

ERC Update

March 1, 2022



ARIZONA
SMALL
BUSINESS
BOOT CAMP &
COLLECTIVE

RESPOND → PLAN → RETURN STRONGER



CariAnn J. Todd, CPA

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Disclaimer

This presentation is based on relevant government guidance available as of March 1, 2022. This presentation includes our best interpretation of the guidance available today.

The information provided here today is high level. Consult with your CPA for more detailed information specific to your situation.

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Employee Retention Credit

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Employee Retention Credit (ERC)

- Companies who received PPP loans are still eligible for ERC.
- Full length of ERC program: March 13, 2020 – September 30, 2021
- 2020 credit = 50% of eligible wages
- 2021 credit = 70% of eligible wages

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ERC – Compute the Credit

IMPORTANT CONCEPT:

The reference period for several of the ERC metrics is 2019.

Why? 2019 is the last “normal” year.

Note these highlights in future slides:

in 2019

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ERC 2020 - Eligibility

Two different ways to be eligible for the 2020 credit:


- Business had operations that were fully or partially suspended during any calendar quarter in 2020 due to government COVID-related orders. The credit only applies to wages paid during the portion of the quarter that the business is suspended, not the entire quarter, **OR** ★
- Business experienced a significant decline in gross receipts during any quarter in 2020. An employer is considered to have a significant decline in gross receipts for the period beginning with the first quarter in 2020 for which its gross receipts are less than 50 percent of gross receipts from the same quarter **in 2019** and ending with the earlier of January 1, 2021 or the first quarter after the quarter for which gross receipts are greater than 80 percent of gross receipts for the same quarter **in 2019**.

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ERC 2021 - Eligibility

Two different ways to be eligible for the **2021** credit:

- Business had operations that were fully or partially suspended during the 1st, 2nd or 3rd quarter in 2021 due to government COVID-related orders. The credit only applies to wages paid during the portion of the quarter that the business is suspended, not the entire quarter, **OR** 
- Business experienced a significant decline in gross receipts during any quarter of 2021. An employer is considered to have a significant decline in gross receipts only for the quarters for which its gross receipts are less than 80 percent of gross receipts from the same quarter **in 2019**.

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ERC - Eligibility

- For the first bullet, the company should document the specific government orders that caused them to be fully or partially shut down
- Only wages and allocable health costs during the shut down period are eligible for the ERC

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ERC - Eligibility

- For the second bullet, the company will have to look at 2021, 2020 and 2019 gross receipts
- Use the accounting method that the company uses for internal accounting or their income tax method of accounting
- For **2021** only: There is a lookback rule, that says if you don't meet the test for a quarter you can look at the immediately preceding quarter

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ERC 2020 - Eligibility

EXAMPLE 1					EXAMPLE 2				
2019					2019				
Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
50,000	60,000	70,000	80,000	260,000	50,000	60,000	70,000	80,000	260,000
2020					2020				
Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
75,000	25,000	35,000	60,000	195,000	75,000	25,000	58,000	75,000	233,000
Relationship of 2020 to 2019					Relationship of 2020 to 2019				
Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
150%	42%	50%	75%	75%	150%	42%	83%	94%	90%
NOT ELIGIBLE	Eligible Qtr	Eligible Qtr	Eligible Qtr		NOT ELIGIBLE	Eligible Qtr	Eligible Qtr	NOT ELIGIBLE	

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ERC 2021 - Eligibility

EXAMPLE 1		The example at right is a demonstration of the allowable lookback rule.	EXAMPLE 2		
2019			2019		
Q1	Q2	Q4 2019	Q1 2019	Q2 2019	
50,000	60,000	80,000	50,000	60,000	
2021		2020	2021	2021	
Q1	Q2	Q4 2020	Q1 2021	Q2 2021	
35,000	45,000	60,000	45,000	45,000	
Relationship of 2021 to 2019		Relationships			
Q1	Q2	Q4	Q1 2021	Q2 2021	
70%	75%	75%	90%	75%	
Eligible Qtr	Eligible Qtr		Eligible Qtr	Eligible Qtr	

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ERC – Compute the Credit

Wages/costs eligible for the credit is dependent on how many employees (EEs) you had **in 2019**.

Compute the number of full-time EEs you had **in 2019**.

Only include EEs who average more than 30 hrs/wk, OR who had 130 hours in a month.

Formula:

Number of full-time EEs in each calendar month in 2019
divided by 12

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ERC 2020 – Compute the Credit

- Employers with 100 or fewer full-time EEs **in 2019** can use all wages (including health care costs) paid: during the affected period/quarter and after March 12, 2020, minus any FFCRA wages.
- Employers with more than 100 employees can only take the credit on wages and health care costs paid to/for employees who were not working (literally paid while staying home and not providing services).

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ERC 2020 – Compute the Credit

The credit is the first 50% of the first \$10,000 in wages and allocable health care costs paid during the affected period/quarter to each eligible employee

Maximum credit for 2020 is \$5,000 per employee

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ERC 2021 – Compute the Credit

- Employers with 500 or fewer full-time EEs in 2019 can use all wages (including health care costs) paid: during the affected period/quarter in 2021, minus any FFCRA wages.
- Employers with more than 500 employees can only take the credit on wages and health care costs paid to/for employees who were not working (literally paid while staying home and not providing services).

