

Employee Retention Tax Credit Eligibility for Businesses and Non-Profits
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Was your Business or Non-Profit advised that it would not qualify for the Employee Retention Tax Credit?

If so, read on - here is how to get your Business or Non-Profit qualified for the ERTC.

If your Business or Non-Profit has not evaluated the Employee Retention Tax Credit (ERTC), your Business or Non-Profit could be missing out on a lucrative government incentive program. The Employee Retention Tax Credit is the new, revised form of the PPP program. It is the Government's way to help businesses and tax-exempt organizations keep their doors open, maintain current employee levels, or incentivize the business to increase hiring during these troubled economic times.

This tax credit is a *Refundable Payroll Tax Credit* of up to \$26,000 per W2 employee! This means that a Business or Non-Profit that has 100 employees, could potentially get \$2,600,000 of these payroll tax credits refunded to them in cash! This government program funding is included in the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020, and the American Rescue Plan Act (ARPA) passed in 2021. Currently, there is \$80 Billion approved and allocated for funding the ERTC. The current period a business is eligible to receive the tax credit is from March 13, 2020 through September 30, 2021.

Two Ways to Qualify for the ERTC

Gross Receipts (Revenues) Test

If you have looked into this tax credit already, you are probably familiar with the first way to qualify. It is a test based on your Business or Non-Profit's Revenue decline, Quarter over Quarter, from 2019 to 2020, and from 2019 to 2021. The requirement to qualify under the Revenue Test for 2020 is a 50% decline in Revenues from 2019. The requirement to qualify under the Revenue Test for 2021 is a 20% decline in Revenues in 2021 compared to the comparable Revenues for the Quarter in 2019.

Most Business or Non-Profits may not qualify under the Revenue Test because they had increased revenues in 2020 and 2021. However, don't lose heart, as there is a Second way to qualify your Business or Non-Profit for the ERTC even though your Business or Non-Profit may have had increased revenues and profits in 2020 and 2021!

Government Orders Test

The second way to qualify your Business or Non-Profit for the ERTC is under the Government Orders Test. This is more of a Qualitative Test versus a Quantitative Test that the Revenue Test uses. The concept with the Government Orders test is to demonstrate that your Business or Non-Profit was negatively impacted by the various Government Orders imposed, which restricted Business or Non-Profit operations in 2020 and 2021, compared to the Business or Non-Profit's previous operations in the pre-COVID year of 2019. These Governmental Orders include orders from the Federal Government, or any State or Local Government that has jurisdiction over the Employer's operations. If such orders limit commerce, travel, or group meetings due to COVID-19 in a manner that affects an Employer's operation of its trade or business, the Employer is qualified for the ERTC.

The IRS clarifies this test in Code Section 3134. It speaks specifically as to the criteria for an Employer to be eligible for the ERTC:

I.R.C. § 3134(c)(2)(A)

"The term "eligible employer" means any employer which was carrying on a trade or business during the calendar quarter for which the credit is determined under subsection (a), and with respect to any calendar quarter, for which the operation of the trade or business described in clause (i) is 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 (COVID-19)."

The criteria for ERTC Qualification is not a "Both" qualification under the Revenues Test AND the Government Orders Test. It is an "OR" Qualification in that there are two ways to qualify. An entity can qualify for the ERTC if they qualify under the Revenue Test, "OR" they can qualify for ERTC using the Government Orders Test.

Many Businesses or Non-Profits have missed the Government Orders Test as a standard of qualification for the tax credit. This is a largely misunderstood qualification leading to many Businesses or Non-Profits being told that they did not qualify for the Employee Retention Tax Credit. This is not the case as many Businesses or Non-Profits do in-fact qualify for the ERTC and *are currently receiving the Employee Retention Tax Credit using the Government Orders Test* as a means to qualify for the ERTC.

Employee Count and Impact on the ERTC Calculation

The number of Full-Time Employees in 2019 is the Benchmark to determine if the Employer meets the definition of a Small or a Large Employer. This calculation is critical as it determines the Eligible Wage Calculation for the Employer for each year.

In 2019, an Employer with 100 or less Full-Time employees is considered a Small Employer for 2020. If in 2019, the Employer has up to 500 Full-time employees, the Employer will be treated as a Small Employer for the 2021 year.

The distinction between a Small and Large Employer for 2020 and 2021 is very important to the ERTC Calculation as it can amount to thousands of dollars of potential tax credits. Both Small and Large Employers qualify for the Employee Retention Tax Credit, however, the definition of Eligible Wages is different for each Category.

An Employer classified as a “Small Employer” for purposes of ERTC can take all Active Wages, Bonuses, and Paid Health Insurance to calculate the wage base to determine the tax credit. An Employer classified as a “Large Employer” for purposes of ERTC can take only wages that are considered “Non-Service” Wages. These wages are wages paid to employees for “Non-Active” work time. These wages may be “Idle-Time” paid (non-productive work time), bonuses not tied to work performance, and paid health insurance to calculate the wage base to determine the tax credit.

The difference between the tax credit a Small Employer receives, and the tax credit a Large Employer receives per employee can amount to \$20,000 or more per Employee.

It is important to be specific on this Full-Time headcount calculation as an Employer may mistakenly classify themselves as a Large Employer because they included Part-Time Employees as a “Full-Time Equivalent” (FTE) Calculation in the Employee Headcount - mistakenly moving them from a Small Employer classification to a Large Employer Classification. For purposes of determining if a business is counted as a Small or Large Employer it is based ONLY upon the Full-Time Employee Head Count in 2019 and does not include Part-Time employees in 2019 to calculate the Full-Time head count.

