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FAQs: Sec. 2301 Employee Retention Credit Under the CARES Act
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The Federal CARES Act at Section 2301 provides employers with a refundable tax credit against the employer portion of Social Security taxes (6.2 percent of wages) or Railroad Retirement Act taxes paid on behalf of employees. It applies to employers who, during the period beginning March 13, 2020 up to December 31, 2020 either:

- Experienced a full or partial suspension of business operations due to orders from a governmental authority limiting commerce, travel, or group meetings (e.g., stay at home or lockdowns) due to COVID-19, or
- Experienced a drop in gross receipts of more than 50% for a calendar quarter, as compared to the same calendar quarter in 2019.

The Retention Credit applies to all employers, but applies differently based on the size of the employer’s workforce. Employers are strongly encouraged to also review the FAQs published by the Internal Revenue Service (IRS) on March 31, 2020: https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act

The information in this article is current as of April 1, 2020. Because future regulations will be published by the IRS or Secretary of the Treasury, members should check for updates on the IRS website and on HEC’s website.

Employer Eligibility

Q.1. Which employers are eligible for the retention credit?
All employers who carry on a trade or business in calendar year 2020 are generally eligible for the retention credit, unless the employer is receiving an SBA loan under the CARES Act Paycheck Protection Program (Section 1102). However, different rules apply depending on whether the employer averaged more than 100 full-time employees in calendar year 2019, or averaged 100 or less full-time employees in calendar year 2019.

Q.2. How are full-time employees counted for purposes of the retention credit?
Section 2301(c)(3)(A) defines the “average number of full-time employees” by reference to IRC 4980H, which is the large employer “shared responsibility” provision of the Affordable Care Act. It is not clear whether Section 2301 intends that all of the definitions applicable to a “large employer” under the ACA apply, to determine whether an employer employed, on average, 100 or more full-time employees during 2019.

“Full-time” employees under 4890H are those who average, for any month, at least 30 hours per week. In addition, in determining whether an employer is an “applicable large employer” under 4890H for any month, the employer also adds the total hours worked by part-time employees in the month then divides by 120 to determine the number of full-time equivalent (FTE) employees.
for any month. It is likely that forthcoming DOL rules will flesh out the requirements for determining the average number of full-time employees employed in 2019 under Section 2301.

Q.3. What happens if my company obtains a Paycheck Protection Program loan under the CARES Act?
Employers who receive a Paycheck Protection Program loan described in Section 1102 of the CARES Act are not eligible for the Section 2301 retention credit.

Qualifying Conditions for the Tax Credit

Q.4. What business conditions qualify an employer for the credit?
The retention credit applies to employers (regardless of size) who continued to pay employees during:

(a) any calendar quarter during the period from March 13, 2020 to December 31, 2020, in which the business was subject to a full or partial suspension of operations due to orders from a governmental authority limiting commerce, travel, or group meetings (for commercial, social, or other purposes) due to COVID-19, OR
(b) any calendar quarter between January 1, 2020 to December 31, 2020, in which gross receipts for the quarter were less than 50% of the gross receipts for the same quarter in 2019. For reductions in gross receipts, the credit begins in the quarter where receipts drop below 50% for the same period in the prior year, but ends when gross receipts in a quarter rise to more than 80% of the receipts for the same calendar quarter in the prior year.

The two basic qualifying business conditions are (a) a full or partial suspension of operations due to a governmental “stay at home,” lockdown, or similar order, or (b) a calendar quarter 2020 in which gross receipts were more than 50% below the gross receipts during the same calendar quarter in 2019.

In its March 31, 2020 FAQs, the IRS gives, as an example of a partial shutdown of operations, a restaurant which has stopped dine-in service but has continued take-out service or delivery due to a government order relating to COVID-19. This would be an example of a partial shutdown. One question that remains to be answered is whether an employer in the above example can claim the retention credit for all of its employees (assuming it has 100 or less full-time employees), or only employees in those “operations” affected by the shutdown. For example, if the restaurant had an increase in delivery drivers as a result of the shutdown, it is not completely clear whether it could claim the retention credit for the qualifying wages of delivery drivers. Hopefully further guidance from the IRS or the Treasury Department will provide better guidance.
Q.5. Can I qualify for the credit if my gross receipts dropped more than 50% during a calendar quarter in 2020, even though the revenue decline was not related to the COVID-19 pandemic?

Apparently, yes. Section 2301(c)(2)(B), which allows for a retention credit for quarters with a significant decline in gross receipts, does not include any language linking the decline in gross receipts to the COVID-19 pandemic. So, for example, if the decline in gross receipts was due to a product defect, or to media reports of customer complaints, it seems that an employer can still claim the retention credit.

