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New guidance clarifies employee retention credit

From Grant Thornton's Washington National Tax Office

The IRS has released guidance in the form of 95 frequently asked questions (FAQ) on the employee retention credit (ERC) enacted by the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The FAQ addresses nearly all aspects of the ERC and clarifies several issues regarding eligibility for the credit and which wages and health plan expenses count toward it.

Under the ERC, eligible employers may qualify for a fully refundable credit of up to $5,000 against Social Security taxes for certain employees retained during the COVID-19 pandemic. The FAQ provides clarity to many of the open issues taxpayers were facing when determining whether they could benefit from the ERC, but unanswered questions remain.

The ERC presents a significant opportunity for organizations to reduce their payroll tax burden and receive refunds, but the credit may conflict with other benefits provided in response to the pandemic. Businesses should carefully consider whether they are eligible for the credit, particularly in light of the aggregation rules, and which wages qualify.

Background

Congress included the ERC in the CARES Act to encourage businesses to retain employees. The credit applies against the employer's 6.2% share of Social Security tax, but it is fully refundable and covers 50% of qualified wages up to $10,000 per employee. The credit is generally available to businesses either fully or partially suspended due to a government order or those that saw a greater than 50% reduction in gross receipts in a 2020 quarter compared to the same quarter in 2019.

The wages eligible for the credit depend on an employer's average number of full-time employees in 2019. In general, for an eligible employer with more than 100 full-time employees, the only wages that can be taken into account are those paid for the time employees are not providing services during the period the employer is eligible for the credit. In contrast, for those with 100 or fewer full-time employees, all wages paid during the period an employer is eligible for the credit can be taken into account. In both cases, wages include properly allocable health plan expenses.

The credit cannot be taken with certain other benefits, including those provided by Congress in response to COVID-19. It is unavailable for required wage payments under the new sick pay and paid family leave requirements enacted by the Families First Coronavirus Response Act (FFCRA) and businesses taking Paycheck Protection Program loans.

Aggregation rules

For purposes of the ERC rules, all aggregated entities are treated as a single employer. The FAQ makes it clear that the aggregation rules apply for all purposes of the credit, including determining whether:

- The employer has a trade or business operation that was fully or partially suspended due to orders related to COVID-19 from an appropriate governmental authority
- The employer has a significant decline in gross receipts
- The employer has more than 100 full-time employees
- Any member of the aggregated group received a PPP loan under the CARES Act, which would preclude all members in the aggregated group from claiming the ERC

Entities are aggregated if they are treated as a single employer under Sections 52(a), 52(b), 414(m) or 414(o). Section 52(a) includes a controlled group of corporations generally based on a more than 50% ownership threshold, including a parent-subsidiary controlled group, a brother-sister controlled group or a combined group. Section 52(b) applies similar aggregation rules to partnerships, trusts, estates and sole proprietorships. Sections 414(m) and (o), which are normally used to determine related entities for purposes of qualified retirement plans and other employee benefits, apply to affiliated service groups.

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Employers should first determine whether they are part of an aggregated group before determining whether they are eligible for the credit or the amount of the credit. The aggregated group rules affect all aspects of the credit and may help or hinder an employer when determining eligibility and the amount of the credit.

Employers eligible for the credit

The CARES Act left open issues regarding which businesses are eligible for the credit, and the FAQ fills many of those gaps. Employers of any size may be an eligible employer. However, an employer that receives a loan under the PPP may not receive an ERC, regardless of whether all or a portion of the loan is forgiven under the terms of the program. If any entity in an aggregated group treated as a single employer receives a PPP loan, the entire aggregated group is not eligible for the credit.

Grant Thornton Insight:
Employers that were otherwise an eligible employer and otherwise paid qualified wages prior to receiving a PPP loan are not eligible for the credit even for the qualified wages paid prior to receiving the loan.

An employer that received a PPP Loan and repays it by May 14, 2020, (in accordance with the Limited Safe Harbor With Respect to Certification Concerning Need for PPP Loan Request in the interim final rules issued by the Small Business Association effective April 28, 2020, as modified by FAQ 43 in the Small Business Association's PPP FAQs updated May 5, 2020) may be eligible for the ERC. These employers are treated as not having received a PPP Loan.

