FROST LAW

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The Employee Retention Credit ("ERC") and Bankruptcy

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Rebecca Sheppard, Esq. is a tax attorney and a Director in the Tax Controversy practice group at Frost Law. Over the last two years, Rebecca has used her background in government practice to work with business clients across the country in helping them secure government funding from PPP, EIDL, and the Employee Retention Credit (ERC). Unlike many other tax professionals, Rebecca used her tax and legal background to closely follow the legislative changes and relief programs, giving her a thorough understanding of the complexities of how businesses from all industries can maximize claims for refundable tax credits. Her efforts have allowed her clients to recover significant refunds for many small and medium-sized businesses around the country.

Rebecca previously worked for the Comptroller of Maryland as a tax attorney in the Hearings and Appeals Section.
She conducted administrative hearings, issued binding legal determinations, and negotiated settlement agreements on behalf of the Comptroller of Maryland. Rebecca's experience both in government and private practice allows her to effectively navigate how businesses can best make tax law work in their favor.

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PETER
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Peter Haukebo is a Director at Frost Law. He concentrates his practice in the areas of tax controversy and planning and business transactions. Since 2020, Peter has leveraged his background in tax and business law to work with business owners throughout the country to help them claim much-needed relief from the Paycheck Protection Program ("PPP"), Economic Injury Disaster Loan ("EIDL), and Employee Retention Credit ("ERC"). From 2013 to 2019, Peter served as an adjunct professor of law instructing in the Low Income Taxpayer Clinic at the University of Maryland Francis King Carey School of Law. He has been a member of the Maryland State Bar Association ("MSBA") Taxation Law Section Council since 2015, and currently serves as the section council's Vice Chair.

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DANIEL
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Dan is the lead bankruptcy attorney at Frost Law. He provides individuals and businesses with assistance in workouts, restructuring, negotiations, and real estate transactions representing the buyer or banking institution in a property transaction or properties in distress. Dan's practice has intersected many times in federal and state tax areas. He regularly files bankruptcy cases for individuals to work with tax debt. He has been on the cutting edge of the new small business bankruptcy law practice. He has filed many cases in Maryland, Virginia, and the District of Columbia under Chapter 11, Subchapter V. Recently several have been confirmed as consensual plans.

Dan gained hands-on experience in multiple practice areas, including:

- Bankruptcy
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PAUL
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Paul Sweeney is the managing member at YVS Law and has over 30 years of experience in complex Chapter 11 bankruptcy and commercial litigation. His experience includes an emphasis on bankruptcy reorganization, bankruptcy litigation, business litigation, out of court restructurings and workouts, receiverships and related insolvency litigation in state and federal courts in Maryland, Virginia and the District of Columbia.

Mr. Sweeney has served as a bankruptcy trustee for the Office of the U.S. Trustee in the Greenbelt and Baltimore Divisions of the U.S. Bankruptcy Court for the District of Maryland. He is admitted to practice in all trial courts in the state and federal courts of Maryland, the District of Columbia and the Commonwealth of Virginia. Mr. Sweeney is a past president of the Maryland Bankruptcy Bar Association and a past member of the Board of Directors. He is a frequent lecturer on bankruptcy law and related litigation.

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DISCLAIMER

The information in this presentation is for general information purposes only. Nothing in this presentation should be construed as legal advice or tax advice for any individual case or situation.

BACKGROUND

- Paycheck Protection Program ("PPP")
- Families First Coronavirus Response Act ("FFCRA")
- Deferral of employment tax payments
- Employee Retention Credit ("ERC")
- Restaurant Revitalization Fund ("RRF")
- Shuttered Venue Operators Grant ("SVOG")
- Economic Injury Disaster Loan ("EIDL")

Bankruptcy Background

- Funding a case in a Chapter 11 Plan
- Use as disposable income under 11 USC 1191(c) as projected disposable income in a Subchapter V
- Chapter 7 liquidation
- The possible personal exposure from the ERC
- Possible state receivership

