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IRS Provides Guidance on Key Aspects of CARES Act Employee Retention Credit

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Section 2301 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) provides a refundable employment tax credit for certain employers that carry on a trade or business during 2020 and (1) have operations that were fully or partially suspended during the calendar quarter due to orders from a governmental authority limiting commerce, travel or group meetings due to the coronavirus pandemic or (2) experienced a significant decline in gross receipts during the calendar quarter. The credit is limited to 50% of qualified wages of $10,000 per eligible employee paid after March 12, 2020, and before January 1, 2021, excluding wages for which the employer receives a tax credit for paid sick leave or paid family leave under the Families First Coronavirus Response Act.

The CARES Act's employee retention credit is not available to employers that receive a loan under the Payroll Protection Program (PPP), and it applies differently for employers that had more than 100 full-time employees on average during 2019. Certain related entities are treated as a single employer for purposes of the credit. According to **frequently asked questions** recently issued by the IRS, the employer aggregation rules apply for purposes of determining whether there has been a suspension of operations due to a governmental order or a significant decline in gross receipts, whether an employer averaged more than 100 full-time employees, and whether an employer has received a PPP loan.

Many employers will not know for several months whether they have experienced a significant decline in gross receipts, which is measured by comparing receipts in a calendar quarter in 2020 to the same calendar quarter in 2019. Accordingly, at the present time, employers generally have been focused on whether they are eligible for the credit based on a partial suspension of operations due to a COVID-19 related governmental order. The statute does not explain what it means for a business' operations to be "fully or partially suspended" due to a governmental order and leaves room for varying interpretations. The IRS has issued guidance in the form of FAQs, which appear to adopt a narrow interpretation of what constitutes a partial suspension of operations due to a governmental order. Although the FAQs do not constitute legal authority, they represent the current views of the IRS and should be considered by employers in determining whether to claim the credit.

When are operations fully or partially suspended due to a governmental order?

FAQs 30 through 38 describe several situations that various businesses have faced as a result of the coronavirus pandemic and explain which of those situations the IRS views as a suspension of operations due to a governmental order.

1. Employers with operations that continue through teleworking

The IRS has taken the position that, if an employer's workplace is closed by a governmental order but the employer is able to continue operations comparable to its operations prior to the closure by requiring employees to telework, the employer's operations are not considered to have been fully or partially suspended as a consequence of a governmental order. The FAQs include the following 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.

It remains uncertain how comparable the telework operations must be to the employer's operations before the closure. For example, it is not clear if the IRS would reach a different conclusion if certain employees of the software development company were not teleworking prior to the governmental order. It also is not clear whether the IRS shares the view expressed in the description of the CARES Act recently released by the Joint Committee on Taxation that an accounting firm is treated as being partially suspended when it closes its office under a directive from public health authorities to cease all activities other than minimum basic operations and does not require any services from employees who cannot work from home (e.g., custodial employees, mail room employees).

2. Essential businesses allowed to continue operations

The FAQs state that an employer that operates an essential business is not considered to have been fully or partially suspended if the governmental order allows the employer to remain open, even though the order requiring non-essential businesses to close may have an effect on the employer's operations. However, the FAQs provide that an employer with an essential business may be considered to have a full or partial suspension of operations if the business' suppliers are unable to make deliveries of critical goods or materials due to a governmental order that causes the supplier to suspend its operations. According to the IRS, if the facts and circumstances indicate that the essential business' operations are fully or partially suspended as a result of the inability to obtain critical goods or materials from their suppliers that were required to suspend operations, then the essential business would be an eligible employer for purposes of the credit. The FAQs include the following 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.

3. Essential businesses with customers subject to a stay-at-home order

The IRS makes clear that it does not consider the fact that a governmental order causes customers of an essential business to stay at home to be sufficient for a business to qualify as having a full or partial suspension of operations for purposes of the credit.

4. Businesses that remain operational for limited purposes

Under certain circumstances, the FAQs treat an employer that is required by a governmental order to close its workplace for certain purposes, but may remain operational for other limited purposes, as being partially suspended due to a governmental order. The examples provided by the IRS are (1) a restaurant that must close its location to in-room dining but is allowed to continue sales on a carry-out or delivery basis and (2) a retail business that is forced to close its retail storefront locations but maintains a website through which it continues to fulfill online orders. These are narrow examples and presumably would not extend to employers that are able to continue operations comparable to their operations prior to the closure by requiring employees to telework, such as the software development company in the example above.

