Tax Notes

CARES Act includes Payroll Tax Deferral and Employee Retention Credit

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The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), enacted on March 27, 2020, contains provisions related to taxation of employee benefits, compensation and wages. This article addresses the payroll tax provisions, specifically the payroll tax deferral and the employee retention credits.

Payroll Tax Deferral

The CARES Act delays the timing of required federal tax deposits for certain employer payroll taxes and self-employment taxes incurred between March 27, 2020 and December 31, 2020.

All employers and self-employed individuals (including partners in partnerships) may avail themselves of the payroll tax deposit deferral. There is no need-based eligibility. Generally, the deferral relates to the employer's 6.2% Social Security tax or the equivalent amount for a self-employed individual.

Amounts will be considered timely paid if 50% of the deferred amount is paid by December 31, 2021, and the remainder by December 31, 2022. There is no dollar cap on the wages that are counted in calculating the taxes that may be deferred.

The payroll tax deferral is not available to a taxpayer that obtains a Small Business Act (SBA) loan under the Paycheck Protection Program established by the CARES Act **<u>if the loan is later forgiven</u>**.

Employee Retention Credit

The CARES Act also creates a new employee retention credit (the Retention Credit) for wages paid from March 13, 2020 to December 31, 2020, by employers that are subject to closure or significant economic downturn due to COVID-19, during the quarters in which the employer is affected.

The credit amount takes into account up to 50% of qualified wages, which are capped at $10,000. Thus, the maximum credit is $5,000 per employee.

The Retention Credit applies to the employer's share of the Social Security tax, i.e., 6.2% of wages.

To be eligible for the Retention Credit, an employer [including IRC Section 501(c) tax–exempt organizations] must carry on a trade or business where:

1. Operations were fully or partially suspended on orders from a governmental authority due to COVID-19 (COVID-19 Shutdown), or
2. The business experienced a 50% reduction in gross receipts for a calendar quarter as compared to the same calendar quarter in the prior year (Gross Receipts Decline). The eligibility period ends

when the business' gross receipts for a calendar quarter are 80% of the gross receipts in the same calendar quarter in the prior year. This test requires employers to analyze gross receipts among all aggregated entities.

Any employer that receives an SBA Paycheck Protection Program loan is not eligible for the Retention Credit.

For employers with an average of more than 100 employees in 2019, qualified wages are wages paid to an employee who is not providing services due to a COVID-19 Shutdown or Gross Receipts Decline. In determining whether the employer has more than 100 employees, businesses are aggregated to the extent they are considered one employer under IRC Section 52(a) and (b) and IRC Section 414(m) and (o).

For employers of 100 or fewer employees, qualified wages are wages paid to any employee without regard to whether the employee is providing services.

In either case, qualified wages include qualified health plan expenses paid or incurred by the employer for health coverage excludable under IRC Section 106(a).

The Retention Credit is refundable. However, it is subject to a number of rules to prevent double-dipping. For example, an employer's deduction for wages must be reduced by the amount of the Retention Credit.

The combination of the retention credit with the payroll tax deferral will allow employers to reduce this year's Social Security tax and defer any remaining liability to 2021 and 2022.

	Payroll Tax Deferral	Employee Retention Credit
Who is eligible?	No requirement of direct effect of COVID-19 on business	Must be fully or partially shut down or have significant effects on gross receipts due to COVID-19
What taxes does this apply to?	Applies to employers' Social Security tax and Self-employment tax	Applies to employers' Social Security tax
Are there limits on the amount?	No cap on total amount	Limited to $5,000 credit per employee / further limits on businesses with more than 100 employees
What time period is covered?	March 27, 2020 through December 31, 2020	Calendar quarters in 2020 in which the business is affected
Interaction with SBA Loans	Not available if business SBA Paycheck Protection Loan is forgiven	Not available if business receives SBA Paycheck Protection Loan

Contact Us

PKF O'Connor Davies is monitoring the situation regarding the CARES Act. If you have any questions regarding the payroll tax provisions, specifically the payroll tax deferral and the employee retention credits, contact your PKF O'Connor Davies client account team or any of the following:

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