ERC LEGISLATION

- Coronavirus Aid Relief, and Economic Security Act (“CARES Act”) **3-27-2020**
- Taxpayer Certainty and Disaster Tax Relief Act of 2020 (“Relief Act”) **12-27-2020**
- American Rescue Plan Act of 2021 (“ARP”) **3-11-2021**
- Infrastructure Investment and Jobs Act (“Infrastructure Act”) **11-15-2021**

ERC GUIDANCE

- Notice 2021-20
- Notice 2021-23
- Notice 2021-49
- Notice 2021-65
- Rev. Proc. 2021-33
- Rev. Proc. 2021-48

PAYROLL TAX BASICS

- Employers file Forms 941 quarterly to report wages paid to employees and self-assess employment taxes.
- Payroll taxes are split between employee and employer.
- Employers withhold income tax and FICA (Federal Insurance Contributions Act) taxes from employees pay and then remit to the government on the employees behalf.
- The employer is liable for its portion of FICA taxes.

BANKRUPTCY BENEFITS OF ERC

- The ERC provides money to fund a Chapter 11 plan
- The ERC pays administrative expenses in all Chapters
- The ERC allows distributions to creditors who wouldn’t get one before
- The ERC helps to avoid potential objections in plan confirmation
- The ERC is found money for debtors

WHAT IS THE EMPLOYEE RETENTION CREDIT?

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IRC § 3134.

- There are different rules for 2020 and 2021.
- For 2020, an eligible employer is allowed a credit against applicable employment taxes equal to 50% of the qualified wages (up to $10,000) for the entire year.
- For 2021, an eligible employer is allowed a credit against applicable employment taxes for *each calendar quarter* an amount equal to 70% of the qualified wages (up to $10,000) with respect to each employee for such calendar quarter for tax year 2021.
- **$5,000+$7,000+$7,000+$7,000=$26,000!!!**

ELIGIBLE EMPLOYER DEFINED

The term “eligible employer” means an employer which was carrying on a trade or business during the calendar quarter for which the credit is determined, ***and…***

ELIGIBLE EMPLOYER DEFINED

Method 1: Significant Reduction in Gross Receipts

- The gross receipts are less than 50 percent of the gross receipts for the same quarter in calendar year 2019 for 2020.
- The gross receipts are less than 80 percent of the gross receipts for the same quarter in calendar year 2019 for 2021.
- There are alternative reference periods for 2021 quarters that allow for automatic qualification for successive quarters.

ELIGIBLE EMPLOYER DEFINED

Method 2: Full/Partial Suspension of Trade or Business Operations

- The operation of the **trade or business** is 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 the coronavirus disease** 2019 (COVID-19).

ELIGIBLE EMPLOYER DEFINED

Method 2: Full/Partial Suspension of Trade or Business Operations

- Facts and circumstances tests, but…
- Deemed more than nominal if the business ***portion*** which was closed is equal to 10% or greater of either total gross receipts or hours worked in the corresponding reference period in 2019.
- The analysis is simple when operations are completely closed. Must also consider the conditions of reopening (i.e., modifications) that businesses were required to make and analyze whether there was more than a nominal ***effect*** also.

WARNING: IR-2022-183

IR-2022-183, October 19, 2022

WASHINGTON — The Internal Revenue Service today warned employers to be wary of third parties who are advising them to claim the Employee Retention Credit (ERC) when they may not qualify. **Some third parties are taking improper positions related to taxpayer eligibility for and computation of the credit.**

These third parties often charge large upfront fees or a fee that is contingent on the amount of the refund and may not inform taxpayers that wage deductions claimed on the business' federal income tax return must be reduced by the amount of the credit.

If the business filed an income tax return deducting qualified wages before it filed an employment tax return claiming the credit, the business should file an amended income tax return to correct any overstated wage deduction.