Tax-exempt organizations described under Section 501(c) may be eligible for the ERC and are deemed to be engaged in a trade or business with respect to all operations of the organization. Federal, state and local governments are not eligible for the credit. The FAQ adds that political subdivisions, agencies and instrumentalities of governments are also not eligible for the credit. The FAQ lists six factors the IRS considers when determining whether an organization is an instrumentality for this purpose. Certain public colleges and universities may be ineligible for the credit under this test.

Self-employed individuals are not eligible for the credit with respect to their own self-employment income, but qualified wages paid by self-employed individuals to their employees may be eligible for the credit. Household employers are not eligible for the credit for amounts paid to their household employees because they are not considered to be operating a trade or business with respect to those employees.

The credit is available for businesses that are not excluded from eligibility and fit within either of the following categories:

- The business operations are fully or partially suspended due to applicable government orders limiting commerce, travel or group meetings due to COVID-19
- The business experiences a greater than 50% decline in gross receipts in a 2020 calendar quarter compared to the same quarter in 2019

Full or partial suspension

According to the new FAQ, an employer's business operations are partially suspended when the employer can still continue some, but not all of its operations. The new language differs from that in a prior set of FAQs, in which the IRS said that an employer's business operations were partially suspended when the operations can still continue, but not at its normal capacity. The IRS did not indicate why it changed this language.

Even if an employer's business operations are fully or partially suspended, the business must determine whether the suspension is required by a government order limiting commerce, travel or group meetings due to COVID-19. The FAQ goes into detail to help businesses determine whether they are eligible under this category. Government orders include orders, proclamations and decrees from the federal, state or local government that has jurisdiction over the employer's operations.

According to the FAQ, government orders include:

- An order from the city's mayor stating that all non-essential businesses must close for a specified period
- A state's emergency proclamation that residents must shelter in place for a specified period, other than residents who are employed by an essential business and may travel to and work at the workplace location
- An order from a local official imposing a curfew on residents that impacts the operating hours of a trade or business for a specified period

Because all members of an aggregated group are treated as a single employer for purposes of the credit, all members of an aggregated group that operate the same trade or business are considered to have a full or partial suspension of business operation due to a government order if one member of the group has business operations fully or partially suspended by such an order. This applies even if some of the members of the group operate in jurisdictions that have not issued government orders.

A business that is not subject to a government order that restricts operations but voluntarily suspends operations or reduces hours is not eligible for the credit under the fully or partial suspension category.

The FAQ generally provides that an employer that operates an essential business is not considered to have a full or partial suspension of business operations if the government order allows the business to remain open, even though government orders on non-essential businesses may have an effect on the employer's operations. The FAQ includes some exceptions to this general statement:

- If an essential business's suppliers are unable to make deliveries of critical goods and materials due to government orders that cause the supplier to suspend its operations, the essential business may be eligible for the credit due to a full or partial suspension of operations if it is unable to procure the goods or materials from an alternative supplier.
- If a government order requires an employer to reduce its operating hours, the employer is considered to have a partial suspension of operations.

An essential business that is not required to close its locations or otherwise suspend its operations is not considered to have a full or partial suspension of business operations for the sole reason that its customers are subject to a government order requiring them to stay at home.

Grant Thornton Insight:
The FAQ makes clear that a business is not fully or partially suspended solely because its customers must stay at home under a government order. It provides an example of an automobile repair service that is an essential business and not required to close or suspend operations. This business operates in a jurisdiction that is subject to a stay at home order from the government, so the business's operations have declined significantly. The FAQ concludes that the business is not considered to have a full or partial suspension of business operations due to a government order.

An employer that is required under a government order to close its workplace for certain purposes but is permitted to remain operational for other purposes is considered to have experienced a partial suspension. The FAQ provides as examples a restaurant that can serve food through take-out or delivery instead of sit-down service and a retail business that must close shops but can sell products online.

