

April 2020

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Q&A on the Employee Retention Credit

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The Employee Retention Credit (Section 2301)

Question 1. What is the credit?

The Employee Retention Credit is a refundable payroll tax credit applied to the 6.2 percent employer portion of the Social Security payroll tax, reduced by any applicable credits—including those provided to compensate employers for paid sick and family leave under sections 7001 and 7003 of the [Families First Coronavirus Response Act](#).

“Eligible Employers” may claim the Credit for 50 percent of “Qualified Wages.” Amounts properly claimed under the credit do not need to be repaid.

Question 2. How much is the credit worth?

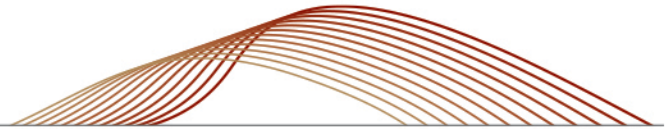
Eligible Employers may claim a federal payroll tax credit per employee (both part-time and full-time) that is equal to the lesser of:

- 50 percent of each employee’s Qualified Wages, or
- \$5,000 per employee.

Question 3. What is an “Eligible Employer”? Who can claim the credit?

An employer is an “Eligible Employer” who may claim the Credit under two circumstances:

1. An employer is an “Eligible Employer” during any calendar quarter in which its operations are partially or fully suspended due to an order from a governmental authority to limit commerce, travel, or group meetings due to COVID-19.
2. An employer is an “Eligible Employer” during a period in which it experiences a “significant decline in gross receipts,” which is defined as the period of time spanning from:
 - a. The first calendar quarter in 2020 in which its gross receipts are less than 50 percent of its gross receipts for the same quarter in 2019, to



- b. The calendar quarter *after* the first subsequent calendar quarter in which its gross receipts exceed 80 percent of its gross receipts for the same quarter in 2019.
 - i. Note that this provision is effective from March 12, 2020 to January 1, 2021. If a business does not make a requisite recovery under this eligibility criterion by that date, then the business will simply be able to claim the credit through the end of 2020.
 - ii. Note that Treasury guidance will be needed to determine eligibility for the credit, as businesses will certainly want to claim the credit *during* quarters in which they are eligible but cannot know their quarterly performance until the *end* of a given quarter when its quarterly revenues are known.
 - iii. As a practical matter, this means that if an employer becomes an Eligible Employer in calendar Q1 of 2020 (subject to the March 12, 2020 effective date, discussed at Question 6 below), the soonest that it could cease to be an Eligible Employer is calendar Q3 of 2020. An employer that becomes eligible in calendar Q2 or later under this criterion will be an Eligible Employer through the end of 2020.

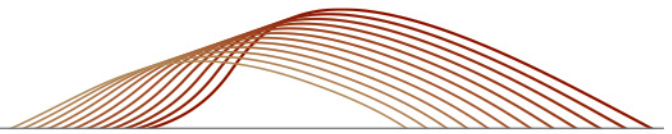
There are no restrictions based on business size or industry to claim the credit. C corporations, LLCs, S corporations, partnerships, tax-exempt organizations, and sole proprietorships may all be Eligible Employers provided they meet the criteria discussed above.

Question 4. What are “Qualified Wages”?

An employer may claim the credit for certain wages paid during the calendar quarter(s) in which the employer is an Eligible Employer, as discussed above. Whether particular wages or compensation paid during those calendar quarters are considered “Qualified Wages” is determined based on the employer’s size:

- Eligible Employers with more than 100 full-time employees may claim the credit for **wages paid to employees who are not providing services** due to (1) a COVID-19-related governmental shutdown, or (2) the specified “significant decline in gross receipts.”
 - In the event that an employee is working on a reduced schedule, an Eligible Employer may claim a credit for wages paid to that employee to the extent that wages actually paid exceed the amount that would normally be paid to that employee for the same amount of work. For example, if an employee works 15 hours in a week and the employer pays them for 25 hours, the employer would be able to claim the credit for 10 hours of wages.
- Eligible Employers with 100 or fewer full-time employees may claim the credit for **wages paid to all employees** during the specified periods in which the employer is an “eligible employer.”

Qualified Wages include any expenses associated with the Eligible Employer’s qualified health plan that are allocable to the wages paid as described above.



The maximum amount of Qualified Wages for which the credit may be claimed is \$10,000. This \$10,000 cap applies on an overall per-employee basis across all calendar quarters for which an employer is an Eligible Employer and means that the effective maximum per-employee value of the credit is \$5,000, as discussed above at Question 2.

Question 4a. What “wages” may be “Qualified Wages”?

Under the credit, “wages” encompasses both “wages” under IRC section 3121(a) and “compensation” under IRC section 3231(e). Broadly, this means all cash compensation provided to employees, including severance payments, upon which Social Security payroll tax is imposed. Specific items are carved out of the definitions of “wages” and “compensation” by statute.

