

CORONAVIRUS RESOURCE CENTER

New IRS FAQs on CARES ACT Employee Retention Credit Answer Some Questions, Raise Others

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The IRS has issued new guidance in the form of FAQs that clarify a number of elements of the employee retention credit under the CARES Act. However, the FAQs also signal that the IRS may seek to curb employers' use of the credit in certain circumstances. Employers who anticipate using the tax credit should consider the impact of these FAQs on their situation, even though the IRS cautions that the FAQs may not be relied upon as legal authority.

Overview of the Employee Retention Credit

The CARES Act allows eligible employers to receive a fully refundable tax credit equal to 50% of up to \$10,000 of "qualified wages" paid between March 12 and December 31, 2020 to each qualified employee. To be eligible, an employer must have either: (a) suspended or partially suspended business due to government order (the "Suspension of Business Test"); or (b) a more than 50% reduction in gross receipts relative to same quarter in 2019 (the "Reduced Gross Receipts Test").

For employers with more than 100 full-time employees, qualified wages include only wages for the time employees are not providing services as a result of the Suspension of Business Test or Reduced Gross Receipts Test. The tax credit is not available for any eligible employer that has obtained a loan under the Paycheck Protection Program under the Small Business Act.

Key Takeaways

- An employer's eligibility to receive the tax credit is determined on an aggregated basis with all entities under common control (under a tax "single employer" test).
- The FAQs impose restrictions on qualifying for the Suspension of Business Test, and say that businesses that are not required to suspend operations may not qualify even if government orders requiring non-essential businesses to close or requiring customers to stay at home adversely effect operations. These employers may still qualify for the Reduced Gross Receipts Test.
- Essential businesses (and presumably other businesses too) that cannot procure goods or materials due to a governmental order that causes a supplier to suspend operations may qualify for the Suspension of Business Test even though the business itself is not suspended by a governmental order.
- Qualified wages do not include healthcare expenses paid for employees, unless those employees are paid other wages. As a result, there is no tax credit for healthcare coverage of furloughed employees who are not paid wages.

Specific Guidance

Determining Which Entities Are Considered a Single Employer under the Aggregation Rules

For determining an employer's eligibility for the tax credit, aggregation rules treat business entities under common control as a single employer. (Generally, entities are under common control if a parent entity owns more than 50% of the total value or voting power of the underlying entities or 80% of the vote or value of the entities are owned by five or fewer individuals, trusts or estates.)

The FAQs say that the aggregation rules apply to determine key issues of the tax credit:

- whether an employer meets the Suspension of Business Test;
- when an employer meets the Reduced Gross Receipts Test;
- whether an employer has more than 100 full-time employees; and

- whether an employer is precluded from receiving the tax credit due to receiving a loan under the Paycheck Protection Program under the Small Business Act.

For example, if one business entity within an aggregated group meets the Reduced Gross Receipts Test but the combined revenue of the aggregated group does not qualify for the Reduced Gross Receipts Test, no entity in the group can qualify for the tax credit under this test. Similarly, if one business entity within an aggregated group receives a loan under the Paycheck Protection Program, no entity in the aggregated group can qualify for the tax credit.

Comment: Notwithstanding the aggregation rule, if one business entity within an aggregated group meets the Suspension of Business Test, it will not be precluded from claiming the tax credit because, in this situation, the entire aggregated group is considered to have a partial suspension.

Comment: To determine eligibility for the credit over time, aggregated groups will have to monitor each of their controlled entities, and brother/sister companies, including as circumstances change, which can present logistical and informational challenges.

Comment: The FAQs do not address whether the controlling entity in a group must itself be engaged in a trade or business in order to be part of an aggregated group. This question has particular significance to portfolio companies of private equity funds and other financial sponsors.

Determining Eligibility to Receive the Employee Retention Credit under the Suspension of Business Test

Generally, an employer's business is considered to be fully or partially suspended if the business must close all or a portion of its workplace or reduce the hours of business operations due to a federal, state, or local governmental mandate.

- Under the approach of the FAQs, when the relevant government mandate is lifted, business operations will no longer be considered to be suspended, even if employees do not return to work for practical reasons.
- Generally, an employer is not eligible for this tax credit due to a voluntary closure (unless the employer satisfies the Reduced Gross Receipts Test). However, an employer whose business is limited by governmental order in certain states and chooses to employ a nationwide closure is considered to have partially suspended operations in all jurisdictions.

- The FAQs say that a loss of revenue resulting from COVID-19, by itself, may not be sufficient basis for this tax credit.
- Employers whose customers stay home due to a governmental mandate while the employer remains open are *not* eligible to receive the tax credit under the Suspension of Business Test *solely on this basis*.
- On the other hand, employers whose operations are suspended because their supply chains are impacted by a governmental order are eligible to receive the tax credit on this basis.
- The FAQs also say that employers that are able to continue operations *comparable* to before the governmental order through *telework* may not be eligible to receive the tax credit under the Suspension of Business Test, even though employees are less productive while teleworking.

Comment: The FAQs do not say how comparability would be determined, but based on JCT Guidance it appears that Congress intended that this type of analysis would be undertaken by looking at how various functions carried out by employees are affected.

- Although loss of productivity alone is not sufficient for a business suspension, the tax credit is available for a portion of salary paid to employees of a business that has less work because the business is closed. Employers may use any reasonable method to determine the number of hours worked (but not an assessment of productivity alone).

Comment: Employers that are not eligible to receive the credit under the Suspension of Business Test may still be eligible to receive the credit under the Reduced Gross Receipts Test.

Qualified Wages Will Not Always Include Health Care Expenses

- Qualified wages may also include expenses for providing and maintaining a group health plan, if the employer pays other wages to those employees. For an employer with more than 100 employees (taking into account aggregated affiliates), (i) the employer must pay other wages to those employees for the time they are furloughed and (ii) only the portion of the health care costs apportioned to the time those employees are furloughed are counted.

Comment: The FAQs provide an example of an employer with more than 100 employees that is subject to governmental order that partially suspends operations. In the example, the employer reduces employees' hours by 50% and wages by 40% and

continues to cover health plan expenses. In this case, the employer may treat as qualified wages (a) 10% of the wages it pays for employees (the wages for time they do not provide services) and (b) 50% of the health plan expenses (apportioned between the hours worked and not worked). If the employer reduced wages by 50%, no wages and no health plan expenses would count as qualified wages.

Other Considerations for Using the Employee Retention Credit

- Employers may obtain the benefit of the tax credit by offsetting any federal employment taxes otherwise required to be remitted to the IRS (including employment taxes withheld on behalf of employees). Alternatively, an employer may seek the benefit of the tax credit by filing for a refund with the IRS.
- Although this tax credit is not taxable income, an employer who uses it may not deduct the amount of covered qualified wages equal to the tax credit from its taxable income.

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Please do not hesitate to contact us with any questions.

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