If an employer's workplace is closed by a government order, but the employer is able to continue comparable operations by requiring its employees to telework, the FAQ provides that the employer's operations are not fully or partially suspended due to a government order. The FAQ includes an example of a software developer. A government order requires the software company's office to close because it is not an essential business. Prior to the order, all employees teleworked once or twice per week, and business meetings were held at various locations. Following the order, the business required employees to telework and conduct meeting via phone or video conference. The FAQ concludes that the software company's operations are not fully or partially suspended due to a government order because its employees may continue to conduct its business operations by teleworking.

The FAQ provides relief for an employer that has operations in multiple locations (regionally or nationally) that are affected differently by government orders. An employer may have operations in some locations where a government order limits operations resulting in a full or partial suspension of business operations, while operations in other business locations are not limited by government orders, including because the business is essential in those locations.

The FAQ addresses a situation where, in order operate in a consistent manner in all jurisdictions, the businesses establishes a policy in all locations that complies with all government orders, as well as the Center for Disease Control and Prevention (CDC) recommendations and the Department of Homeland Security (DHS) guidelines. The FAQ concludes that even though the business is not subject to a government order to suspend business operations in all locations, the employer would still be considered to have partially suspended operations in all locations even though it is merely following CDC or DHS guidelines in some of those locations.

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This is helpful for a business that fully or partially suspend operations in all locations and jurisdictions, even though the business is only required to do so by government orders in some jurisdictions but not in others. This is an exception to the rule that a voluntary suspension of business operations is not a full or partial suspension of operations due to a government order.

Significant decline in gross receipts

An employer that experiences a significant decline in gross receipts, even if the decline is not related to COVID-19, is eligible for the ERC. A significant decline in gross receipts occurs when a business's gross receipts in a 2020 calendar quarter are less than 50% of its gross receipts in the same quarter in 2019.

Businesses may begin by comparing the first quarter of 2020 to the first quarter of 2019. If gross receipts have not declined by more than 50%, the test is performed again in subsequent quarters. The business is eligible for the credit in the first quarter in 2020 in which its gross receipts decline by greater than 50% and each subsequent quarter in 2020 in which gross receipts are not greater than 80% of their 2019 comparable quarter gross receipts. Businesses continue to be eligible for the credit through the first quarter gross receipts rebound to greater than 80% of the 2019 comparable quarter but are no longer eligible as of the first day of the next quarter.

The term "gross receipts" is defined for this purpose by reference to Section 448(c). The FAQ describes gross receipts as generally including total sales (net of returns and allowances) and all amounts received for services. In addition, gross receipts include any income from investments, and from incidental or outside sources. For example, gross receipts include interest (including original issue discount and tax-exempt interest), dividends, rents, royalties and annuities, regardless of whether such amounts are derived in the ordinary course of the employer's trade or business. Generally, gross receipts are not reduced by cost of goods sold but are reduced by the employer's adjusted basis in capital assets sold. Gross receipts do not include the repayment of a loan, or amounts received with respect to sales tax if the tax is legally imposed on the purchaser of the goods or services, and the taxpayer merely collects and remits the sales tax to the taxing authority.

The FAQ states that the IRS intends to issue guidance addressing how tax-exempt organizations determine their gross receipts for this purpose. This guidance will likely address whether donations are treated as gross receipts.

An employer's gross receipts include the total gross receipts from all members of the aggregated group.

Qualified wages

The ERC is equal to 50% of the qualified wages eligible employers pay their employees. Qualified wages include the employer's qualified health plan expenses that are properly allocable to the wages. The ERC applies only to qualified wages paid on or after March 13, 2020, and through December 31, 2020. The maximum amount of qualified wages taken into account with respect to each employee for all calendar quarters is $10,000, so that the maximum credit for qualified wages paid to any employee is $5,000.

