

CARES Act Employee Retention Credit Update

Tax and Estates Alert | April 17, 2020

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The Internal Revenue Service (IRS) has issued supplemental guidance regarding The Coronavirus Aid, Relief, and Economic Security Act's (CARES Act) employee retention credit (Credit). We have previously summarized the key aspects of the Credit and the supplemental guidance is summarized below.

The IRS posts information on its website regarding COVID-19 and the Coronavirus and Economic Impact Payments: Resources and Guidance page contains frequently asked questions regarding the Credit (FAQs). The FAQs (and IRS Form 7200, as described below) outline the mechanics on how the Credit is calculated and claimed.

The key aspects of the FAQs are as follows:

- **Maximum Credit Amount.** The CARES Act uses a formula based on qualified wages (including qualified health plan expenses) to calculate the Credit amount. The FAQs confirm that employers can use qualified wages paid from March 13, 2020 through December 31, 2020 up to a maximum amount of \$10,000 of wages per employee. Given that the Credit is equal to 50 percent of qualified wages, the FAQs confirm that the maximum Credit is \$5,000 per employee. The Credit is calculated on a calendar quarter basis, starting with the second quarter of 2020. If the \$10,000 qualified wages amount is not reached in a quarter, the remaining wages are used in the following quarter(s).
- **Eligible Employer.** An eligible employer for purposes of the Credit is an employer that carries on a trade or business in 2020 that either suspends operations due to a COVID-19 order or experiences a significant decline in gross receipts. The FAQs refer to these events as "economic hardship." The FAQs give examples on what is intended to be within the scope of a COVID-19 order, such as a state governor issuing an executive order closing all restaurants, bars, and similar establishments in order to reduce the spread of COVID-19. The FAQs also provide a detailed example of how to determine whether there has been a significant decline in gross receipts.
- **Qualified Wages.** How qualified wages are calculated depends on the average number of full-time employees during 2019. If the average number of full-time employees is 100 or less, qualified wages are counted as those wages paid to any employee during the period of economic hardship.

If the average number of full-time employees is more than 100, qualified wages are those wages paid to an employee "for time that the employee is **not providing services**" due to the economic hardship, subject to a limitation that the wages cannot exceed those that the employer would have paid to the employee for working the same amount of time during the prior 30 days (emphasis added). The Instructions to Form 7200 for the more than 100 full-time employee test state that an employer should "count only wages paid to employees that did not provide services" due to the economic hardship. The CARES Act uses slightly different language and states that an employer should count wages paid "with respect to which an employee is not providing services" due to the economic hardship.

For the 100 or less full-time employee test, all wages seem to be counted to the extent paid during the period of economic hardship regardless of whether the services are curtailed. For example, if an employee provides administrative services and retail services, and only the retail services are curtailed due to economic hardship, all wages paid during the period of economic hardship to the employee are counted even if the administrative services continue and the retail services have stopped.

However, for the more than 100 full-time employee test, it appears that only wages paid that relate to the services curtailed are counted. For example, if administrative services continue and retail services cannot be performed, then wages that relate to the curtailed retail services count while the wages paid for the administrative services that continue would not count.

- **Employment Taxes and Refundable Credit.** The CARES Act states that the Credit is allowed against the employer portion of Social Security taxes and the portion of taxes imposed on railroad employers under the Railroad Retirement Tax Act that corresponds to social security taxes. The employer portion of Social Security is 6.2% of wages (up to the applicable wage base). Since the employer portion of Social Security taxes is only part of total employment taxes (which includes the employer portion of Medicare, the employee portion of Social Security and Medicare, and the employee withheld income tax), stating that the Credit is allowed against the employer portion of Social Security tax leads to the question of how the Credit can be refundable when it is allowed only against a portion of total employment taxes.

The answer is that while the CARES Act states that the Credit is allowed against the employer portion of Social Security taxes, in operation the Credit is first used against the employer portion of Social Security tax. If the Credit exceeds the employer portion of Social Security, the excess amount is then applied against the balance of the remaining employment taxes (employer and employee portions, including employee income tax withholding). If there remains an excess Credit amount, the excess amount can be credited to the next calendar quarter or refunded.

By way of illustration, assume we have qualified wages for an employee of \$10,000. The credit on this amount is 50% of the qualified wages, or \$5,000. On \$10,000 of wages, the employer portion of Social Security is \$620 (6.2% of \$10,000). The \$5,000 Credit is first used against the \$620, leaving \$4,380. Assume further that the income tax withholding amount is \$2,000, the employee portion of Social Security is \$620 and the employee and employer portion of Medicare is \$290, for a remaining employment tax obligation of \$2,910. The \$4,380 Credit offsets the \$2,910 of remaining employment taxes and an employer has a remaining Credit of \$1,470, which can be carried over to the next calendar quarter or refunded by using IRS Form 7200 to obtain a payment of this amount.

- **Form 941 and Form 7200.** The IRS has indicated that the Credit will be claimed on Form 941, starting with the second quarter of 2020. This is the case even for qualified wages paid between March 13, 2020 and March 31, 2020 which are in the first quarter of 2020.

Using the illustration from above, the employer would use \$3,530 of the \$5,000 credit against the entire employment tax liability. The employer can then use Form 7200 to receive a refund of the \$1,470 excess credit.

- **Families First Coronavirus Response Act (FFCRA).** The FFCRA requires certain businesses to provide paid leave to workers who are unable to work or telework due to circumstances related to COVID-19 and provides refundable tax credits to offset the cost of the paid leave. Wages used for purposes of the credit under the FFCRA cannot also be used for purposes of the Credit.
- **Paycheck Protection Program.** If an employer obtains a Small Business Interruption Loan under the Paycheck Protection Program, the employer is not eligible for the Credit.

While these rules are complicated, they do provide welcome relief (and cash flow) in order to fund employment tax during difficult economic times.

The availability of the Credit is an important aspect of the Act and employers should evaluate whether they can benefit from this provision. To discuss how the Credit provision affects your business, please contact John Eagan (eaganj@whiteandwilliams.com; 212.868.4835) or Stephen Bowers (bowersss@whiteandwilliams.com; 215.864.6247).

As we continue to monitor the novel coronavirus (COVID-19), White and Williams lawyers are working collaboratively to stay current on developments and counsel clients through the various legal and business issues that may arise across a variety of sectors. Read all of the updates [here](#).

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