmental order
 - What about orders that are later overturned?
- Order must limit “commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to” COVID-19

What If an Employer is Suspended for Part of the Quarter?

- A business that is fully or partially suspended during a portion of a calendar quarter is an eligible employer for the entire calendar quarter
- *But* only wages paid with respect to the period during the suspension are considered qualified wages



The Recovery Startup Test

What Is the Recovery Startup Test?

- Employer must:
 1. Have begun carrying on a trade or business after February 15, 2020;
 2. Have annual gross receipts for the 3-taxable-year period ending with the taxable year that precedes the calendar quarter which do not exceed \$1,000,000;
 3. Not otherwise be an eligible employer

- This test is only applicable in the third and fourth calendar quarters of 2021

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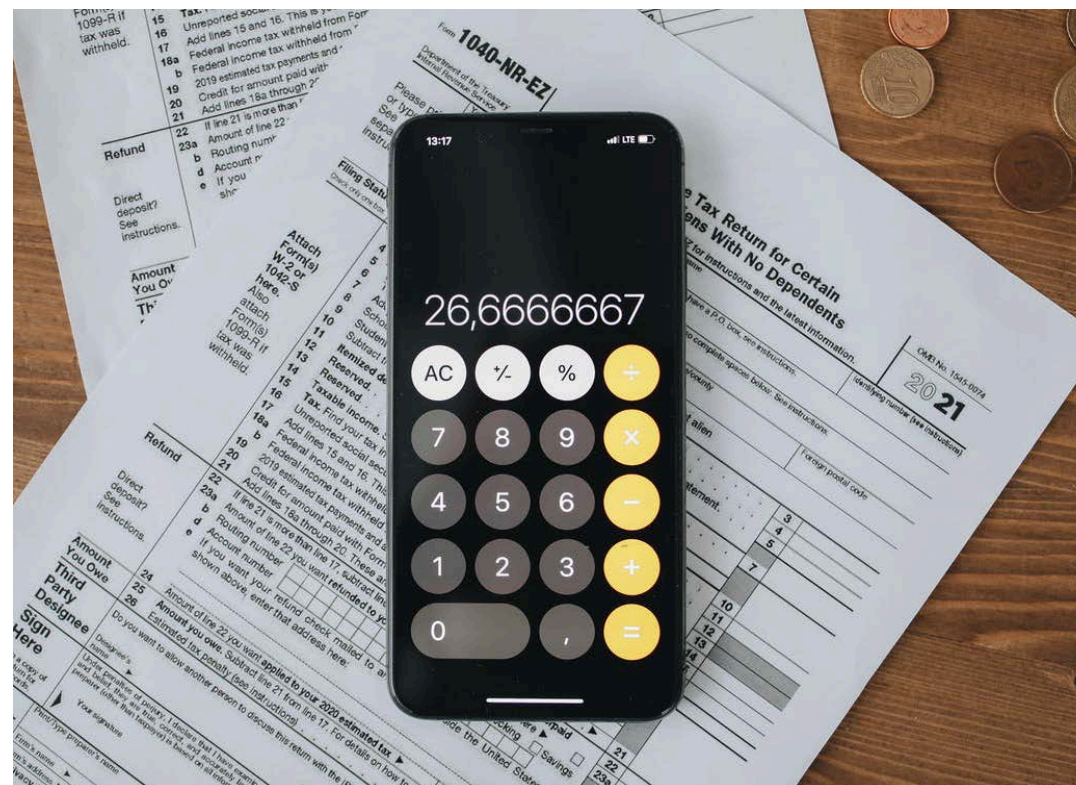
- Calculating the Credit
- Claiming the Credit

Other Considerations

Calculating the Credit

How is the Credit Calculated?

- **2020:** The credit amount is equal to 50 percent of qualified wages per employee for each applicable quarter
 - Up to \$10,000 of qualified wages for all of 2020
- **2021:** The credit rises to 70 percent of qualified wages per employee for each applicable quarter
 - Up to \$10,000 of qualified wages per quarter
- Separate limit applies to recovery startup businesses



What Are Qualified Wages?

- Qualified wages are restricted for large employees, measured by the average number of full-time employees
- Qualified wages are wages as defined in section 3121(a) of the Code and compensation as defined in section 3231(e) of the Code
 - This includes amounts paid by an eligible employer to provide and maintain a group health plan if excluded from gross income under section 106(a)
 - *However*, severance payments or other post-termination payments made to former employees following termination are not qualified wages

Qualified Wages: Large Eligible Employers

- Employer is a large employer if it averaged more than:
 - 100 full-time employees during 2019 for 2020 ERTC purposes; or
 - 500 during 2019 for 2021 ERTC purposes
- Qualified wages are the wages paid to an employee only for time that the employee is not providing services
 - This does not include amounts paid to employees for vacations, holidays, sick days or other days off
- Qualified wages are limited to the amount that the employee would have been paid for working an equivalent duration during the 30 days leading up to the period



Qualified Wages: Small Eligible Employers

- Qualified wages are those paid to an employee during any period relating to a calendar quarter for which:
 - The entity is fully or partially suspended; or
 - For which there is a decline in gross receipts
- May treat pre-existing vacation, sick and other leave as qualified wages
- But what about deferred compensation or alternative payroll schedules (e.g., teachers)?



