Chief Tax Officer Insights

Employee Retention Credit: Seeking clarity amid COVID-19

July 2020

As we move past the half-year mark of the first cases of COVID-19 in the United States, tax functions in every industry continue to navigate an unprecedented economic and social environment. Chief tax officers (CTOs) of large organizations are anxious to start looking forward and planning for the new unfolding reality. But first they must lead their teams through immediate challenges.

One of the most pressing issues is how to approach government aid opportunities created to protect businesses from financial hardship due to COVID-19. Atop the agenda is the mechanics of qualification and how to claim the Employee Retention Credit (ERC), a refundable payroll tax credit introduced through the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the major federal stimulus package that was signed into law in March 2020.

The ERC is designed to encourage businesses to retain their full-time employees through the COVID-19 situation. It does this through a refundable tax credit (calculated in reference to qualified wages and associated health plan expenses) lowering eligible employers' liability for the employer's share of social security taxes and can operationally be applied on other certain employment taxes (including income tax withholdings).

To qualify for the credit, businesses must have experienced either of the following situations in 2020:

— Suspended operations, fully or partially, due to government orders

— Seen at least a 50 percent decline in gross receipts compared to the same 2019 calendar quarter.

The ERC can amount to a substantial financial benefit for organizations through the end of the year. Employers can receive up to $5,000 per full-time employee (FTE). For eligible businesses with fewer than 100 FTEs, the credit is based on wages paid to all employees. For larger employers, it is based on wages paid only to the extent employees have been paid, but did not actually work during the affected quarter.

The ERC, which does not have to be repaid, can inject needed cash flow at a vulnerable time for many organizations. Companies can receive the credit by reducing employment tax deposits or by filing for an advance refund and accounting for it later on their federal tax return.

Yet despite its potential benefits, many organizations are still evaluating if they will claim the ERC. In fact, in our conversations with CTOs, we have found that businesses are essentially split on whether or not to take the credit.

Three primary questions stand out as CTOs and other stakeholders weigh the benefits and risks and make a final decision.

CTOs are expected to align tax with business goals, drive strategic value, increase transparency, *and* improve the efficiency of tax operations. KPMG LLP's (KPMG) *CTO Insights* is designed to highlight top-of-mind issues for tax executives and ways CTOs are addressing these opportunities and challenges. We are confident that you will find the information in each issue of *CTO Insights* practical and actionable in demonstrating the value you and your department bring to your organization.

Do we qualify?

Determining eligibility for the ERC has proven difficult, creating a great deal of confusion and uncertainty in the tax function. The main challenge is that the first criteria for credit eligibility—experiencing a shutdown due to a government mandate—is quite open to interpretation, and many organizations remain unclear about what impacts qualify for relief and if they are allowed to make a claim.

Since the start of COVID-19, government shutdown rules have been vague. The rules, which are numerous and regularly evolving, impact businesses deemed "nonessential," while "essential" businesses have been allowed to continue to operate. Yet there is no clear or consistent definition of essential versus nonessential business in the CARES Act.

This ambiguity is forcing companies to rely on recent IRS guidance in the form of government FAQs. The guidance has marginally improved understanding of the credit, including who counts as an eligible employer, and there may be further updates from the U.S. Congress coming out in the next few weeks, yet the waters remain muddy. The FAQ scenarios outline ways almost all businesses have been effected by shutdown orders and could qualify for relief.

Some CTOs are interpreting the ERC provisions as only applicable to businesses that have been measurably affected by federal- or state-level shutdowns—i.e., businesses that have been forced to close. However, even determining credit qualification under that interpretation isn't always clear, especially for large, multidimensional organizations.

For example, some parts of the workforce, such as traveling sales teams or property managers, may have been grounded by stay-at-home orders and not able to provide comparable services, even as the core business remains open. Likewise, some companies may have suspended some business operations while keeping others open, such as a manufacturer that closed production facilities where a virus outbreak occurred while continuing work at other plants, or a retailer that stopped selling nonessential items like toys while continuing to sell grocery items. In addition, some businesses that were deemed essential have nonetheless had to cut employees' hours and pay due to a decline in demand. Each of these relatively widespread scenarios raises questions as to whether companies qualify for the retention benefit and requires CTOs to consider claiming the credit on a business-by-business basis.