The starting point for determining qualified wages is the definition of wages for FICA tax purposes under Section 3121(a), which is initially defined broadly to include all remuneration for employment, but then expressly excepts a laundry list of items (see Sections 3121(a)(1) – (23)). The FAQ also notes that amounts paid which are not otherwise treated as wages for FICA tax purposes are not considered wages for ERC purposes. The salary and parsonage allowance paid to an ordained minister who is a common law employee of a church generally do not constitute wages within the meaning of Section 3121(a), and therefore, are not wages for purposes of the ERC. Similarly, the amounts paid to licensed real estate agents who are treated as statutory nonemployees do not constitute wages within the meaning of Section 3121(a), and therefore, are also not wages.

The ERC is also available to railroad employers who are subject to the Railroad Retirement Tax Act (RRTA), and the starting point for wages for eligible railroad employers is the definition of compensation under Section 3231(e).

The FAQ clarifies that wages are determined without regard to the social security taxable wage base, which is $137,700 for 2020.

Full-time employee threshold

The definition of qualified wages depends, in part, on the average number of full-time employees employed by an eligible employer during 2019. For an eligible employer that averaged 100 or fewer full-time employees in 2019, qualified wages include all wages paid to any employee during any period in the calendar quarter in which the business operations are fully or partially suspended due to a governmental order or any calendar quarter the business is experiencing a significant decline in gross receipts.

In the case of an eligible employer that averaged more than 100 full-time employees in 2019, qualified wages are limited to the wages paid to an employee for time the employee is not providing services due to either a full or partial suspension of operations by government order or a significant decline in gross receipts.

For hourly or non-exempt salaried employees who do not have a fixed schedule of work, the hours for which the employees are not providing services may be determined using any reasonable method. The method that the eligible employer would use to determine the employees' entitlement to leave under the Family and Medical Leave Act would be a reasonable method for this purpose. Similarly, the method that the DOL has prescribed to determine the number of hours for which employees with an irregular schedule are entitled to paid sick leave under the FFCRA would be considered reasonable for this purpose.

For exempt salaried employees, an eligible employer may use any reasonable method to determine the number of hours the salaried employees are not providing services, but for which the employees receive wages either at the employees' normal wage rates or at reduced wage rates. Reasonable methods include those the employer uses to measure exempt employees' entitlement to leave on an intermittent or reduced leave schedule under the Family and Medical Leave Act, or the method the employer uses to measure exempt employees' entitlement to and usage of paid leave under the employer's usual practices.

The FAQ notes 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.

Grant Thornton Insight:
Determining the hours for which exempt salaried employees are being paid wages while not providing services generally is more difficult than for hourly employees, particularly if the salaried employees do not have to submit time reports that reflect regular hours that were not worked. In those cases, eligible employers will have to develop a method for determining and substantiating the paid hours that were not worked. For example, an employer could require salaried employees to track and report hours that were not worked, or require the employee's supervisor to estimate and document the hours not worked, but both approaches could raise employee relations concerns (e.g., employees' reluctance to report time not worked during these unprecedented times). The guidance also treats as unreasonable methods that would deem an employee's working hours to have been reduced because of decreases in productivity while working (e.g., based on inefficiencies and/or distractions experienced while working from home).

In addition, for eligible employers with more than 100 full-time employees, qualified wages paid to an employee may not exceed what the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the commencement of the full or partial suspension or the first day of the calendar quarter in which the employer experienced a significant decline in gross receipts. For a variable-hour employee, the amount paid for working an equivalent duration during that 30-day period may be determined using any reasonable method. The FAQ indicates that the method(s) the DOL has prescribed to determine the amount to pay an employee with an irregular schedule who is entitled to paid sick leave under the FFCRA would be considered reasonable for this purpose.

Payments excluded from qualified wages

The FAQ identifies a number of payments that are not considered qualified wages in certain cases.

Pre-existing PTO

If an eligible employer averaged more than 100 full-time employees in 2019, the employer may not treat as qualified wages amounts paid to employees for paid time off (PTO) for vacations, holidays, sick days and other days off. The IRS explains that these wages are paid pursuant to existing leave policies that represent benefits accrued during a prior period in which the employees provided services and are not wages paid for time in which the employees are not providing services.

