KPMG

Initial impressions of additional FAQs on the employee retention credit (COVID-19)

April 30, 2020

The IRS on April 29, 2020, released additional **"frequently asked questions" (FAQs)** on the employee retention credit (ERC) provided by the "Coronavirus Aid, Relief, and Economic Security Act" (CARES Act) (Pub. L. No. 116-136).

Background

The ERC is a refundable payroll credit of 50% of qualified wages paid by eligible employers whose business has been affected by COVID-19. Qualified wages are limited to $10,000 of compensation, including health benefits, paid to each employee. Thus, the maximum credit is $5,000 (50% x $10,000) per employee.

The IRS on March 31, 2020, released an initial set of FAQs concerning the employee retention credit. Read ***TaxNewsFlash***

The Senate Finance Committee also on March 31, 2020, released a set of 12 FAQs on the employee retention credit. Read ***TaxNewsFlash***

New FAQs

The new **FAQs** include dozens of questions and answers regarding the ERC under the CARES Act. The FAQs also include this statement:

> *This FAQ is not included in the Internal Revenue Bulletin, and therefore may not be relied upon as legal authority. This means that the information cannot be used to support a legal argument in a court case.*

The Joint Committee on Taxation (JCT) previously released a non-binding description of the CARES Act. Read ***TaxNewsFlash***. The current IRS FAQs are also non-binding, as such FAQs have not been published in the Internal Revenue Bulletin as legal authority. However, the IRS is responsible for enforcing the ERC and such future enforcement will likely be consistent with the FAQs.

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 of 80% of its gross receipts for the same calendar

quarter in 2019.

Aggregation rules

For purposes of the ERC, certain related entities must be aggregated and treated as a single employer.

Specifically, all entities that are (1) members of a controlled group of corporations or (2) a group of entities under common control under section 52(a) or (b) rules; or that are (3) members of an affiliated service group under section 414(m), or (4) otherwise aggregated under section 414(o) are treated as a single employer for the following purposes of the ERC—

- Determining whether the employer has a trade or business operation that was fully or partially suspended due to orders related to COVID-19 from an appropriate governmental authority.
- Determining whether the employer has a significant decline in gross receipts.
- Determining whether the employer has more than 100 full-time employees.
- Application of the rules that preclude an employer from claiming the ERC if any member of the aggregated group received a Paycheck Protection Program (PPP) loan under the CARES Act and under the Small Business Act.

Suspension due to governmental order

An employer is treated as an eligible employer if its operations are fully or partially suspended during a 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. Orders from the federal government, or any state or local government, are considered orders from an appropriate governmental authority if the orders limit commerce, travel or group meetings due to COVID-19 affecting an employer's operation of its trade or business, including orders that limit hours of operation. The orders must be from the state or local government with jurisdiction over the employer's operations.

Statements from government officials made during press conferences and interviews with media are not governmental orders for purposes of the ERC. State of emergency declarations are not governmental orders unless the declaration limits commerce, travel or group meetings. In addition, a declaration limiting commerce, travel or group meetings, but that does not affect the employer's operation of its trade or business is not a governmental order for purposes of the ERC.

The FAQs provide that governmental orders include:

- An order from the city's mayor stating that all non-essential businesses must close for a specified period;
- A state's emergency proclamation that residents must shelter in place for a specified period, other than residents who are employed by an essential business and may travel to and work at the workplace location;

- An order from a local official imposing a curfew on residents that impacts the operating hours of a trade or business for a specified period.

An employer that voluntarily suspends operation while not subject to a governmental order is not an eligible employer.

KPMG observation

This view of voluntary suspension may present an issue for businesses that voluntarily close for location clean-up due to a COVID-19-related discovery and continue to pay employees during such suspension of operations.

An employer that operates an essential business is not considered to have a full or partial suspension of operations if the governmental order allows the employer to remain open, even if the order requiring non-essential businesses to close may have an effect on the operations.

The FAQs put a lot of weight on the term "essential business," which in and of itself is not within the CARES Act. In particular, the FAQs provide that if a governmental order causes the suppliers to an essential business to suspend operations, the essential business may be considered to have a partial suspension. The facts and circumstances need to provide that the operations of the essential business are fully or partially suspended because of the inability to obtain critical goods or materials from its suppliers that were required to suspend operation. The essential business would be considered an eligible employer for the ERC.

The following examples are provided in the FAQs.