Question 4b. What is a “full-time employee” for the purposes of claiming this credit?

In general, only U.S.-based employees who work on average at least 30 hours per week are considered “full-time employees.” Note that 130 hours of service in a calendar month is treated as equivalent to 30 hours of service per week.

A “full-time employee” for the purposes of the credit is defined in section 4980H of the Internal Revenue Code. Section 4980H provides that a full-time employee is an employee who is employed for an average of at least 30 hours of service per week. Regulations under section 4980H provide that an “hour of service” does not include hours for which the employee’s compensation is considered not to be U.S.-sourced. Under general principles of U.S. tax law, compensation for services is considered to be “sourced” where the services are performed.

Guidance from Treasury will be required to determine which calculation method or methods provided for under section 4980H will be appropriate to determine the number of full-time employees an employer has for the purposes of this credit.

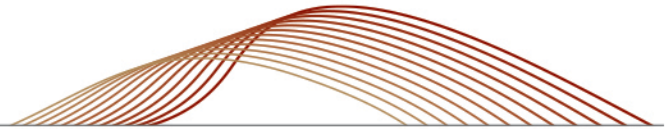
Question 4c. When are affiliated entities considered one “employer” for the purposes of claiming this credit?

The Act provides several ways in which a group of affiliated organizations may be considered one employer for the purposes of the credit, citing to the aggregation rules under Internal Revenue Code sections 52(a), 52(b), 414(m), and 414(o).

IRC 52(a) Controlled Corporate Groups: In general, a group of corporations will be considered a single “employer” where they share at least 50 percent common ownership by vote or value.

IRC 52(b) Parent-Subsidiary Groups: A corporate parent and subsidiary will be considered a single employer where the parent owns more than 50 percent of the vote and value of the subsidiary. A noncorporate parent and subsidiary group will be considered a single employer where the parent owns more than 50 percent of the profit interest or capital interest.

IRC 52(b) Brother-Sister Groups: Where a group of businesses are owned by the same five or fewer individuals, estates, or trusts, they will be considered a single employer where the controlling individuals own either (1) at least 80 percent of the vote and value (in the case of a corporation), or (2) at least 80 percent of the profit interest or capital interest (in the case of a partnership).



IRC 414(m) Affiliated Service Groups: Organizations are deemed to be an “affiliated service group” and thus to be a single employer where:

1. An organization is a shareholder or partner in another organization and regularly performs services for that organization or is regularly associated with that organization in providing services to third parties; or
2. A significant portion of the business of one organization is the performance of services for another organization, the services performed are of a type historically performed by employees, and 10 percent or more of the interests in the service-providing organization are held by “highly compensated employees” of the organization receiving the services.

Treasury regulations provide detail on specific taxpayer circumstances.

Question 5. What if the allowable amount of credit for a quarter exceeds the employer share of Social Security payroll taxes for that quarter?

To the extent that the amount of credit to which an Eligible Employer is entitled in any calendar quarter exceeds the amount of Social Security payroll taxes paid in that calendar quarter, the Treasury will issue the employer a refund to make up the difference and give the employer the full amount of the credit.

Question 6. If I am an Eligible Employer, when can I start claiming the credit?

This credit is available to reimburse wages paid by Eligible Employers after March 12, 2020, and before January 1, 2021.

Question 7. How can I claim the credit?

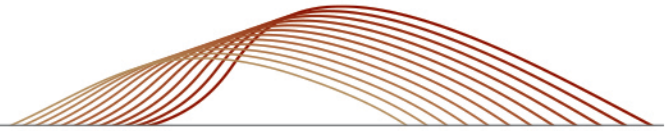
Eligible Employers may immediately begin claiming the credit by reducing their required deposits of the employer’s share of Social Security payroll tax. Eligible Employers seeking an advance of the credit should submit [IRS Form 7200, Advance Payment of Employer Credits Due to COVID-19](#) (instructions for Form 7200 [here](#)).

Eligible Employers should report their total qualified wages and associated health insurance costs for each quarter on their quarterly employment tax returns or [IRS Form 941](#) beginning with the second quarter of their eligibility. If the Social Security payroll tax amounts withheld are not sufficient to cover the amount of the credit, an Eligible Employer may receive an advance payment from the IRS by submitting IRS Form 7200.

Question 8. Are there limits on an employer’s ability to claim the credit?

Yes.

- Employers receiving a Small Business Interruption Loan as provided for in section 1102 of the CARES Act may not claim the credit.
- Wages included within Qualified Wages cannot be included in determining the amount of an Eligible Employer’s credit provided in IRC section 45S for amounts paid to employees taking leave under the Family and Medical Leave Act (as modified by the [Families First Coronavirus Response Act](#)).



- Eligible Employers may not claim the credit on wages for which the employer has already claimed the Work Opportunity Tax Credit.

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If you have any questions concerning these developing issues, please do not hesitate to contact the following Paul Hastings New York lawyer:

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