

# THE EMPLOYEE RETENTION TAX CREDIT

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## Potential applicability for law firms

The Employee Retention Tax Credit (“ERC”) has been a hot topic in tax circles lately. A refundable payroll tax credit for businesses meeting certain requirements that was enacted alongside the Paycheck Protection Program in 2020, the ERC was widely overlooked until recently. Despite its rise in popularity, law firms in the U.S. may be overlooking its availability to them.

Here, we discuss the basics and its potential applicability to law firms.

## ERC Basics

### *What and How Much is It?*

The ERC is a refundable payroll tax credit for eligible employers that meet certain requirements (discussed below). If an eligible employer qualifies, the refundable credit can be substantial. For 2020, [1] the ERC can be up to \$5,000 per employee. In 2021, Congress increased the ERC substantially to \$7,000 per quarter for each of the first three quarters of 2021. [2] Thus, the maximum ERC is \$26,000 per employee if the employer meets all the requirements in each of the ERC periods.

### *What are the Requirements?*

Given the dollar amount of the ERC, it is no surprise employers must meet numerous requirements to qualify. This article discusses the two primary requirements: being (1) being an “eligible employer” and (2) a “small eligible employer.” To complicate this, these definitions differ depending on whether the ERC being claimed is for 2020 or 2021.

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# Who is an "Eligible Employer"?

The ERC is only available to "eligible employers" – those carrying on a trade or business during 2020 and/or 2021 that meets at least one of the two following requirements during any calendar quarter during 2020 or quarters one through three of 2021:

- Experienced a full or partial suspension of an employer's business operations due to a government order ("full or partial suspension test"); or
- Experienced a significant decline in gross receipts ("gross receipts test").

## ***Full or Partial Suspension Test***

To qualify under this test, the employer must have (1) a full or partial suspension of operations that (2) was caused by a government order.

Whether a full or partial suspension occurs depends on the facts and circumstances of each employer. However, "[a]n employer that operates an essential business may be considered to have a partial suspension of operations if, under the facts and circumstances, more than a nominal portion of its business operations are suspended by a governmental order."<sup>[3]</sup>

"[A] portion of an employer's business operations will be deemed to constitute more than a nominal portion of its business operations if either:

- (i) the gross receipts from that portion of the business operations is not less than 10 percent of the total gross receipts (both determined using the gross receipts of the same calendar quarter in 2019), or
- (ii) the hours of service performed by employees in that portion of the business is not less than 10 percent of the total number of hours of service performed by all employees in the employer's business (both determined using the number of hours of service performed by employees in the same calendar quarter in 2019)." <sup>[4]</sup> Id. at 28.

Government orders include "[o]rders, proclamations, or decrees from the Federal government or any State or local government . . . only if they limit 'commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to the coronavirus disease 2019 (COVID-19)' and relate to the suspension of an employer's operation of its trade or business." <sup>[5]</sup>

Thus, an employer may qualify for the ERC under partial suspension test if an appropriate government order causes a suspension effecting more than a nominal portion of the employer's business. <sup>[6]</sup> A full or partial suspension does not require the impact on the business be more than nominal, an important distinction.

## ***Gross Receipts Test***

An employer may qualify for the ERC under the gross receipts test if it experiences a significant decline in gross receipts for a quarter when compared to the same quarter in 2019. Whether an employer experienced a "significant decline in gross receipts" differs depending on whether the ERC period is in 2020 or 2021.

For 2020, a significant decline in gross receipts requires a reduction in gross receipts of greater than fifty percent when compared with the same quarter in 2019. <sup>[7]</sup> For 2021, the reduction in gross receipts need only be greater than twenty percent when compared with the same quarter in 2019.

