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KPMG report: JCT description of employee retention credit, payroll deferral provisions in CARES Act

The staff of the Joint Committee on Taxation (JCT) on April 22, 2020, released its description of the tax provisions of the “Coronavirus Aid, Relief, and Economic Security Act” (CARES Act) (Pub. L. No. 116-136) enacted March 27, 2020. Among other provisions, JCT described the employee retention credit (ERC) and the payroll deferral, with additional narrative and examples that are helpful to taxpayers considering the provisions, as well as Treasury in constructing related guidance.

KPMG observation

Additional guidance, possibly as “frequently asked questions” (FAQs) are expected from Treasury. The JCT publication is a “description” and not the release of a general explanation (i.e., a Blue Book), which qualifies as authority under section 6662 for purposes of establishing a “substantial authority” position and accuracy-related relief rules.

Read the JCT description: [JCX-12R-20](#)

The following discussion examines provisions as described by the JCT.

Employee retention credit

The CARES Act provides a refundable payroll tax credit for 50% of “qualified wages” paid by eligible employers to employees.

Eligible employer: Eligibility is determined quarterly and an employer is eligible for the ERC for a given quarter if either (an “or” test) of the following occurred/occurs:

- The employer was carrying on a trade or business during the quarter, and the operation of the employer’s trade or business is/was 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 COVID-19.

- The employer was carrying on a trade or business during the quarter, and the employer's gross receipts for the quarter are less than 50% of gross receipts for the same calendar quarter in the prior year. Such qualification ends on the first day of the first calendar quarter following the calendar quarter in which gross receipts are more than 80% of its gross receipts for the same calendar quarter in 2019.

Qualified wages: The definition of qualified wages depends on how many full-time employees an eligible employer had in 2019.

- If an employer averaged more than 100 full-time employees during 2019, qualified wages are generally those wages, including certain health care costs, (up to \$10,000 per employee) paid to employees for time not providing services because the business was fully or partially suspended or due to the decline in gross receipts.
- If an employer averaged 100 or fewer full-time employees during 2019, qualified wages are those wages, including certain health care costs, (up to \$10,000 per employee) paid to any employee during the period that operations of the applicable trade or business were suspended or the period of the decline in gross receipts, regardless of whether or not its employees are providing services.

Average number of full-time employees is determined based on 2019 under section 4980H rules. The section 4980H shared responsibility rules under the Affordable Care Act provide that a full-time employee includes an employee that who is employed on average at least 30 hours per week.

JCT descriptions address the employee retention credit application and terminology in several ways, including, but not limited to the following:

Partial suspension

An employer can be an eligible employer if there is a partial suspension due to a government order. The JCT description provides several examples of a partial suspension, including:

- A restaurant in a state under a statewide order that only allows take-out.
- A concert venue in a state under a statewide order limiting closed gatherings to no more than 10 people.
- An accounting firm in a county where accounting firms are among the businesses subject to a directive from a public health authorities to cease all activities other than minimum basic operations and closes its offices and that does not require employees who cannot work from home to work (e.g., mail room employees, custodial employees).

The JCT description provides an example of a business that is **not** subject to a partial suspension. The description provides that a grocery store in a state that imposes limitations on food service, gathering size, and travel outside the home, but exempts grocery stores (and travel to and from grocery stores) would not meet the government suspension test.

Reduction in gross receipts

An employer can be an eligible employer if it meets a significant decline in gross receipts. The JCT report provides an example of how this test is applied. If an employer had gross receipts of \$100 in each calendar quarter of 2019 and then had gross receipts in each quarter of 2020 for \$100, \$40, \$90, and \$100, the employer would be an eligible employer for both the second and third quarter.

Section 501(c) organizations

The JCT description clarifies that a section 501(c) organizations may qualify as an eligible employer under either the government suspension test or the gross receipts test. All operations of the organization are considered in applying the government order test, and not merely those which are treated as a trade or business.

Qualified wages

The JCT discussion points out that controlled group rules apply to treat entities as one employer for this purpose and provides several examples of qualified wages for an employer with more than 100 employees, including:

- A restaurant only required employees to work 15 hours per week, but still continues to pay for 40 hours per week. The 25 hours for not providing services are qualified wages.
- An accounting firm closes its office and does not require custodial and mail room employees to work but continues to pay them their full salaries, wages paid to custodial and mail room employees for the time they do not work are qualified wages.
- An accounting firm continues to pay administrative assistants their full salaries but only required them to work two days per week on a rotating schedule reflecting reduced demand for assistance resulting from the office closure, the portion of an administrative assistant's salary attributable to days not worked is qualified wages.

The JCT description provides that wages cannot be changed to increase qualified wages. An employer cannot reduce wages to an hourly employee when they are working and then increase the hourly rate for hours the employee is not working. For example, an hourly employee makes \$15 per hour prior to receiving qualified wages. An employer could not pay \$10 for wages while working, but \$20 for qualified wages when not working. Further, the employer could not increase wages to \$20 for all nonworking hours for 40 hours per week.

The JCT description provides an example for employers with 100 or less employees.

- Restaurant employees who used to work 40 hours are now reduced to 15 hours, but are still paid for 40 hours. All 40 hours are qualified wages. However, if employees are only being paid for 15 hours, then only those 15 hours are qualified wages.

Qualified health expenses

The CARES Act provided that the term qualified wages includes qualified health expenses allocated to qualified wages. Qualified health expenses are allocated to qualified wages in a manner to be determined by Treasury. The JCT description provides that this broad grant of authority permits Treasury to treat health plan expenses as qualified wages even if there are no other qualified wages paid by the eligible employer or to that particular employee. Therefore, Treasury could provide guidance allowing health care expenses to be treated as a qualifying wage even if no other qualifying wages are paid.

Payments to relatives

A taxpayer claiming a credit is subject to rules similar to section 51(i)(1) providing that certain individuals are ineligible to be treated as employees. Therefore, the JCT description provides that an employee retention credit may not be generated by an individual employer hiring his or her children.

Employer deduction

The JCT description provides that an employer cannot take a deduction for wages equal to the amount of the credit. The JCT description provides an example:

- An employer has \$2,500 of qualified wages and receives credit for \$1,250. The employer's social security liability for the quarter is \$155. The employer may deduct \$1,405. The calculation for deduction is $\$2,500 - (\$1,250 - \$155) = \$1,405$.

Payroll tax deferral

The CARES Act allows employers to defer the deposit and payment of the employer's share of social security taxes that are otherwise required to be made during the period beginning on March 27, 2020, and ending on December 31, 2020, without incurring failure to deposit and failure to pay penalties. Railroad employers may defer payment of their share and the employee representative's share of "Tier 1" taxes attributable to the tax rate for the employer portion of social security.

The provision also allows individuals to defer payment of 50% of the social security tax on net earnings from self-employment income otherwise due during the same period. These amounts are not used to calculate the estimated tax due.

The JCT description provides that the payment is treated as made timely if paid by the applicable date. Half of the applicable employment taxes is required to be deposited on or before December 31, 2021, and the remaining portion on or before December 31, 2022. For SECA tax purposes, the 50% tax liability is not treated as taxes requiring estimated tax payment until the applicable due dates.

The JCT description provides that in order to be eligible to defer deposit of the applicable employment taxes, the employer or self-employed person may not have had indebtedness forgiven under the Small Business Administration loan provisions of the CARES Act.

The JCT description provides that so long as the employer directs the 3504 agent designated to perform the employment tax obligations to defer payment of the employment taxes during the payroll tax deferral period, the employer is solely liable.

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