Q.6. Can you give an example of how the retention credit is calculated based on a decline in gross receipts?

The IRS FAQ gives this example: An employer’s gross receipts were $100,000, $190,000, and $230,000 in the 1st, 2nd, and 3rd calendar quarters of 2020, respectively. In 2019, its gross receipts were $210,000, $230,000, and $250,000 in the 1st, 2nd, and 3rd quarters, respectively. Thus the employer’s 2020 1st, 2nd, and 3rd quarter gross receipts were approximately, 48%, 83%, and 92% of its receipts for the same quarters in 2019. Accordingly, the employer had a significant decline in gross receipts commencing on the first day of the 1st calendar quarter of 2020 (the calendar quarter in which gross receipts were less than 50% of the same quarter in 2019) and ending on the first day of the 3rd calendar quarter of 2020 (the quarter following the quarter for which the gross receipts were more than 80% of the same quarter in 2019). Thus the employer is entitled to a retention credit with respect to the 1st and 2nd calendar quarters of 2020.

Amount of Credit Available for “Large” vs. “Small” Companies

Q.7. Assume my company, on average, employed more than 100 full-time employees in 2019. What retention credit can I receive?

Employers averaging more than 100 full-time employees in 2019 may obtain a retention credit of up to 50% of the wages paid to employees for periods from 3/13/20 to 12/31/20 when the employees were not providing services to the employer (i.e., were not working) because of a full/partial suspension of operations, or during quarters where gross receipts dropped below 50% of the same quarter in the prior year.

For example, wages paid to employees who were not working because of “stay at home” orders, or because there was insufficient business, would count towards the retention credit for large employers. However, wages paid by large employers to employees who were able to telework do not count towards the tax credit.

The 50% retention credit applies to qualifying wages paid (to non-working employees) up to a maximum of $10,000 per employee during the period from 3/12/20 to 12/31/20. As noted below in Q.13, “qualifying wages” includes employer expenses for group health plan coverage paid to non-working employees.
Q.8. What happens if my company averaged 105 full-time employees in 2019, but between January and February 2020, I laid off 40% of my workforce?
The measurement period for determining whether an employer averaged 100 or more employees is calendar year 2019. Therefore, fluctuations either above or below 100 full-time employees occurring after December 31, 2019 do not appear to matter.

Q.9. My company averaged less than 100 full-time employees in 2019. What retention credit can I receive?
“Small” employers averaging 100 or fewer full-time employees in 2019 can claim a retention credit against wages and compensation paid to any employee (whether the employee worked or not) during either periods of a full/partial suspension as described in Q.4(a) above, or during quarters when it experiences a revenue decline of 50% as described in Q.4(b) above. Again, this is for wages paid from 3/13/20 up to 12/31/20, and as noted in Q.13, includes employer expenses for group health insurance benefits.

Q.10. What is the maximum retention credit an employer can receive per employee?
The retention credit is calculated based on the quarterly compensation paid to each eligible employee. For quarters spanning March 13, 2020 through December 31, 2020, both “large” and “small” employers can receive a retention credit of 50% of the qualifying wages paid to an eligible employee for the quarter. The 50% credit can be assessed against a maximum of $10,000 paid per employee in qualifying wages during March 13, 2020 to December 31, 2020. Therefore, the maximum credit per employee is $5000.

Note again, that for employers averaging more than 100 full-time employees, only qualifying wages paid to non-working employees are counted.

“Large” employers with more than 100 full-time employees are subject to one additional limitation. Section 2301(c)(3)(B) provides as follows:

“LIMITATION.—Qualified wages paid or incurred by an eligible employer described in subparagraph (A)(i) with respect to an employee for any period described in such subparagraph may not exceed the amount such employee would have been paid for working an equivalent duration during the 30 days immediately preceding such period.” (emphasis added)

Subparagraph (A)(i) describes the requirement that a “large” employer can only obtain the credit for periods during which it pays employees who are not working due to either a full/partial suspension, or due to a decline in gross receipts. Therefore, it appears (but is not clear) that if a large employer is claiming a retention credit for wages paid to an employee in any qualifying period, the maximum amount of qualifying wages is the wages paid to the employee in the 30 day period immediately preceding the qualifying period for which the employer is claiming the credit.
Under this interpretation, if an employee of a “large” employer was paid $6,000 (including health insurance expenses) for the period from March 2 to March 31, and then was paid $9000 (including health insurance) for time not worked during April 1 to May 30, it appears that the employer can only obtain a total retention credit of 50% x $6000 = $3000 for the entire period from April 1 to December 31, 2020. This confusing ambiguity may be cleared up once the DOL publishes explanatory rules on the retention credit.