Who Is a Full-Time Employee?

- An employee is full time if, with respect to any month in 2019, the employee had an average of:
 - 30 hours of service per week; or
 - 130 hours of service in the month
- This is not based on full-time equivalent employees (“FTEs”)

Claiming the Credit

How Can an Entity File for the Credit?

- Eligible employers currently claim the ERTC by filing Form 941-X for each quarter claimed
 - Eligible employers could previously claim the credit directly on Form 941
- Form 941-X provides two methods of correcting overpayments on Forms 941 previously filed:
 1. The adjustment process, and
 2. The claim process



Reference Materials: Filing for the Credit - the Adjustment Process

- To elect the adjustment process, an employer must:
 1. Check the box on line 1 of Form 941-X,
 2. Complete the Form 941-X to show an overpayment from a previous quarter, and
 3. Claim a credit for the overpayment on Form 941-X on the current quarter's Form 941
- Constraints
 - There must be at least ninety (90) days remaining on the period of limitations for claiming the credit (discussed later)
 - The IRS encourages employers utilizing the adjustment process to file Form 941-X in the first two months of the quarter
 - This ensures that the IRS has enough time to process the Form 941-X before the employer files its Form 941, avoiding an erroneous balance due notice

Reference Materials: Filing for the Credit - the Claim Process

- To elect the claim process, an employer must:
 - Check the box on line 2 of Form 941-X,
 - Complete the Form 941-X to show an overpayment on a Form 941 from a previous quarter, and
 - Claim a refund for the amount of the overpayment calculated

What Records Should an Employer Keep to Substantiate the Credit?

- Employers who claim the ERTC must maintain appropriate records, including:
 - Documentation to show how the employer determined it was an eligible employer that paid qualified wages, such as:
 - Governmental orders;
 - Records showing that there was a suspension of more than a nominal part of the business;
 - Records showing a significant decline in gross receipts;
 - Records of qualified wages paid;
 - Records on how the employer determined allocable qualified health plan expenses;
 - Documentation of the employer's aggregation analysis;
 - Copies of any completed Forms 7200 that the employer submitted to the IRS; and
 - Copies of the completed federal employment tax returns submitted to the IRS

How Long Does an Employer Have to Claim the ERTC?

- An eligible employer may claim a credit:
 - within 3 years of the deemed filing date of Form 941; or
 - within 2 years from the date that the eligible employer is deemed to have paid the tax reported on Form 941, whichever is later
- Any Form 941 that an employer timely files and pays, is deemed by the IRS to have occurred on April 15 of the next year
 - An employer who timely filed and paid taxes on a Form 941 for 2020 or 2021 generally has until April 15, 2024 or April 15, 2025 respectively to claim the ERTC

How Long Does the IRS Have To Assess a Tax Related to the ERTC?

- The IRS may assess a tax related to 2020 or the first two quarters of 2021 within 3 years of the deemed filing date of Form 941
 - 3-year period began running on April 15, 2021 and April 18, 2022 for timely filed Forms 941
- For Q3 and Q4 of 2021, the IRS may assess a tax within 5 years of the date on which the employer files the original Form 941, or the deemed filing date, whichever is later
 - The 5-year period began running on April 18, 2022 for timely filed Forms 941



What Are the Income Tax Consequences of the ERTC?

- The ERTC is not includable in the employer's gross income
- But, the ERTC reduces the wage expenses otherwise deductible
 - An employer should file an amended federal income tax return that reduces the wage expenses otherwise deductible for the year the ERTC is claimed
- States vary in their treatment of the ERTC – e.g., North Carolina does not require eligible employers to amend

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How Does the ERTC Interact with Other Programs?

PPP Loan

- An employer can claim the ERTC even if the employer received a PPP loan
- Any wages that could count toward eligibility for the ERTC or PPP loan forgiveness can be applied to either of these two programs, but not both

Shuttered Venue Operators Grant

- Any wages that could count toward ERTC eligibility or the shuttered venue operators grant can be applied to either of these two programs, but not both

Restaurant Revitalization Grant

- Any wages that could count toward eligibility for the ERTC or restaurant revitalization grant can be applied to either of these two programs, but not both

So, What's Next?



- Congress (some members) considering extending the ERTC retroactively
- Currently, this seems unlikely

**Any
Questions?**



For more information



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