5. Businesses subject to a governmental order in only some of the jurisdictions in which they operate

The IRS views an employer that operates a business in multiple jurisdictions, but is subject to a governmental order limiting operations in only some of those jurisdictions, as having a partial suspension of operations. These employers may establish a policy to operate consistently in all jurisdictions that complies with the local governmental orders, as well as recommendations from the Center for Disease Control and Prevention (CDC) and guidance from the Department of Homeland Security (DHS). Even though the employer would be merely following CDC or DHS guidelines in jurisdictions where it is not required by a governmental order to suspend operations, the employer would be considered to have partially suspended operations and therefore would be an eligible employer for purposes of the credit with respect to all of its operations in all locations.

6. Businesses operated by an aggregated group in which the operations of that business by another member is suspended by a governmental order

As stated above, certain related entities are treated as a single employer for purposes of the employee retention credit. According to FAQ 37, the aggregation rules apply for purposes of determining whether an employer's operations of a trade or business are fully or partially suspended, so that if a trade or business is operated by multiple members of an aggregated group, and the operations of one member of the aggregated group are suspended by a governmental order, then all members of the aggregated group are considered to have their operations partially suspended, even if another member of the group is in a jurisdiction that is not subject to a governmental order. The FAQs include the following 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.

What types of governmental orders qualify for purposes of the credit?

FAQs 28 and 29 explain the "orders from an appropriate governmental authority" that may be taken into account for purposes of the employee retention credit. A governmental order does not include comments made by government officials during press conferences or in interviews with the media. Furthermore, a declaration of a state of emergency by a governmental authority does not rise to the level of a governmental order if it does not limit commerce, travel, or group meetings in any manner; such a declaration that limits commerce, travel, or group meetings, but does so in a manner that does not affect the employer's operation of its trade or business, also does not rise to the level of a governmental order.

An employer that voluntarily suspends its operations or reduces hours due to the coronavirus, even though it is not required to do so by a governmental order, is not considered to have a full or partial suspension of its operations due to a governmental order. The IRS' position in this regard may prevent an employer that operates an essential business from claiming the credit on the basis of a partial suspension of operations, if the essential business is allowed under a governmental order to remain open, but the employer voluntarily reduces staffing or operations under a policy consistent with CDC or DHS guidelines (unless, for example, the operations are suspended as a result of an inability to obtain critical goods or materials from the employer's suppliers that were required to suspend operations).

What are qualified wages?

FAQs 48 through 61 address the meaning of qualified wages for purposes of the employee retention credit. Qualified wages include wages (as defined in Internal Revenue Code (Code) section 3121(a)) paid after March 12, 2020, and before January 1,

2021 during any period in which there is (1) a full or partial suspension of operations by order of a governmental authority due to the coronavirus, or (2) a significant decline in gross receipts. Payments made to a former employee in connection with or following termination of employment are not considered qualified wages for purposes of the employee retention credit. The FAQs provide that employers claiming the employee retention credit based on a full or partial suspension of operations due to a governmental order can claim the credit only for wages paid during the period the order is in force. Furthermore, the definition of qualified wages depends, in part, on the employer's average number of full-time employees, as defined in Code section 4980H, during 2019 (applying the aggregation rules).

If the employer averaged more than 100 full-time employees in 2019, qualified wages are the wages paid to an employee for time that the employee is not providing services due to the circumstances described in (1) or (2) above, and may not exceed what the employee would have been paid for working an equivalent duration during the 30 days immediately preceding that period. Furthermore, the FAQs explain that an employer that averaged more than 100 full-time 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. If the employer averaged 100 or fewer full-time employees in 2019, qualified wages are wages paid to any employee during the relevant period.

The method that an employer that averaged more than 100 full-time employees uses to determine the hours for which its employees are not providing services, but for which they receive wages, must be reasonable. The FAQs state that it would not be reasonable for the employer to treat an employee's time as having been reduced based on an assessment of the employee's productivity levels during the hours the employee is working. The FAQs include the following examples with respect to exempt salaried employees.

> 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 percent of their typical work hours. In this case, 90 percent of wages paid to these employees during the period the clubs were closed are qualified wages.
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> 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.

Key Contacts

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