Further complicating matters is the fact that which businesses are "essential" is defined state by state, requiring CTOs to take a location-based approach to determine when to take the credit. Some businesses were shut down at the federal level, others only at the state level, possibly classifying a business as essential in some states, but not others with more restrictive orders in place. And as state shutdown orders continue to lift, and businesses that were previously ordered closed are now allowed to reopen, it is further extending the CTOs' evaluation of ERC eligibility, even as we stretch into the second half of 2020.

Is it worth our effort?

Measuring the impact of shutdown orders on the business in order to gauge ERC qualification and credits due also presents a workload and capacity obstacle for tax departments.

Many CTOs are still unsure whether their business qualifies for the ERC as a result of downtime due to COVID-19. Accurately calculating how many FTEs were fully paid while working reduced or no hours is equally complex. Adding to the challenge is the lack of clarity regarding treatment of certain situations under ERC rules, including paid time off prior to furloughs, lost productivity of sales staff at reduced capacity, and more.

To answer those questions and ultimately prepare to file a claim, tax functions must closely track the reduced demand for services across the organization. Documenting changes to employees' work time is an essential step, requiring the tax departments to increase the amount of data collected and reported. CTOs may even need to develop entirely new metrics, such as catalysts for business unit closures. As such, productivity measurement is proving to be a heavy lift in terms of research and documentation.

While CTOs question whether the potential benefits will ultimately be worth the effort, they are focusing on driving efficiency in the process by using technology tools to access data for ERC calculations. Potential approaches include using payroll codes or other familiar methods to track paychecks sent to furloughed employees, and more nuanced methods, such as statistical sampling.

What's our risk?

When it comes to accepting the ERC—like other government aid—reputational risk is a top concern of CTOs, and, of course, their leaders in the C-suite.

While the tax credit can bring short-term financial gains, it can also force companies into the undesirable of explaining the need for relief and defending their strategy and performance. This is particularly concerning for companies that have not been ordered closed and shown steady growth during COVID-19, even if they also may have incurred massive costs to do business.

In addition, large organizations that accept the credit fear they may be viewed as unfairly competing for limited funds, possibly at the expense of small businesses.

Given current public sentiment, many companies have weighed the risk and reward and decided not to pursue the ERC, even though they qualify. Some of these companies have even used their decision to decline government relief as a public relations tool—a statement of confidence that the business does not need to rely on outside assistance.

Other companies have opted to claim the credit, but publicly positioned the decision as a way of supporting their employees rather than a company necessity. Communicating the right justification is especially critical in jurisdictions where credits will have to be publicly disclosed, such as Europe and Canada.

For businesses that decide ERC benefits outweigh the costs, one risk they don't have to worry about is penalty exposure. The CARES Act allows companies to repay appropriate taxes without penalty for mistakes found under audit, as long as they acted reasonably in pursuing relief.

Questions to consider

— What additional guidance do you need to understand and evaluate the impact of the ERC on your business?

— What data will you need to calculate, claim, and report the ERC and how will you manage recordkeeping requirements?

— How will you weigh the benefits of the ERC versus the potential risks to your corporate reputation?

Explore the resources below for deeper insights on the topics in this edition of *CTO Insights*.

COVID-19: Insights on Tax Impacts
COVID-19 is having wide-ranging economic, business, and social impacts. Tax, trade, and other authorities around the world are responding with regulatory change, relief measures, and extensions. Updates on these developments and tax insights from KPMG related to the impact of COVID-19 on business can be found here.

The CARES Act – Executive summary
The main tax and nontax provisions of the more than 800-page CARES Act are summarized in one page, outlining the act's breadth of provisions intended to help businesses and individuals mitigate the impact of COVID-19.

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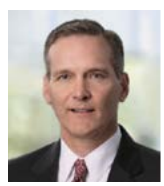

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