Q. 11. I am a “small employer” who employed fewer than 100 full-time employees in 2019. Does the 30 day limitation period described in Q. 10 above apply to me?
No. Only employers employing 100 or fewer full-time employees in 2019 are subject to the restriction that limits the amount of qualifying wages to the amount “such employee would have been paid for working an equivalent duration during the 30 days immediately preceding such period.”

Q. 12. What about non-profits, such as 501(c)(3), 501(c)(4), 501(c)(6) etc. organizations? Do special rules apply to them?
Yes. The statute provides that with respect to any 501(c) organization that is exempt from tax, the eligibility provision applying to business operations that were “fully or partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to the coronavirus disease 2019 . . . shall apply to all operations of such organization.”

Unfortunately, it is not completely clear at present just what this non-profit rule means. It could mean that the retention credit can only be applied to wages of non-profit employees who were working specifically in operations that were fully or partially suspended, and not to the wages of employees working in operations that were unaffected. Conversely, it could also mean the opposite – i.e., that if only a small portion of the non-profit’s operations were fully or partially suspended, all of the otherwise eligible wages of the employees are subject to the retention credit.

Q. 13. What counts as “qualifying wages?” What about tips, commission, and health insurance premiums?
For purposes of the retention credit, “qualifying wages” includes tips, commission, and other amounts treated as “wages” that are subject to FICA tax under 26 USC 3121(a). Expenses incurred by an employer for group health plans (including medical, dental, drug, and vision) also count towards “qualifying wages.” Payments made by the employer for benefits excluded from Social Security taxes, such as group life insurance, 401K matches, etc., are not counted as qualifying wages.

There is an additional exclusion from “qualifying wages” for wages paid to family members of sole proprietors, and if the employer is a business entity, to any individual who is a more than 50% owner of the entity. Special rules also apply to estates and trusts.
Q.14. Does the retention credit apply to wages paid to employees for emergency paid sick leave or paid FMLA leave under the Families First Coronavirus Response Act (“FFCRA”)?
No, that would be double-dipping. Wages paid to employees for periods of emergency paid sick leave or paid FMLA leave are already reimbursable through a separate federal payroll tax credit under the FFCRA, so those wages may not be counted when applying the Section 2301 retention credit.

Q.15. What other exclusions apply to employers affected by a full/partial suspension of operations, or a 50% reduction in gross receipts?
In addition to the exclusion for wages paid for emergency paid sick leave and paid family leave under FFCRA, the following exclusions apply:

- Employers who obtain a Small Business Administration Paycheck Protection Program Loan under the CARES Act are ineligible for a retention credit.
- IRC 51 provides a Work Opportunity Tax Credit (“WOTC”) for employers who employ persons in certain targeted groups, such as unemployed or disabled veterans, food stamp recipients, and ex-felons. An employer cannot claim both a WOTC credit and the retention credit for the same wages. In most cases, the retention credit under the CARES Act for wages paid to an employee in a targeted group will be higher than the WOTC credit for the same period.

Q.16. What is the procedure for obtaining the retention tax credit from the IRS? Can the retention credit be applied to all of the payroll taxes for my employees, including federal income tax withholding?
In its March 31, 2020 FAQ, the IRS described the procedure as follows:

- The retention credit is calculated for each calendar quarter for the period from March 13, 2020 to December 31, 2020.
- Eligible employers report their total qualified wages and the retention credits claimed for each quarter on their federal employment tax returns, usually IRS Form 941. Form 941 is used to report employee income tax, Social Security, and Medicare taxes withheld from wages, as well as the employer’s portion of Social Security and Medicare taxes.
- Eligible employers can apply the retention credit against the employee federal income tax, as well as both the employee and employer’s portion of Social Security and Medicare taxes, that the employer would ordinarily submit to the IRS. Generally, federal payroll taxes are submitted either monthly or semi-weekly. On a quarterly basis, the employer would be required to account for the retention credit it took when submitting payroll taxes on Form 941.
- If the retention credit is greater than the employee income tax, Social Security, and Medicare taxes owed, an Eligible Employer must first apply the retention credit against the federal payroll taxes owed. For the amount of the retention credit for the quarter that exceeds the payroll taxes owed, the IRS directs employer to file form IRS 7200, to claim an advance refund.