Additionally, employers may use an alternative quarter election for 2021. The alternative quarter election allows the employer to "determine if the decline in gross receipts test is met for a calendar quarter in 2021 by comparing its gross receipts for the immediately preceding calendar quarter with those for the corresponding calendar quarter in 2019." <sup>[8]</sup> Thus, for example, "[f]or the second calendar quarter of 2021, an employer may elect to use its gross receipts for the first calendar quarter of 2021 compared to those for the first calendar quarter of 2019 to determine if the decline in gross receipts test is met." <sup>[9]</sup>

# Who is a "Small Eligible Employer?"

The definition is different depending on whether the ERC period is 2020 or 2021.

In order to potentially qualify for the maximum ERC amount for 2020 and 2021, the employer must not have greater than 100 and 500 full-time employees in 2019, respectively. "Full time employee" is defined as at least 30 hours of service per week or 130 hours of service per month.

## Do Law Firms Qualify?

Each law firm must analyze its situation on a case-by-case basis, but law firms may qualify for the ERC under the two following situations.

### *Law Firms with Partial Suspensions*

As many readers know, several states issued numerous COVID-related orders [10] in 2020 that resulted in continuation of scheduled trials, which may qualify as a partial suspension of a law firm's operations.

The IRS does not specifically address the legal industry, but based on the guidance provided by the IRS, there is a strong argument that numerous trial continuances as a result of court order qualify as a partial suspension of the law firm's operations. According to the IRS, "a governmental order that results in a reduction in an employer's ability to provide goods or services in the normal course of the employer's business of not less than 10 percent will be deemed to have more than a nominal effect on the employer's business operations."

Additionally, IRS Notice 2021-20 uses as an example of a partial suspension a restaurant that, as a result of a government order, closes its indoor dining that is more than a nominal portion of the business operations. [11] The same Notice concludes that the same restaurant continues to have a partial suspension when it resumes indoor dining if all tables in the indoor dining room are spaced at least six feet apart. [12]

Under this guidance, a law firm may qualify for the ERC under the partial suspension test if the law firm's litigation revenue or hours in 2019 make up more than 10 percent of the total revenue or hours in 2019 (analyzed on a quarterly basis) and in 2020 or 2021 that firm had a significant number of trials continued due to COVID-related court orders.

### *Law Firms with a Decline in Gross Receipts*

Even if a law firm does not qualify for the ERC under the full or partial suspension test, it should analyze whether it qualifies under the gross receipts test as outlined above, paying particular attention to the alternative quarter election for purposes of the 2021 ERC.

## Conclusion

This article addresses the basic qualifying requirements of the ERC. Once a law firm determines it qualifies, it must also determine the periods for which they qualify, properly calculate, and file the proper documents to claim the ERC.

### *For More Information*

For additional information on the ERC, access the "Clarifying Misconceptions Surrounding the Employee Retention Credit" on the Dickinson Law Blog at [www.dickinsonlaw.com](http://www.dickinsonlaw.com).

## References

[1] The ERC period for 2020 begins March 16, 2020.

[2] Recovery startup businesses may qualify for Q4 2021 if specific requirements are met. See Generally IRS Notices 2020-49 and 2021-65.

[3] IRS Notice 2021-20 at 27, Q&A 11.

[4] Id. at 28, Q&A 11.

[5] Id. at 24, Q&A 10.

[6] Id. at 34-39, Q&As 18 and 19.

[7] See Id. at 44-45, Q&A 23. More specifically, an employer experiences a “significant decline in gross receipts for the period beginning with the first calendar quarter in 2020 for which its gross receipts are less than 50 percent of gross receipts from the same calendar quarter in 2019 and ending with the earlier of January 1, 2021 or the first calendar quarter after the quarter for which gross receipts are greater than 80 percent of gross receipts for the same calendar quarter in 2019.”

[8] IRS Notice 2021-23 at 6-7.

[9] Id. at 7.

[10] Many states issued numerous court orders that caused continuances of trials.

[11] IRS Notice 2021-20 at 35, Example 1.

[12] Id. at 35-36, Example 2.



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Cody and Charles are currently assisting over 50 eligible employers claim an Employee Retention Tax Credit.



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