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IRS provides official guidance on employee retention credit and PPP loans

The IRS issued a whopping 94 FAQs on its website regarding the employee retention credit — and you can't rely on any of them if it questions your payroll practices in an audit. The IRS has now fixed this glitch in a new notice. The guidance, which incorporates those FAQs, also fills in crucial details on certain aspects of the employee retention credit, including its interaction with loans under the Paycheck Protection Program.

The guidance covers the employee retention credit through Dec. 31, 2020. However, it doesn't cover changes made by the Consolidated Appropriations Act, although many of the issues are the same. The 2021 issues will be addressed later.

Like the FAQs, the IRS presents its guidance in question and answer form. Below, we look at some of the key highlights and what they mean for businesses.

What counts as a full or partial suspension of operations of an essential business, if employers operate both essential and nonessential businesses?

Original FAQ 30, which is now FAQ 11, considers a full or partial suspension of an essential business to occur if a government order suspending business operations hits more than a nominal amount of an employer's business.

New FAQ 11 defines *more than a nominal amount of business* as:

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- When the essential business's gross receipts are at least 10% lower than total gross receipts, when compared to gross receipts for the same calendar quarter in 2019, or
- When employees' work hours in the essential business are at least 10% lower than the total number of work hours performed by all employees, when compared to work hours in the same calendar quarter in 2019.

What factors go into determining whether an employer has experienced a complete or partial shutdown?

Original FAQ 33 asked whether an employer experiences a complete or partial shutdown if employees can telecommute. The answer was no, if the new arrangement is comparable to employees' pre-pandemic work.

New FAQ 16 specifies the factors to be considered in determining whether an employer's business operations are continuing in a comparable fashion:

- The employer's WFH capabilities
- The portability of employees' work
- Whether employees need to be at the office
- The transition to telecommuting, when working from home wasn't allowed pre-pandemic. *IRS:* If there's a significant delay (e.g., beyond two weeks) in moving operations to comparable telecommuting, including implementing telecommuting policies or providing employees with equipment, business operations may be considered subject to a partial suspension during the transition period.

Similarly, under old FAQ 34, employers' workplace modifications, like adding a drive-through window, wouldn't trigger a complete or partial shutdown, unless those modifications were more than nominal.

New FAQ 18 describes what *more than nominal* means:

- Limiting occupancy to provide for social distancing
- Requiring services to be performed only on an appointment basis (for businesses that previously offered walk-in service)
- Changing the format of service (e.g., restrictions on buffet or self-serve, but not prepackaged or carry-out)
- Requiring employees and customers to wear face coverings
- Sustaining at least a 10% reduction in your ability to provide goods or services in the normal course of business.

How do PPP loans affect the employee retention credit?

Originally you had to choose either the employee retention credit or a PPP loan. The Consolidated Appropriations Act allows you to take both, provided payroll costs attributed to a forgiven PPP loan weren't part of the payroll costs you took as part of the employee retention credit. And what's more, the CAA made this change retroactive to 2020.

Because wages can't be counted twice, employers receiving PPP loans that are forgiven are automatically considered to forgo the employee retention credit, up to the amount of payroll costs covered by the forgiven PPP loan. And this remains true, even if you make a mistake on your PPP loan forgiveness application.

Example. Speedy incurred $130,000 in payroll costs and $70,000 in other costs. Speedy received a $200,000 PPP loan, which was forgiven in total. Oops: It didn't apportion its payroll costs and nonpayroll costs on its loan forgiveness application. Result: No portion of qualified wages reported as payroll costs, not even the $70,000, may be treated as qualified wages for purposes of the employee retention credit.

If your PPP loan was only partially forgiven, you can file Form 941-X and claim the employee retention credit for the wages that weren't forgiven.

What substantiation must employers keep?

Of course, you must retain documentation showing you were eligible for the employee retention credit. New FAQs 70 and 71 specify you must retain the following records for the later of four years after a return was either due or filed:

- Documentation backing up your eligibility for the credit, records to determine whether more than a nominal portion of your operations were suspended or a government order had more than a nominal impact on your business, records used to determine whether you experienced a significant decline in gross receipts, and records of employees who received qualified wages and in what amounts
- Documentation showing how you determined the amount of allocable qualified health plan expenses
- Copies of Forms 7200, 941 and 941-X.

Additional Resource: Your 2021 payroll questions answered.

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