Grant Thornton Insight:
Consider an employer that averaged more than 100 full-time employees in 2019. The employer is subject to a government order that fully suspends the operations of its trade or business. The employer furloughs its employees and requires the employees to use all of their previously accrued PTO before the employer will continue paying 75% of their regular wages during the furlough. Under the position adopted by the IRS in the FAQ, because any previously accrued PTO paid during the furlough are considered benefits that accrued during a prior period in which the employees provided services, the PTO would not be considered wages paid for time not worked and would not be considered qualified wages. However, the reduced wages (75%) paid after the employees have used all their previously accrued PTO would represent wages paid for time not worked, and therefore, should be qualified wages.

However, if the employer gives employees an additional period of PTO in connection with or after the furlough begins and requires the employees to use that PTO during the furlough period, any such PTO paid during a period the employer is eligible for the credit may be considered qualified wages because the PTO was not earned for services previously provided.

In contrast, the FAQ generally treated previously accrued PTO as qualified wages for Eligible Employers with 100 or fewer employees. If an Eligible Employer averaged 100 or fewer full-time employees in 2019, all wages paid to employees during the period of the full or partial suspension of operations or the significant decline in gross receipts, even if under a pre-existing vacation, sick and other leave policy, are qualified wages for purposes of the ERC (unless the wages are qualified sick and/or family leave wages under sections 7001 and 7003 of the FFCRA).

Severance and other post-termination payments

The FAQ explains that payments are considered qualified wages only if the payments are made to an employee who continues to be employed by the eligible employer. Accordingly, payments, including severance payments, made in connection with a former employee's termination of employment are not qualified wages because they are payments for the past employment relationship and thus are not attributable to the time for which the ERC may be claimed. Whether an employee has terminated employment is based on all the facts and circumstances, including whether the employer has treated the employment relationship as terminated for purposes other than the continuation of wage payments.

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Instead of terminating employees and paying the employee severance, employers may explore retaining and paying the workers as employees over a certain period of time. Several non-tax considerations must be addressed if employers explore retaining employees.

Other exclusions

Qualified wages do not include:

- The related payroll taxes and withholdings, including the employee's or employer's shares of Social Security taxes, the employee's and employer's shares of Medicare taxes, and the federal income taxes required to be withheld
- Wages for which the employer received a credit for qualified sick or family leave wages under Sections 7001 and 7003 of the FFCRA
- Wages paid to an employee for purposes of the Work Opportunity Tax Credit under Section 51 or the credit for paid family medical leave under Section 45S.

Determining full-time employees

As As discussed above, the definition of qualified wages depends, in part, on the average number of full-time employees employed by an eligible employer during 2019. For this purpose, the FAQ provides that the term "full-time employee" means an employee who, with respect to any calendar month in 2019, had an average of at least 30 hours of service per week or 130 hours of service in the month (130 hours of service in a month is treated as the monthly equivalent of at least 30 hours of service per week), as determined in accordance with Section 4980H. An employer that operated its business for the entire 2019 calendar year determines the number of its full-time employees by taking the sum of the number of full-time employees in each calendar month in 2019 and dividing that number by 12.

Special computation rules apply if an employer started its business operations either during 2019 or 2020. The full-time employees of all entities that are treated as a single employer under the employer aggregation rules must be combined for purposes of determining whether the employer had more than 100 full-time employees in 2019.

Grant Thornton Insight:
The FAQ does not require employers to count part-time employees for purposes of determining whether the employers averaged more than 100 full-time employees in 2019. The statutory language references full-time employees within the meaning of Section 4980H, which requires part-time employees to be taken into account as full-time employees based on their combined full-time equivalents (by dividing their combined number of hours in a month by 120). This interpretation will mean fewer employers will have averaged more than 100 full-time employees in 2019 and will be eligible for the more favorable definition of qualified wages, which includes all wages paid while an employer is eligible for the credit, even for services performed. The Joint Committee on Taxation's summary of the ERC and CARES Act indicates that part-time employees should be taken into account when determining the 100-employee threshold, so there is a possibility the IRS could change its position in future guidance.