> **Q/A 31 Example:** Employer A operates an auto parts manufacturing business that is considered an essential trade or business in the jurisdiction where it operates. Employer A's supplier of raw materials is required to shut down its operations due to a governmental order. Employer A is unable to procure these raw materials from an alternate supplier. As a consequence of the suspension of Employer A's supplier, Employer A is not able to perform its operations. Under these facts and circumstances, Employer A would be considered an Eligible Employer because its operations have been suspended as a result of the governmental order that suspended operations of its supplier.

If a governmental order keeps customers at home and the customers do not patronize the essential business, this is not considered a suspension of the operations. An employer that operates an essential business that is not required to close its physical locations or suspend operations is not under a full or partial suspension because of a governmental order.

If a governmental order requires an employer to close its workplace, but the employer is able to continue operations **comparable to** its operations prior to the closure because employees are required to telework, the employer has not had a full or partial suspension because of the governmental order.

> **Q/A 32 Example:** Employer C, a software development company maintains an office in a city where the mayor has ordered that only essential businesses may operate. Employer C's business is not essential under the mayor's order and must close its office. Prior to the order, all employees at the company teleworked once or twice per week, and business meetings were held at various locations. Following the order, the company ordered mandatory telework for all employees and limited client meetings to telephone or video conferences. Employer C's

business operations are not considered to be fully or partially suspended by the governmental order because its employees may continue to conduct its business operations by teleworking.

Naturally, there may be some debate regarding the meaning and application of the "comparable to" language pulled into this analysis.

If an employer is closed by a governmental order for only certain purposes, but may remain open for other purposes or is able to continue work remotely, the employer is partially suspended.

> **Q/A/ 34 Example 1:** Employer D, a restaurant business, must close its restaurant locations to in-room dining due to a governmental order closing all restaurants, bars, and similar establishments for sit-down service. Employer D is allowed to continue food or beverage sales to the public on a carry-out, drive-through, or delivery basis. Employer D's business operations are considered to be partially suspended due to the governmental order closing all restaurants, bars, and similar establishments to sit-down service.
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> **Q/A/ 34 Example 2:** Employer E, a retail business, is forced to close its retail storefront locations due to a governmental order. The retail business also maintains a website through which it continues to fulfill online orders; the retailer's online ordering and fulfillment system is unaffected by the governmental order. Employer E's business operations would be considered to have been partially suspended due to the governmental order requiring it to close its retail store locations.

An employer forced to reduce operating hours due to a governmental order is considered to have partially suspended operations.

The FAQs provide that an employer with a trade or business in multiple locations with some jurisdictions limiting operations, but not all jurisdictions, is still considered to have a partial suspension of operations. An employer may choose to operate in a consistent manner in all jurisdictions and adopt a policy that complies with local orders, as well as Centers for Disease Control and Prevention (CDC) recommendations and Department of Homeland Security (DHS) guidance. The employer may not be subject to a governmental order to suspend operations of its trade or business in all jurisdictions, but is still considered to have partial suspension and would be an eligible employer for all its operations in all locations.

> **Q/A 36 Example:** Employer F is a national retail store chain with operations in every state in the United States. In some jurisdictions, Employer F is subject to a governmental order to close its stores, but it is permitted to provide customers with curbside service to pick up items ordered online or by phone. In other jurisdictions, Employer F is not subject to any governmental order to close its stores or is considered an essential business permitting its stores to remain open. Employer F establishes a company-wide policy, in compliance with the local governmental orders and consistent with the CDC and DHS recommendations and guidance, requiring the closure of all stores and operating with curbside pick-up only, even in those jurisdictions where the business was not subject to a governmental order. As a result of the governmental orders requiring closure of Employer F's stores in certain jurisdictions, Employer F has a partial suspension of operations of its trade or business. The partial suspension results in Employer F being an Eligible Employer nationwide.

KPMG observation

Compliance with CDC guidelines, etc., appears to be an available trigger only once there are other governmental orders impacting a business.

The FAQs provide that all members of an aggregated group are treated as a single employer for the ERC. If a trade or business is operated by multiple members of the aggregated group and one member is partially suspended by a governmental order, all members of the group are considered to have their operations partially suspended even if not subject to that governmental order.

> **Q/A 37 Example:** Employer Group G is a restaurant chain that operates a single trade or business through multiple subsidiary corporations located in various jurisdictions. Certain members of Employer Group G's operations are closed by a governmental order, while other members of Employer Group G's operations remain open. As a result of a governmental order causing the suspension of operations of certain of Employer Group G members, the operations of all members of Employer Group G's controlled group of corporations are treated as partially suspended due to the governmental order.