Businesses are encouraged to be cautious of advertised schemes and direct solicitations promising tax savings that are too good to be true. Taxpayers are always responsible for the information reported on their tax returns. **Improperly claiming the ERC could result in taxpayers being required to repay the credit along with penalties and interest.**

…

https://www.irs.gov/newsroom/employers-warned-to-beware-of-third-parties-promoting-improper-employee-retention-credit-claims

ELIGIBLE EMPLOYER DEFINED

Method 3: Recovery Startup Business

- The business began operations after February 15, 2020.
- The average gross receipts of the business were less than $1 million annually.
- Not qualified under Method 1 or Method 2.
- Credit for Quarter 3 2021 and Quarter 4 2021 cannot exceed $50,000 per quarter.

QUALIFIED WAGES ELIGIBLE

Percent of Qualified Wages Eligible for Credit - 2020 rule

- If an employer averaged 100 or fewer full-time employees during 2019, wages paid to employees providing services and not providing services are qualified wages.
- The credit is 50% of up to $10,000 in qualified wages, per employee for the year (including certain health care expenses and tips).

QUALIFIED WAGES ELIGIBLE

Percent of Qualified Wages Eligible for Credit - 2021 rule

- If an employer averaged 500 or fewer full-time employees during 2019, wages paid to employees providing services and not providing services are qualified wages.
- The credit is 70% of up to $10,000 in qualified wages per employee per calendar quarter (including certain health care expenses and tips).

IMPACT OF OTHER CREDIT RELIEF PROVISIONS

- The employer's ability to claim the Employee Retention Credit is impacted by other credit and relief provisions. Employers must back out credits or forgivable loan wages from the qualified wage analysis.

- PPP loan forgiveness is the big one, but consider ways to maximize the the credit due to majority owner wages, deemed owner wages, and family attribution rules.

- RRF has unique rules related to the interplay with ERC.

HOW TO CLAIM THE CREDIT

- Eligible employers will report total qualified wages and the related health plan expenses for each quarter on the quarterly employment tax returns, Form 941.
- Form 941-X is utilized when amending a Form 941 to claim the credit or additional credit.
- The Credit will be taken against the employer's share of Social Security tax but the excess is refundable under normal procedures

Worksheet 2. Employee Retention Credit for the Second Quarter of 2021 Only (Wages Paid After March 31, 2021, and Before July 1, 2021)

Keep for Your Records

Determine how you will complete this worksheet. (If you're a third-party payer, you must complete this worksheet for each client for which it is applicable, on a client-by-client basis.)

If you paid qualified wages after March 31, 2021, and before July 1, 2021, for purposes of the employee retention credit, complete Step 1 and Step 2. If you're claiming a credit for qualified sick and family leave wages in the second quarter of 2021 for leave taken before April 1, 2021, complete Worksheet 1 before starting this worksheet. **Caution:** Use Worksheet 4 to figure the employee retention credit for qualified wages paid in the third and fourth quarters of 2021.

Step 1. **Determine the employer share of social security tax for the second quarter of 2021 after it is reduced by any credit claimed on Form 8974 and any credit to be claimed on Form 5884-C and/or Form 5884-D**

1a If you completed Worksheet 1 for the second quarter of 2021 to claim a credit for qualified sick and family leave wages for leave taken before April 1, 2021, enter the amount from Worksheet 1, Step 1, line 1l, and go to Step 2. If you're not claiming a credit for qualified sick and family leave wages for leave taken before April 1, 2021, continue by completing lines 1b–1n below and then go to Step 2 . . . 1a ______

1b Enter the amount of social security tax from Form 941, Part 1, line 5a, column 2 . . . 1b ______

1c Enter the amount of social security tax from Form 941, Part 1, line 5b, column 2 . . . 1c ______

1d Add lines 1b and 1c . . . 1d ______

1e Multiply line 1d by 50% (0.50) . . . 1e ______

1f If you're a third-party payer of sick pay that isn't an agent and you're claiming credits for amounts paid to your employees, enter the employer share of social security tax included on Form 941, Part 1, line 8 (enter as a positive number) . . . 1f ______

1g Subtract line 1f from line 1e . . . 1g ______

1h If you received a Section 3121(q) Notice and Demand during the quarter, enter the amount of the employer share of social security tax from the notice . . . 1h ______

1i **Employer share of social security tax.** Add lines 1g and 1h . . . 1i ______