Qualified health plan expenses

Qualified wages include the eligible employer's qualified health plan expenses that are properly allocable to the wages. For this purpose, qualified health plan expenses generally are amounts paid or incurred by an eligible employer to provide and maintain a group health plan, but only to the extent that these amounts are excluded from the employees' gross income.

The rules for determining the extent to which an eligible employer can treat health plan expenses as qualified wages are different depending on the average number of full-time employees employed by an eligible employer during 2019.

Eligible employers with 100 or fewer full-time employees

An eligible employer that averaged 100 or fewer full-time employees in 2019 may treat its health plan expenses paid or incurred as qualified wages, even if the employees are not working and the eligible employer does not pay the employees any wages for the time they are not working.

The FAQ provides the following example: Employer Z averaged 100 or fewer employees in 2019. Employer Z is subject to a government order that suspends the operation of its trade or business. In response to the government order, Employer Z lays off or furloughs all of its employees. It does not pay wages to its employees for the time they are laid off or furloughed and not working, but it continues the employees' health care coverage. Employer Z's health plan expenses allocable to the period its operations were partially suspended may be treated as qualified wages for purposes of the ERC.

Eligible employers with more than 100 full-time employees

The FAQ provides that an eligible employer which averaged more than 100 full-time employees in 2019 can treat its health plan expenses as qualified wages to the extent the expenses are allocable to the time the employees are not providing services during any period in a calendar quarter in which the employer's business operations are fully or partially suspended due to a government order or a calendar quarter in which the employer has experienced a significant decline in gross receipts. This includes situations where the employer has furloughed employees without pay but continues to provide the employees with health care coverage. However, qualified wages do not include health care expenses allocable to the time the employees provide services.

The FAQ provides several examples to help taxpayers understand the allocation of health plan expenses to qualified wages. In one example, an eligible employer that has fully suspended the operations of its trade or business due to a government order lays off or furloughs its employees and does not pay wages to the employees. The employer continues to cover |100% of the employees' health plan expenses. The FAQ concludes that the employer may treat as qualified wages the health plan expenses that are allocable to the time that the employees are not providing services.

In another example, an eligible employer reduces its employees' hours by 50%, but then reduces wages by only 40%. The employees receive 60% of their wages for 50% of their normal hours. The employer continues to cover 100% of the employees' health plan expenses. The FAQ concludes that qualified wages include: (1) the 10% of the wages that it pays employees for time the employees are not providing services, plus (2) 50% of the health plan expenses, because the health plan expenses are allocable to the time the employees were not providing services.

Grant Thornton Insight:
The original FAQ issued by the IRS on April 29 provided that an eligible employer that averaged more than 100 full-time employees in 2019 could not treat any portion of its health plan expenses as qualified wages if it did not pay its employees any wages for time that the employees are not providing services. As a result, if an employer furloughed or laid off employees with no pay, but continued to pay all or a portion of the cost of health care coverage, the health plan expenses were not qualified wages. The position drew immediate backlash from Congress and prompted a bipartisan letter to Treasury Secretary Steven Mnuchin urging reconsideration. As such, the IRS amended the FAQ on May 7 to allow these employers, along with employers who do not pay wages in excess of the services actually provided, to treat the health plan expenses allocable to the time the employees are not providing services as qualified wages.

Allocating health plan expenses to qualified wages

In general, qualified health plan expenses are properly treated as qualified wages if the allocation is made on a pro rata basis among covered employees (for example, the average premium for all employees covered by a policy) and pro rata on the basis of periods of coverage (relative to the time periods for which such wages relate).

The FAQs include specific allocation guidance for both fully insured group health plans and self-insured group health plans.

- Fully-insured group health plans: The FAQ explains that an eligible employer who sponsors a fully-insured group health plan may use any reasonable method to determine and allocate the plan expenses, including (1) the COBRA applicable premium for the employee typically available from the insurer, (2) one average premium rate for all employees or (3) a substantially similar method that takes into account the average premium rate determined separately for employees with self-only and other than self-only coverage.