The FAQs specify that an employer that was subject to a governmental order causing partial suspension, but the order is lifted, is only subject to the partial suspension for the period of the order. A credit for wages can be only be claimed for wages paid during the period the order was in force.

Significant decline in gross receipts

An employer can be an eligible employer for the ERC if its gross receipts were less than 50% of its gross receipts for the same calendar quarter in 2019. Gross receipts has the same meaning as used in section 448(c). Gross receipts means gross receipts of the tax year and include total sales (net of returns and allowance) and all amounts received for services. Gross receipts include any income from investments and incidental or outside sources. Gross receipts can include interest, dividends, rents, royalties, and annuities. Gross receipts are generally not reduced by cost of goods sold, but are reduced by the taxpayer's adjusted basis in capital assets sold. Gross receipts do not include the repayment of a loan or the amount received for sales tax if the tax is legally imposed on the purchaser of the good or service, and the taxpayer merely collects and remits the sales tax to the taxing authority.

The significant decline in gross receipts does not need to be related to COVID-19. Employers need to maintain records for relevant calendar quarters in 2019 and 2020 to document significant decline in gross receipts. Records should be available to the IRS for at least four years.

If an employer started a business in the second quarter of 2019, it should use that quarter as the base period for determining whether it experiences a significant decline in gross receipts for the first two quarters of 2020. However, the company would use the third and fourth quarter of 2019 to compare to the third and fourth quarter of 2020.

An employer that acquires a trade or business during 2020 is required to include the gross receipts from the acquired business in its gross receipts computation for each calendar quarter that it owns and operates the acquired business. Solely for purpose of the ERC, when the employer compares the 2020 calendar quarter to 2019, if the information is available, the employer may include the gross receipts of the acquired business in its gross receipts from the 2019 calendar quarter. The FAQs provide this safe harbor even though the employer did not own the acquired business during 2019. If an employer uses this safe harbor and the business was acquired for only a portion of a quarter, the employer must estimate the gross receipts for the full quarter. However, if an employer does not use this safe harbor,

the gross receipts only need to be included for the portion of the quarter during which the business was acquired.

KPMG observation

The FAQs often reference the gross receipts test in situations where the eligible employer definition appears to be narrowly interpreted. Unfortunately, many businesses may not have the wherewithal to continue operating at a gross receipt reduction exceeding 50% and such a trigger is less likely to see practical utilization than a governmental orders suspension that could benefit a business with an ERC before it is forced to cease all operations.

Qualified wages

Qualified wages are wages (determined without regard to the contribution and benefits base) paid by an eligible employer after March 12, 2020, and before January 2, 2021. For eligible employers with more than 100 full-time employees in 2019, qualified wages are wages paid to an employee for time that the employee is not providing services (1) due to either a full or partial suspension of the employer's business due to a governmental order, or (2) the business experiences a significant decline in gross receipts. In this manner, qualified wages relate back to the employer eligibility. For eligible employers with 100 or fewer employees in 2019, qualified wages are wages paid to any employee during any period of the calendar quarter in which the business operations are fully or partially suspended due to governmental order or any calendar quarter the business is experiencing a significant decline in gross receipts.

A "full-time employee" is an employee who, during any calendar month in 2019, had an average of at least 30 hours of service per week or 130 hours of service in the month as determined under section 4980H. If an employer operated its business for the entire 2019 calendar year, the number of full time employees is determined by taking the sum of the number of full-time employees in each calendar month in 2019 and dividing by 12.

An employer that started business in 2020 uses the same approach except the determination is based on full-time employees during the 2020 calendar months.

KPMG observation

The FAQs do not specify the need to determine full-time equivalent employees as provided in the JCT description.

An eligible employer with more than 100 employees in 2019 cannot treat all wages paid to employees as qualified wages. Only the wages paid to employees after March 12, 2020, through December 31, 2020, for the time the employees were not providing services during a quarter in which the business is fully or partially suspended due to governmental order or in which the employer had a significant decline in gross receipts are treated as qualified wages. The FAQs provide two examples on this point.

> **Q/A 51 Example 1:** Employer Q, a local chain of full service restaurants in State X that averaged more than 100 full-time employees in 2019, is subject to a governmental order for restaurants to

discontinue sit-down service to customers inside the restaurant, but may continue food or beverage sales to the public on a carry-out, drive-through, or delivery basis. Employer Q continues to pay wages to kitchen staff and certain wait staff needed to facilitate fulfillment of carry-out orders. Wages paid to these employees for the time that they provide carry-out service are not qualified wages.

