Mar 8, 2021,02:46pm EST|18,584 views - Forbes

Employee Retention Credit: Top Ten Mistakes Of Business Owners And Their Advisors

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The Employee Retention Credit (ERC) is a tax credit first put in place last year as a temporary coronavirus-relief provision to assist businesses in keeping employees on payroll. Since then, the ERC has been significantly expanded – and in the most recent relief bill that will be sent to President Biden for signature – the ERC has been extended for all of 2021(see Note). Great news for both employers and employees.

Note: "The infrastructure legislation ends the employee retention credit (ERC) early, making wages paid after Sept. 30, 2021, ineligible for the credit (except for wages paid by an eligible recovery startup business)." – Journal of Accountancy

Congress – with the ERC – has provided billions of dollars in tax relief for businesses that are keeping employees on payroll. I've seen first-hand businesses receive tens and hundreds of thousands of dollars in tax credits for the ERC – providing a night-and-day difference for those struggling to keep employees on payroll and their doors open (and of course an incredibly meaningful benefit for those employees and their families who continue to receive a paycheck). Unfortunately I also see, in my work at alliantgroup, far too many business owners who are making mistakes as to whether their business qualifies for the ERC and how their business should properly document that they qualify for the ERC in order to pass muster with the IRS.

The Top Ten Mistakes and Misunderstandings Surrounding the ERC

1. I can't claim ERC if I've already claimed PPP (or gotten my PPP loans forgiven)

Now you can claim both! Congress, in the Consolidated Appropriations Act (CAA) of 2021, removed the limitation on only claiming one or the other. PPP will only account for 2.5 times your monthly payroll expenses and is meant to be spread out over 6 months. This leaves plenty of uncovered wage expenses for claiming ERC.

2. My business did not have a drop in gross receipts of 50% or more

The CAA has changed the qualifications so that a reduction of 20% now qualifies. BUT remember there is also another way to qualify for the ERC – if your business has been subject to a partial or full suspension due to a government order – see the next point

3. My business was not shut down during the pandemic

Even a partial suspension order by the government (federal, state or local) of your business could potentially qualify. For instance, a partial shutdown, a disruption in your business, inability to access equipment, having limited capacity, shutdowns of your supply chain or vendors, reduction in services offered, reduction of hours to accommodate sanitation, shut down of some locations and not others, and shutdowns of some members of a business are all scenarios that still potentially qualify for the ERC. The key considerations are – due to the government ordered partial (or full) suspension is/was your business *not* able to continue its activities in a comparable manner, and did that result in a more than nominal impact on business operations. Remember, the partial or full suspension is an alternative way to qualify for the ERC — separate from the reduction in gross receipts test.

4. My company was deemed an essential business, so I do not qualify because of business suspension

Even if your business is deemed essential, an impact or change in your business may still qualify you. For example, even if you were open but your vendors were closed down or you can't go to a client's job site, you may still qualify. Or alternatively, if part of your business was considered non-essential and was impacted by a government-ordered suspension – you may also qualify. The scenarios discussed above in *Mistake 3* could apply here as well.

5. My company has grown during quarantine; this isn't something I should take

Great news! If your company has grown during quarantine, but experienced a full or partial suspension, there are expenses that may qualify.

6. Sales have rebounded for us in Q1 of 2021, I can't qualify for this credit

With the introduction of the CAA, you have the option to look at one quarter prior to determine qualification. This means we can determine eligibility based on lost revenue in 2020. Also, if you were subject to a full or partial suspension, you may qualify regardless.

7. We were in losses, or do not have any tax liability

This is a refundable credit. In practice, this means that any credit overage above tax liability is sent to the taxpayer/business owner as a refund.

8. My company has grown to over 500 employees, so we are not eligible for the ERC

The employee count restriction is based on full time equivalent (FTE) employees, which is a more involved calculation than just counting everyone in the office. We helped a business with 640 employees and the FTE calculation put them at under 500. Furthermore, if you paid any employees to NOT work, or to work less than the hours for which they were paid, then the employee count restriction *would not apply* for those employees.

9. I'm a charity and the ERC is only for businesses

The ERC also may provide significant benefit to charities – churches, nonprofit hospitals, museums, etc. Charities can be particularly good candidates for the ERC.

The Tenth Mistake – Failure to Document – The Taxman Cometh

The ERC is a refundable tax credit – providing robust benefits. If you had to draw up a tax provision that makes the IRS lie awake at night – it would be a refundable tax credit involving real dollars. I am blinked at the number of businesses – and their tax advisors – I see who believe that they can just create their own simple form, check a few boxes and the IRS will whistle a happy tune. As my drill sergeant would say (often) – "You are doing it wrong."

While the ERC is certainly a taxpayer-friendly relief provision – the IRS is not just giving dollars away (looking at taxpayer submissions both on the front-end and then auditing down the road). In talking with the former senior IRS officials I work closely with at alliantgroup, it is clear that the best practice is for business to provide contemporaneous documentation now – when first determining whether they qualify. To avoid headaches and heartaches down the road – businesses need to have counsel to properly and fully document and paper how the business qualifies for the ERC.

Business owners need to be eyes open as to whether their company qualifies for the ERC (and not miss out on this terrific tax incentive); and, also eyes open on ensuring that their business crosses “t’s” and dot “i’s” to make sure that the IRS is in a happy place. Good opportunities.