1j Enter the amount from Form 941, Part 1, line 11a (credit from Form 8974) . . . 1j ______

1k Enter the amount to be claimed on Form 5884-C, line 11, for this quarter . . . 1k ______

1l Enter the amount to be claimed on Form 5884-D, line 12, for this quarter . . . 1l ______

1m **Total nonrefundable credits already used against the employer share of social security tax.** Add lines 1j, 1k, and 1l . . . 1m ______

1n **Employer share of social security tax remaining.** Subtract line 1m from line 1i . . . 1n ______

Step 2. **Figure the employee retention credit for the second quarter of 2021**

Caution: The total amount included on lines 2a and 2b can't exceed $10,000 per employee.

2a Qualified wages (excluding qualified health plan expenses) for the employee retention credit (Form 941, Part 3, line 21) . . . 2a ______

2b Qualified health plan expenses allocable to qualified wages for the employee retention credit (Form 941, Part 3, line 22) . . . 2b ______

2c Add lines 2a and 2b . . . 2c ______

2d **Retention credit.** Multiply line 2c by 70% (0.70) . . . 2d ______

2e Enter the amount of the employer share of social security tax from Step 1, line 1a, or, if applicable, Step 1, line 1n . . . 2e ______

2f Enter any second quarter amount of the nonrefundable portion of the credit for qualified sick and family leave wages for leave taken before April 1, 2021, from Worksheet 1, Step 2, line 2j . . . 2f ______

2g Subtract line 2f from line 2e . . . 2g ______

2h **Nonrefundable portion of employee retention credit.** Enter the smaller of line 2d or line 2g. Enter this amount on Form 941, Part 1, line 11c . . . 2h ______

2i **Refundable portion of employee retention credit.** Subtract line 2h from line 2d and enter this amount on Form 941, Part 1, line 13d . . . 2i ______

SUBSTANTIATION FOR CLAIMING THE CREDIT

- Government orders or ordinance that caused either a shut down or partial shut down
- Records to show a decline in gross revenue
- Records of qualified wages
- (Large Employers) Evidence to show wages were paid when an employee was not providing services
- Documentation of health plan expenses
- Documentation of aggregate group employer determination, if applicable
- Copies of completed federal employment tax returns

Retain documents for at least 5 years

THE CATCH: SPECIAL ISSUES

- Controlled groups: Ownership aggregation rules may apply and they impact eligible employer analysis differently depending on whether a business is an eligible employer based on a significant reduction in gross receipts (Method 1) or full/partial suspension of trade or business operations (Method 2). There are also special issues with aggregation with Recovery Startup Businesses (Method 3).
  - Note: Family attribution rules
- Majority (>50%) owners (and *deemed* owners) wages are not qualified; sole proprietor income also not qualified.
- Acquisition of business (include receipts after the acquisition and determine your receipts from before the acquisition).
- Household employers are not eligible.

STATUTES OF LIMITATION

- Generally the assessment statute expiration date ("ASED") is 3 years from the date of filing.
  - ASED was expanded to **5 years** for certain periods (Q3 & Q4 2021).

- Refund statute expiration date ("RSED") was NOT extended; therefore, there are definite due dates for claiming ERC:
  - Claims related to 2020 calendar quarters: **Due 4-15-2024**
  - Claims related to 2021 calendar quarters: **Due 4-15-2025**

TAX TREATMENT OF ERC

The tax treatment of the Employee Retention Credit differs from PPP and other state programs regarding COVID relief. The credit operates to reduce wages (rather than tax) due to section 280C.

Practically speaking, this does not permit you to deduct employee wages equal to the amount of the credit.

Issue: You should amend related business and personal income tax returns.

CLOSING THOUGHTS

- Hopeless cases can find relief through ERC
- The ERC is a credit and produces cash to fund plans
- Secured creditors can even suggest a debtor uses the ERC
- The ERC makes confirmation consensual thus saving the debtor money
- The ERC can give the debtor a running start to be able to complete a successful plan.

Question & Answer Session

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