Q/A 51 Example 2: Employer R averaged more than 100 full-time employees in 2019 and was forced to suspend operations at the end of the first calendar quarter in 2020. Its employees performed services during the first part of the calendar quarter but then stopped due to the suspension of operations; however, Employer R continued to pay the employees' normal wages for the entire quarter, including the period during which they were not providing services. The wages paid during the period when employees were not providing services are qualified wages.

The FAQs provide an example showing that if wages are increased during the period the employees are not providing services, the increase in wage is not treated as a qualified wage.

Q/A 53 Example: Employer S, a grocery store chain that averaged more than 100 full-time employees in 2019, is subject to a governmental order limiting store hours. In response, Employer S has reduced the hours the employees work, but in order to incentivize those employees who continue to provide services, the employer increases the employees' rate of pay by $1 an hour. Only the amounts paid to employees for time they are not providing services, and at the rate of pay in effect prior to the increase, would be considered qualified wages.

The FAQs provide an employer that averaged more than 100 employees in 2019 may treat wages paid to hourly and non-exempt salaried workers for not providing services as qualified wages for the ERC. If an employee does not have a fixed schedule of work, the hours for which the employees did not provide services may be determined using any reasonable method. The method used for determining entitlement to leave under the FMLA (Family Medical Leave Act) is a reasonable method. Also, the method for determining the number of hours an employee with an irregular schedule is entitled to paid sick leave under the FFCRA (Families First Coronavirus Response Act) is a reasonable method.

Q/A 54 Example 1: Employer T, a manufacturing business, that averaged more than 100 full-time employees in 2019, has several locations that are closed during the second quarter of 2020 due to a governmental order. Employer T continues to pay hourly employees who are not providing services at the closed locations 50% of their normal hourly wage rates. Employer T also reduced headquarters' administrative staff hours by 40%, but continues to pay them at 100% of their normal hourly wage rates. For employees who are not providing services due to the closure of their location, but are receiving 50% of their normal hourly wage rates, Employer T may treat the wages paid as qualified wages for purposes of the ERC. For the administrative staff whose hours were reduced by 40%, but who are paid for 100% of the normal wage rate, Employer T may treat the 40% of wages paid for time that these employees are not providing services as qualified wages for purposes of the ERC. The 60% of wages that Employer T pays the administrative staff for hours during which the employees are actually providing services are not considered qualified wages for purposes of the ERC.

Q/A 54 Example 2: Employer U, in the business of staging homes that are for sale, averaged more than 100 full-time employees in 2019. Employer U's non-exempt salaried employees cannot perform their usual services of delivering and installing furniture to be used in staging houses because open houses are prohibited in its service area during the second quarter of 2020. However, the employees are required to provide Employer U with periodic status updates about furniture that has been leased out and other administrative matters. Employer U continues to pay wages to employees at their normal rates even though the employees cannot provide

their normal services. Employer U has determined that its employees are working 20% of the time. Employer U is entitled to treat 80% of the wages paid as qualified wages and claim an ERC for 80% of the wages paid.

An eligible employer that averaged more than 100 full-time employees during 2019 is eligible for the ERC for wages paid to exempt salaried employees for time they are not providing services. An eligible employer may use any reasonable method to determine the number of hours that a salaried employee is not providing services, but still receives wages either at the employee's normal wage rate or at a reduced wage rate. The FAQs provide that a reasonable method includes the method the employer uses to measure exempt employees' entitlement to leave on an intermittent or reduced leave schedule under the FMLA, or the method the employer uses to measure exempt employees' entitlement to and usage of paid leave under the employer's usual practices. However, the FAQs specify that it is not a reasonable method to treat an employee's hours as having been reduced based on an assessment of the employee's productivity levels during the hours the employee is working. The FAQs provide two examples.

Q/A 55 Example 1: Employer V, a large fitness club business that employed an average of more than 100 full-time employees in 2019, closed all of its locations in City B by order of City B's mayor. Employer V continues to pay its exempt managerial employees their regular salaries. While the clubs are closed and there is not sufficient administrative work to occupy the managerial employees full-time, they continue to perform some accounting and similar administrative functions. Employer V has determined, based on the time records maintained by employees, that they are providing services for 10% of their typical work hours. In this case, 90% of wages paid to these employees during the period the clubs were closed are qualified wages.

Q/A 55 Example 2: Employer W, a large consulting firm that employed an average of more than 100 full-time employees in 2019, closed its offices due to various governmental orders and required all employees to telework. Although Employer W believes that some of its employees may not be as productive while working remotely, employees are working their normal business hours. Because employees' work hours have not changed, no portion of the wages paid to the employees by Employer W are qualified wages.