  The FAQ includes an example of a reasonable method for determining and allocating health plan expenses. The IRS also indicated that, if an eligible employer chooses to use one average premium rate for all employees, the allocable amount for each day an employee covered by the insured group health plan is entitled to qualified wages could be determined using certain steps outlined in the FAQ.

- Self-Insured Group Health Plans: An eligible employer who sponsors a self-insured group health plan may use any reasonable method to determine and allocate the health plan expenses, including (1) the COBRA applicable premium for the employee typically available from the administrator or (2) any reasonable actuarial method to determine the estimated annual expenses of the plan.

  If the eligible employer uses a reasonable actuarial method to determine the estimated annual expenses of the plan, then rules similar to the rules for insured plans can be used to determine the amount of health plan expenses allocated to an employee. That is, the estimated annual expense can be divided by the number of employees covered by the plan, and that amount can be divided by the average number of work days during the year by the employees (treating days of paid leave as work days and any day on which an employee performs any work as work days). The resulting amount is the amount allocated to each day of qualified wages. Adjustments should be made for any employee after-tax contributions.

Determining health plan expenses

The qualified health plan expenses that can be taken into account generally include both the portion of the cost paid by the eligible employer and the portion of the cost paid by the employee with pre-tax salary reduction contributions. However, qualified health plan expenses do not include any amounts paid by the employee with after-tax contributions.

The FAQ also includes guidance for determining health plan expenses when an employer sponsors more than one group health plan. In addition, it provides rules for determining health plan expenses when an employer sponsors health savings accounts, health flexible spending arrangements, health reimbursement arrangements, qualified small employer health reimbursement arrangements or Archer MSAs.

Other highlights

Additional clarifications on the ERC provided by the FAQ include:

- Qualified wages paid to employees are subject to employment tax withholding and the employer's share of FICA taxes. These wages are also generally treated as compensation for purposes of the employer's qualified retirement plans and other employee benefit plans.
- Employers will report their total qualified wages for each calendar quarter on their Form 941. Qualified wages paid in Q1 of 2020 are reported on the Q2 2020 Form 941. The IRS has issued a draft revised Form 941 that, when finalized, will be used beginning in Q2 2020.
- In anticipation of receiving the ERC, eligible employers can reduce federal employment tax deposits, including withheld taxes from employees. These employers are not subject to a failure to deposit penalty under Section 6656 if (1) the eligible employer paid qualified wages in the calendar quarter before the required employment tax deposit, (2) the total amount of federal employment taxes that is not timely deposited, when reduced by other applicable credits, is less than or equal to the amount of the eligible employer's anticipated ERC for the qualified wages for the calendar quarter as of the time of the required deposit and (3) the eligible employer did not seek an advanced payment of the ERC by filing a Form 7200 with respect to any portion of the anticipated credits it relied upon to reduce deposits.
- Eligible employers may, in certain circumstances listed in the FAQ, request an advance payment of the ERC using Form 7200.
- Each separate member of an aggregated group of employers generally will claim its share of the ERC and report its qualified wages on its own Form 941. Each member's credit will be the amount of the credit apportioned among the members of the aggregated group on the basis of each member's proportionate share of the qualified wages giving rise to the credit.

- Qualified wages paid to an employee are not excludible from the employee's income under Section 139 as a reimbursement or pay for expenses related to a qualified disaster.
- The employer's aggregate tax deduction is reduced by the amount of the ERC.
- The eligible employer does not recognize gross income equal to any portion of the credit received.
- The FAQs address several issues concerning third-party payers, including the information the third-party must collect from the eligible employer.

Next steps

The ERC may provide companies short-term and long-term opportunities with respect to payroll tax savings and refunds. Businesses should complete a thorough analysis of their aggregated group, whether they are eligible for the credit and the amount of their qualified wages.

The FAQs address many of the open issues taxpayers were facing when determining whether they could benefit from the ERC. However, there are still unanswered questions. The IRS will likely issue additional guidance, which may include additional frequently asked questions, notices and regulations. Businesses should stay informed of possible changes to positions taken based on the current guidance and statutory language.

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