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ERC 2021 – Compute the Credit

The credit is the first 70% of the first \$10,000 in wages and allocable health care costs paid during the affected period/quarter to each eligible employee

Credit is computed independently for each quarter

Maximum credit for 2021 is \$21,000 per employee
(\$7,000 per quarter)

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ERC – Compute the Credit

Important restriction #1:

Wages do not include wages paid under the family and/or sick leave provisions of FFCRA, the Families First Coronavirus Response Act. In addition, wages claimed for employees under the Work Opportunity Credit do not qualify as wages that may increase this credit.

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ERC – Compute the Credit

Important restriction #2:

Wages paid to relatives or family members generally do not qualify. With entities, one applies these relationship rules depending on a particular level of ownership.

See question #59: <https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-determining-qualified-wages-faqs>

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ERC – Compute the Credit

Important restriction #3:

Any wages used in the computation of the ERC are not eligible covered costs on the application for forgiveness of a PPP loan.

Retroactively claiming the credit is difficult if you have already applied for PPP forgiveness. Not impossible, just a lot more math.

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ERC – Compute the Credit

Important restriction #4:

There are aggregation rules that can affect parent-subsidiary or brother-sister groups, or a combined group of corporations. These complex rules can also reach partnerships, trusts and estates. Aggregation can affect qualification in such areas as to whether there is a full or partial shutdown as well as measuring the decline in gross receipts.

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ERC – Claim the Credit

- File Form 941X to claim the ERC
- There is a worksheet at the end of the instructions for Form 941X that must be filled out for the 941X to be correct.
- The worksheet computes the “refundable” and “nonrefundable” portions of the ERC.
- No impact on refund, it is for IRS bookkeeping purposes only

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ERC – Claim the Credit

- The 941X must be filed in paper, via mail
- Processing times are up to 9 months
- Once processed, the IRS will mail two things separately:
 - Notice of tax adjustment
 - Refund check

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ERC – Claim the Credit

From the IRS Mission Critical website (2/28/22):

Status of Processing Form 941, Employer's Quarterly Federal Tax Return: The IRS is now opening mail within normal timeframes. As of February 24, 2022, we had 2.6 million unprocessed Forms 941. Tax returns are opened in the order received. If you filed electronically and received an acknowledgement, you do not need to take any further action other than promptly responding to any requests for information. We're working hard to get through the carryover inventory. Please don't file a second tax return or contact the IRS about the status of your return.

As of February 23, 2022, our total inventory of unprocessed Forms 941-X was approximately 391,000, some of which cannot be processed until the related 941s are processed. While not all these returns involve a COVID credit, the inventory is being worked at two sites (Cincinnati and Ogden) that have trained staff to work possible COVID credits.

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ERC – Claim the Credit

ERC must be claimed as income on the business tax return of the same year as the wages were paid.

(Technically it is reported as a reduction of the wage deduction, but the result is the same.)

If you retroactively claim ERC for 2020, your 2020 business and possibly your 2020 individual return will need to be amended.

The additional taxes are paid when the returns are filed.

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ERC – Claim the Credit

The timing of cash flow is to the taxpayer's disadvantage because the 941X refunds are taking so long to process.

The 941X refund will include interest, which may offset some of the interest due with an amended tax return.

Late payment penalties may also be incurred.

Overall, the net cash flow is positive and advantageous to the taxpayer.

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PPP Loan Forgiveness

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PPP Loan Forgiveness

- PPP loans are not “automatically” forgiven, regardless of the amount of the loan.
- Recipients must go through the loan forgiveness process with their lender
- If forgiveness is not applied for, the loan must be repaid.

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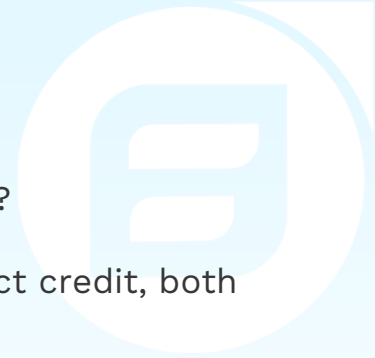
PPP Loan Forgiveness

- All submissions should have already been made and an SBA decision received on all PPP round 1 loans
- Lenders are also accepting forgiveness applications for round 2 PPP loans
- The process generally takes less than 30 days
- We are not aware of any forgiveness denials as long as documentation is in order

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PPP Loan Forgiveness



What happens if you don't repay the PPP loan?