Accrued leave or payment to former employees

The FAQs provide that an employer with more than 100 employees in 2019 may not treat amounts paid to employees for paid time off for vacations, holidays, sick days, and other days off as qualified wages. These wages are paid pursuant to existing leave policies as were accrued by employees previously when services were being provided. This is not wages paid for time when the employee is not providing services. However, the treatment is different for an employer with 100 or fewer employees during 2019. Since all wages paid to employees during the full or partial suspension or during a quarter with a significant decline in gross receipts are qualified wages for employers with 100 or fewer employees, the accrued leave paid to these employees is a qualified wage.

The FAQs provide that payment made to former employees following termination, including severance payments, are not qualified wages for the ERC. Payments may be considered qualified wages only if the payments are made to an employee who continues to be employed by the eligible employer. Similar to the accrued leave, severance is considered paid for the past employment relationship and not attributable to time when the ERC is available. Determining whether employment has been terminated is based on facts and circumstances. One fact to consider is whether the employer has treated the employment relationship as terminated for purposes other than the continuation of wage payments.

Related individuals

The FAQs specify that qualified wages do not include wages paid to related individuals under section 51(i)(1) which includes an employee who is related to the employer as:

- A child or a descendant of a child;
- A brother, sister, stepbrother, or stepsister;
- The father or mother, or an ancestor of either;
- A stepfather or stepmother;
- A niece or nephew;
- An aunt or uncle;
- A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

Qualified health plan expenses

The FAQs provide that qualified health plan expenses are qualified wages, but only to the extent that the expenses are allocable to the hours for which the employees received other qualified wages. If an eligible employer lays off or furloughs its employees and continues the employees' health care coverage, but does not pay any wages for not providing services, the health plan expenses are not qualified wages for the ERC. If an employer does not pay an employee for not providing services, no portion of health expenses are treated as qualified wages. The FAQs provide two examples applying this analysis.

> **Q/A 66 Example 1:** Employer B averaged more than 100 full-time employees in 2019. Employer B is subject to a governmental order that partially suspends the operations of its trade or business. In response to the order, Employer B reduces its employees' hours by 50%, but it reduces its employees' wages by only 40%, so that the employees receive 60% of their wages for 50% of the normal hours. Employer B continues to cover 100% of the employees' health plan expenses. In this case, Employer X may treat as qualified wages: (i) the 10% of the wages that it pays employees for time the employees are not providing services, plus (ii) 50% of the health plan expenses, because the health plan expenses are allocable to the time that employees were not providing services.
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> **Q/A 66 Example 2:** Employer C is subject to a governmental order that fully suspends the operations of its trade or business. Employer C furloughs its employees but continues to pay 25% of the employees' wages. Employer C continues to cover 100% of the employees' health plan expenses. In this case, Employer C may treat as qualified wages: (i) the 25% of wages that it pays its employees for time the furloughed employees are not providing services, plus (ii) the 100% of the health plan expenses that are allocable to the time that the employees are not providing services.

KPMG observation

The JCT description provided that the Treasury and IRS had the authority to allow health plan expenses to be treated as qualified wages for furloughed employees not receiving other wages. However, the FAQs do not view health expenses as qualified wages if there are no other wages

being paid for not providing services.

Calculation of the amount of health plan expenses appears to mirror the determination made for such expenses under the emergency sick leave and extended FMLA provisions under the FAQs released for the Families First Coronavirus Relief Act. An eligible employer with a fully insured plan may use any reasonable method, including:

- The COBRA applicable premium for the employee typically available from the insurer,
- One average premium rate for all employees, or
- A substantially similar method that takes into account the average premium rate determined separately for employees with self-only and other than self-only coverage.

An eligible employer with a self-insured plan may use any reasonable method to allocate expenses, including:

- The COBRA applicable premium for the employee typically available from the administrator, or
- Any reasonable actuarial method to determine the estimated annual expenses of the plan.

Qualified health plan expense may include contributions to a health reimbursement account or a health flexible savings account (FSA), but does not include contributions to a qualified small employer health reimbursement arrangement. Further, the qualified health plan expenses do not include employer contributions to a health savings account or Archer Medical Savings Account.

Interaction with Paycheck Protection Program (PPP)

An employer that receives a PPP loan cannot receive the ERC, regardless of the date of the loan. An employer that is treated as a single employer under the ERC aggregation rules may not receive the ERC if any member of the aggregated group receives the PPP loan.

KPMG observation

The FAQs did not provide guidance addressing application of the ERC in situations where employers immediately returned or paid back PPP related loans.

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