ERTC Payroll Tax Credit Calculation

For Small Employers

Here is the good part of the article - A Small Employer in 2020 (100 or less employees, counted as of 2019) can receive an Employee Retention Tax Credit of up to 50% of Wages, up to a maximum of \$10,000 of Qualified wages per employee, for the Year, regardless if they are a full or part-time employee. This amounts to a potential tax credit of \$5,000 per W2 employee for the 2020 year assuming the employee had \$10,000 of ERTC qualified wages in the year.

For 2021, a Small Employer (500 or less employees, counted as of 2019) can receive an Employee Retention Tax Credit of up to 70% of Wages, up to a maximum of \$10,000 of Qualified wages per employee, per Quarter, regardless if they are a full or part-time employee. This amounts to a potential tax credit of \$7,000 per W2 employee, per Quarter, for three Quarters in 2021, or \$21,000 per W2 Employee - assuming the employee had \$10,000 of ERTC qualified wages in each Quarter, for three Quarters in the 2021 year.

Small Employers can expect to get up to a \$26,000 payroll tax credit per W2 employee if they max out the wage base for those employees for both years. Since the Employer will already have paid the payroll taxes due for the quarters where the 941 is amended, the Employer will receive a refund check from the IRS for the overpayment of the payroll taxes! Amazing!

A Business or Non-Profit with 100 W2 Employees could potentially receive \$2,600,000 of payroll tax credits refunded to them in a form of a check!

For Large Employers

Businesses with more than 100 employees in 2020, or more than 500 employees in 2021 (Based on 2019 Full-Time Head Count) are still eligible for the Employee Retention Tax Credit. Since the Qualified Wages are defined as Non-Service Wages, the ERTC Credit is much less than the tax credit a Small Employer would receive. A typical Large Employer may receive between \$1,000 and \$2,000 per W2 Employee, depending on the amount of Non-Service wages and Health Insurance Benefits paid for the Employee.

For Large Employers, "Non-Active", or "Non-Service" wages are used for calculating the tax credit. These are wages that were not paid to an employee for Active work time. An example of this type of Non-Active Wage would be wages paid to Employees that were sent home with pay for being Quarantined, Covid Sick Pay, Wages paid for employees that got paid for 40 hours and they only worked a portion of the 40 hours during their work week (Idle Time), a general Bonus paid to all employees that was not tied to work performance, Vacation pay, Sick pay, and Health Insurance paid for employees where the employee was sent home without pay but the Company continued to pay the employee's health insurance premiums while they were not working.

The largest component of this "Non-Service" wage calculation is the "Idle Time." To determine Idle Time, a Labor Utilization Study is completed identifying the non-productive "Idle Time" that the employer paid. Doing the Labor Utilization study and calculating the Non-Active wages paid to employees can still amount to a significant tax credit amount for the Employer. An Employer with 1,000 Employees that gets approximately a \$2,000 tax credit per Employee, could re-coup \$2,000,000 in refundable payroll tax credits!

The "Hybrid" Employer

An important distinction to make for the "Large Employer" in 2020, where the Employee head count is more than 100, but for 2021 is still considered a "Small Employer" because they had less than 500 Full-Time employees in 2021. This Employer uses the Large Employer definition for "Non-Service Wages" for 2020, but will use "All Wages" paid to an Employee in 2021 as a Small Employer to calculate the tax credit for 2021.

Here is an example of this type of "Hybrid" situation: An Employer of 300 Employees in 2020 would receive the smaller tax credit of say \$600,000 (300 employees times a \$2,000 tax credit) for being a Large Employer in 2020, plus another \$6,300,000 (300 Employees times a \$21,000 tax credit) for being a Small Employer in 2021, for a total of \$6,900,000 of ERTC tax credits.

As you can see from the above examples, there is a *compelling financial interest* to re-evaluate your Business or Non-Profit's negative operational impacts from the COVID-19 Government Orders to see if your Business or Non-Profit can be qualified to receive the Employee Retention Tax Credit.

Timing in Applying for the ERTC Tax Credit

While the Employee Retention Tax Credit is funded for the period March 13, 2020 through September 30, 2021, there is no assurance that the US Congress will maintain the existing tax credit. This is evidenced by the fact that the ERTC was previously funded through December

31, 2021. The recent Infrastructure Bill that was passed into Law by Congress in November 2021, revoked funding for the ERTC for the 4th Quarter of 2021.

Additionally, the process of applying for the ERTC is done by Amending the Quarterly Payroll Returns for those quarters eligible for the ERTC. The typical timeframe to amend a 941 payroll return is three years from the date the original 941 was filed. However, the IRS recently extended the deadline under Rev. Rul. 2009-39 (citing IRC § 6501(b)(2)), the 3-year statute of limitations for payroll tax forms begins to run from April 15th of the year following the year that the payroll wages were paid. Keeping this in mind, the time limit to file for the 1st Quarter 2020 ERTC tax credit will run out by April 2024.

Conclusion

If your Business or Non-Profit received the PPP Funding, you know how beneficial these Government Incentive Programs are. The Employee Retention Tax Credit is an incredible opportunity to make a material financial impact on your Business or Non-Profit's operations with no restrictions on the use of the funds. Additionally, this is a Private Tax Credit, so there is no visibility by the Public that the entity received the ERTC funds. There is a limited time to claim the ERTC Credit. Contact Mark Reese, CPA to see if your Business or Non-Profit is eligible to qualify for these Payroll Tax Credits using the Government Orders approach.

Contact Information

Mark Reese, CPA is the Owner of the Reese CPA Firm in Eden Prairie, Minnesota. Mark specializes in the Employee Retention Tax Credit and works with Business and Non-Profits in helping them to get qualified for the Employee Retention Tax Credit. He can be reached by email at MarkReese@ReeseCPAFirm.com or by phone at (952) 451-3092.