- Like any loan default, it will negatively affect credit, both business and personal
- The SBA may attempt to collect via withholding of tax refunds
- May affect ability to do business with the U.S. government or obtain U.S. backed loans in the future

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Bonus Material

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Arizona Individual Income Tax

- **Prop 208:**
 - Validity still in litigation...
 - Adds 3.5% “surcharge” to individuals on taxable income above \$250K/\$500K (single/married)
- **SB 1827:**
 - Effective 1/1/2021
 - Establishes combined tax rate cap = 4.5% (mitigates Prop 208 effect)
 - Effectively limits but does not eliminate the impact of taxpayer failing to make SBIT election
- **SB 1828**
 - Effective 1/1/2022
 - Creates flat tax rate by 2023
 - 2022: top tax rate = 2.98% (not including Prop 208)
 - If certain state revenue thresholds are met, then flat tax rate reduced to 2.5% (not including Prop 208)

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AZ “Small Business Income Tax”

- **HB 1783**
 - New tax for certain qualifying pass-through entities, called “small business income tax” that mitigates Prop 208 effect by shielding that Arizona small business income from the education surtax. Completed through Form 140-SBI.
 - Flat rates:
 - 2021 = 3.5%
 - 2022 = 3.0%
 - 2023-2024 = 2.8%
 - 2025 and after = 2.5%

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AZ “Small Business Income Tax”

- **SB 1783 continued**

- Must make election each year by filing Form 140-SBI that allows individual taxpayer to pay their share of income tax from the business outside of their individual income tax return.

To qualify, the individual’s federal adjusted gross income must include at least one of the following income sources:

- Interest and Ordinary Dividends (Schedule B),
- Profit or Loss from Business (Schedule C),
- Supplemental Income or Loss (Schedule E), includes Schedule K-1 income,
- Profit or Loss from Farming (Schedule F),
- Sale of Business Property (Form 4797),
- Farm Rental Income and Expenses (Form 4835), or
- Capital Gains and Losses with Respect to the Taxable Disposition of an Ownership Interest in any Business Entity (Schedule D).

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AZ “Small Business Income Tax”

- **Form 140-SBI highlights**

- Return must be timely filed to include this election, including valid extensions.
- Year by year election made by filing the Arizona Small Business Income Tax Return
- Can be revoked by filing amended returns
- Estimates and Extensions
 - Form 204 extension also applies to Form 140-SBI
 - Will use Form 204-SBI if making a payment of SBI tax with an extension payment for Form 140-SBI
 - No estimates required for 2021. Estimates required for TY2022 if taxpayers making use of this tax and their taxable income exceeds \$150,000.

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AZ “Small Business Income Tax”

- **Form 140-SBI highlights (cont’d)**
 - Credit for other states substantially similar taxes (ARS 43-1071) – ADOR count similar taxes imposed by other states as part of the credit for taxes paid to other states. NOT EFFECTIVE UNTIL 2022.
 - Credits on Form 140-SBI:
 - Line 53 is for nonrefundable credits from AZ Form 301-SBI.
 - Ex: Credit for taxes paid to AZ and another state or country on the same income (Form 309-SBI)
 - Line 54 is Balance of tax
 - Line 57 allows for refundable credits from AZ Form 308-I (Credit for Increased Research Activities) or Form 349 (Credit for Qualified Facilities)
 - Starting in 2022 a taxpayer who is a partner in a partnership or a shareholder in an S corporation who elects to pay the entity level tax and overpays can carry forward 5 years the credit against subsequent years’ income tax liability

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AZ “SBIT” : Form 140-SBI

Balance of Tax	49	Arizona Small Business Taxable Income. Subtract lines 31 through 48 from line 26. If less than zero, enter "0".....	49		00
	50	Small Business Income Tax: Multiply line 49 by 3.5% (.035) and enter the result.....	50		00
Balance of Tax	51	Tax from recapture of credits from Arizona Form 301-SBI, Part 2, line 23.....	51		00
	52	Subtotal of tax: Add lines 50 and 51. Enter the total.....	52		00
Balance of Tax	53	Nonrefundable Credits from Arizona Form 301-SBI, Part 2, line 43.....	53		00
	54	Balance of Tax: Subtract line 53 from line 52. If line 53 is greater than line 52, enter "0".....	54		00
Payments and Refundable Credits	55	2021 AZ estimated tax payments 55a <input type="text"/> Claim of Right 55b <input type="text"/> 00 Add 55a and 55b 55c	55c		00
	56	2021 AZ extension payment (Form 204-SBI).....	56		00
Payments and Refundable Credits	57	Refundable credits: Check the box(es) and enter the total amount 571 <input type="checkbox"/> 308-I 572 <input type="checkbox"/> 349	57		00
	58	Total payments and refundable credits: Add lines 55c, 56 and 57. Enter the total.....	58		00
Tax Due or Overpayment	59	TAX DUE: If line 54 is larger than line 58, subtract line 58 from line 54. Enter amount of tax due. Skip lines 60, 61 and 62.....	59		00
	60	OVERPAYMENT: If line 58 is larger than line 54, subtract line 54 from line 58. Enter amount of overpayment.....	60		00
Tax Due or Overpayment	61	Amount of line 60 to be applied to 2022 estimated tax.....	61		00
	62	Balance of overpayment: Subtract line 61 from line 60. Enter the difference.....	62		00

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Q&A

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