

# EMPLOYEE RETENTION CREDIT

“The ERC was just what our business needed. It gave us the boost we needed to return to normal operations.

- Client

The Employee Retention Credit ("ERC") is a federal tax credit claimed through a company's payroll tax filings. It entitles qualifying companies to up to \$26,000 per employee. The program has been largely overlooked and often misunderstood.

Numerous changes to esoteric qualification criteria has kept qualifying businesses and their advisors from identifying the ERC as a valuable COVID stimulus program to aid in their recovery from the pandemic.

## WHAT'S THE STORY WITH THE ERC?

The Employee Retention Credit was implemented at the start of the COVID-19 pandemic and was initially introduced as part of the CARES Act, signed into law on March 27, 2020.

Though the ERC has been around since the beginning days of COVID stimulus, the program today, in its current form, is largely unrecognizable from the program as it was originally introduced.

Initially, companies that took advantage of the PPP loan program were disallowed from participating in the ERC program. At the time, the PPP program was more lucrative than the ERC program and as a result few companies took advantage of the ERC. Fast forward to December 27, 2020, nine months after the CARES Act was introduced. The ERC program gets a facelift and the most significant change?

Receiving a PPP loan no longer precludes companies from taking advantage of the ERC.

It has been a year and a half since the most significant ERC rule changes but unfortunately, business owners are still not taking advantage of the significant tax credit dollars available to them. This is the result of a few common misconceptions:

- I received PPP so I cannot claim the ERC.
- My business had to have a decrease in revenue to qualify.
- My business had to experience a full shutdown to qualify.
- My CPA told me I don't qualify.

The ERC program requires a specialized knowledge of the rules and requirements to determine qualification and maximize the credit amount.

# HOW DOES A BUSINESS QUALIFY?

There are three paths to qualification, each of which is examined below. Before discussing the three qualification pathways, there are a few high level criteria that a business must meet regardless of how they qualify:

- Must employ W-2 individuals, other than the owner (or owners’ relatives)
- Must have fewer than 500 full-time employees to claim the credit for 2021 and fewer than 100 to claim the credit for 2020 (control group rules come into play if you own multiple companies)

After assessing your business under these two criteria, you can move to the ERC qualification pathways.

**01.** Experienced a significant decline in gross receipts (revenue) during Q2 2020 through Q3 2021 as compared to the same quarter in 2019. Defined as a 50% decline in 2020 and a 20% decline in 2021. The table below illustrates this qualification criteria; however, it is worth noting that everything is not always as it seems under this method. There are certain rules that allow you to look back to other quarters for qualification in an otherwise non-qualifying quarter.

**02.** Fully or partially suspended due to orders from the federal, state, or local government related to COVID-19 (capacity restrictions, shutdowns, etc.) This qualification pathway most often applies to restaurants, bars, retail, physicians who performed elective procedures, entertainment venues, and other businesses that were not deemed essential. Most states had orders in place which restricted many of these industries. What has to be determined is whether this impact was "more than nominal". An ERC specialist can help you decide and document the impact of restrictions on your specific business.

**03.** Started a new business during the COVID-19 pandemic. The specific qualifications are:

- Started business/operations after February 15, 2020 but before December 31, 2021; and
- Average annual gross receipts (revenue) for the three-year taxable period ending with the taxable year that precedes the calendar quarter for which the credit is determined does not exceed \$1,000,000; and
- Employed W-2 individuals, other than the owner (or owners’ relatives), from July 2021 through December 2021.

	Q1	Q2	Q3	Q4
2019 (base period)	\$800,000	\$650,000	\$550,000	\$800,000
2020	\$750,000	\$300,000	\$250,000	\$700,000
2020 % Change	N/A	-53.84%	-54.54%	-12.50%
2021	\$650,000	\$800,000	\$400,000	
2021 % Change	-18.75%	+23.08%	-27.27%	

## HOW MUCH IS IT WORTH?

The value of the ERC is unique to each company and depends on a number of factors. The most important of these factors is the number of quarters you qualify for and how many employees you have. Companies are able to claim a maximum of \$5,000 per employee for the full year 2020 and \$7,000 per employee per quarter in 2021.

The amount of the credit is based on the first \$10,000 of wages paid to an employee during the quarter. This amount is referred to as "qualified wages". For each quarter that you qualify for in 2020, the qualified wage amount is multiplied by 50% to arrive at the credit for that employee. The same methodology is employed in 2021, however the qualified wage amount is multiplied by 70%. A simplified example is presented below:

	<u>Qualified Wages</u>	<u>ERC %</u>	<u>Total ERC</u>
<u>2020, Q2</u>			
Employee #1	\$7,500	50%	\$3,750
Employee #2	\$10,000	50%	\$5,000
<u>2021, Q3</u>			
Employee #1	\$7,500	70%	\$5,250
Employee #2	\$10,000	70%	\$7,000

Of course, there are additional items to take into account when calculating the ERC. For example, PPP loan forgiveness must be navigated and has the potential to reduce (but almost certainly not negate) the amount of your ERC. Additionally, other grant or loan programs can also impact the ERC.

## HOW IS IT CLAIMED?

The ERC is claimed by amending your company's quarterly payroll tax filing(s), Form 941. The amended form is called Form 941-X. The form must be filled out and filed in paper as no E-File option exists. Once filed, we've seen IRS processing times range from four to twelve months, though our most recent data suggests that these wait times are trending towards the low end of that range.

After filing, the company can expect to receive no communication from the IRS until the amended forms have been processed. Once the IRS has processed these forms, a notification will be sent to the business informing them that they have "overpaid" their quarterly payroll taxes and will be receiving a refund. Two weeks later, a paper check will arrive at the address listed on the amended 941(s).

It is worth noting that this credit is taxable to the company and should be accounted for in the year for which the credit is being claimed (e.g. Q2 2020 ERC is taxable in 2020 tax year). This means that if you have already filed your federal income taxes for a period for which you are claiming the credit, you may have to amend your federal income tax return. We recommend consulting with your CPA on how to handle taxation of the credit.

The IRS has indicated that ERCs will be eligible for audit for five years after the filing date. This means that it is important to make sure that you work with a professional who specializes in the ERC and is able to document your qualification and be prepared to defend their work and your case in the event of an audit.

## WHY SHOULD I CARE?

To date, we have helped companies receive more than \$150 million from the ERC program. Our clients range from one employee to hundreds, generating ERCs from \$2,000 to \$5,000,000; this is a highly lucrative program for qualifying companies. Importantly, the program begins to sunset in 2024 as the deadlines to amend payroll tax filings approach.

Our clients have used ERC funds to pay off debt, buy equipment, offset rising materials and labor costs, make distributions, launch new business lines, and create rainy day funds. There is no limitation on how the funds can be used!

Much of the recent guidance pertaining to the ERC has made benefiting from the ERC more complex and challenging. We know this can be frustrating, which is why Seamless's dedicated ERC team stays up-to-date on the latest rules so you don't have to. We will maximize your credit values while always remaining within the bounds of the regulations, and we will never calculate a credit that you can't defend.

Contact us today for a consultation with a ERC specialist.



For more information on how we can help your business claim the ERC:



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### About Seamless

We are CPAs and consultants providing strategic, financial and operational consulting to small and mid-sized businesses.

Our services include transaction advisory, fractional CFO & COO services, and tax credit advisory.