

2021 NATIONAL INCOME TAX WORKBOOK

CHAPTER 12: PAYROLL AND TAX
CREDIT ISSUES



Topics

P. 447

- Issue 1: Payroll Tax Overview
- Issue 2: Payroll Tax Deferral
- Issue 3: Employee Retention Credit
- Issue 4: Sick Leave and Family Leave Credits
- Issue 5: COBRA Premium Assistance Credits

2

Payroll Tax Overview

P. 448

- FICA wages:
 - Old-age, survivors, and disability insurance (OASDI) = 12.4%
Capped at \$142,800 in 2021
 - Employer pays 6.2%, withholds 6.2%
 - Hospital insurance (Medicare) = 2.9%
 - Employer pays 1.45%, withholds 1.45%
- Additional Medicare tax = .9% above \$200,000 for single/HOH and \$250,000 for MFJ, must withhold from employee if employer pays more than \$200,000

3

Payroll Tax Deposits

PP. 449-450

- Schedule based on size of employer's payroll
- Cross-Reference – Penalties – see 2020 NITW
- Payroll Tax Reporting
 - Most file quarterly Form 941
 - Agricultural employers file annual Form 943
 - With IRS permission, very small employers file annual Form 944
- Information Reporting Deadlines for 2022
 - January 31, 2022 – employer must send Form W-2s to employees and file W-2 and W-3 with SSA

4

Self-Employed Taxpayers

P. 450

- 12.4% social security tax on earnings, up to \$142,800 in 2021
 - 2.9% Medicare tax on earnings and an additional .9% Medicare tax on earnings above \$200,000 for single and \$250,000 for MFJ
 - SE tax on 92.35%
 - Reported on Form 1040, Schedule SE
 - No SE tax is due for earnings < \$400
 - Cross-Reference Estimate Tax Payments, NITW 2018, PP 223-224
- Self-employed individuals (who are not farmers) must generally make estimated payments if they expect to owe \$1,000 or more.

5

Issue 2: PAYROLL TAX DEFERRAL

PAYROLL TAX DEFERRALS

P. 451

- CARES ACT – **Employer** deferral
 - 3/27/20 through 12/31/20
- Memorandum – **Employee** deferral
 - 9/1/20 through 12/31/20
 - Bi-weekly wages less than \$4,000

PAYMENT OF EMPLOYER PAYROLL TAX DEFERRAL

P. 451

- Repay 50% by **12/31/21**
- Repay 50% by **12/31/22**
- Observation – **Nonbusiness Days** – pay on the **next business day**
- Payment **first applied** to 50% due in 2021
- **Example 12.1** – Dogwood Landscaping deposited \$10,000 of total \$30,000 owed. Pay \$5,000 (one-half of total owed) by 12/31/21.

How to Pay? – Deferred Amounts

P. 452

- Deferred amounts owed may be paid (1) electronically using the Electronic Federal Tax Payment System (**EFTPS**), (2) by **credit or debit card**, or (3) **by check or money order**.
- If paying by EFTPS, **select Form 941** and the **calendar quarter in 2020** to which the payment relates. **Separate payment for each quarter**.
- If paying by **check or money order**, include a 2020 **Form 941-V**, Payment Voucher. **Fill in the circle** for the correct quarter.

Self-Employed – Deferred Payroll Taxes

P. 453

- Self-Employed could defer 50% of social security tax
- Same as Employer
- Repay the deferred tax in two installments, 50% by December 31, 2021, and the rest by December 31, 2022
- Pay by EFTPS or by credit or debit card, money order or with a check
- Separate payments from other tax payments
- Designate as **deferred Social Security tax**

10

Employee – Deferred Payroll Taxes

P. 453

- Self-Employed could defer 50% of social security tax
- Withhold and pay ratably between 1/1/21 and 12/31/21
- Interest/penalties begin to accrue 1/1/22

11

Issue 3: EMPLOYEE RETENTION CREDIT

Employee Retention Credit

P. 454

- Fully refundable payroll tax credit
 - Amount of credit **may exceed payroll taxes due.**
 - **File Form 7200!**
- Implemented by the CARES Act, modified by the TCDTRA, and extended by ARPA
- Three time-frames with different rules:
 - Wages paid after March 12, 2020, and before January 1, 2021
 - Wages paid during Q1 and Q2 of 2021
 - Wages paid during Q3 and Q4 of 2021

13

2020 Employee Retention Credit

P. 454

- Most of the 2020 rules apply to the 2021 ERC
- Key: CARES Act said **no ERC if client received PPP**
 - TCDTRA: eligible for both, but can't use the same wages for both (retroactive relief)
- Can amend to claim

14

Practitioner Note Self-Employed Col.1, Top

P. 455

- Self-employed individuals are **not eligible** for the ERC because they do not earn wages.
- They **may claim credit for wages paid to their employees.**

15

ERC – Eligible Employers

P. 455

An "eligible employer" is any employer carrying on a "trade or business" during calendar year 2020 for which, during any calendar quarter:

- (1) the operation of the trade or business carried on during calendar year 2020 is "fully or partially suspended" due to "orders from an appropriate governmental authority" limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19, or
- (2) such calendar quarter is within the period in which the employer had a "significant decline in gross receipts."

16

Practitioner Note Eligible Wages Col. 1

P. 455

- Employer Fully or Partially shutdown Portion of Quarter
- Eligible Employer entire QTR, Eligible Wages, shutdown period only
- Eligible Employers
- Must be in a **trade or business**
 - Means that household employers are not eligible for the ERC
 - Tax exempt organizations are deemed to be in a T or B for all their operations

17

Eligible Employers

P. 455

- Practitioner Note, Col. 2 – Entity Type
- Employers of any size are eligible
- Tax exempt organizations under IRC §501(c) and §501(a) are eligible
- Federal, state, and local government entities not eligible in 2020
- Tribal governments are eligible

18

Suspended Business Test

P. 455

- If a **government order** has "**fully suspended**" an employer's operations, it will generally qualify for the ERC.
- Employers may also qualify if their operations were "**partially suspended**" by government order.

19

Governmental Orders

- Must be an actual order by a governmental authority with jurisdiction over the operations. Must be mandatory, not advisory.
- Do not include press conference comments, declaration of a state of emergency that does not limit or suspend actual operations.
- Don't look at whether government enforced the order.

20

Eligible Employers – Partially Suspended

P. 456

- If **more than a nominal portion of business operation** was suspended – Practitioner Note
 - Gross receipts from that portion of business operation are not less than **10% of the total gross receipts**
 - Hours of service performed by the employees in that portion of the business are **not less than 10%** of the total hours of service

21

Not Partially Suspended

PP. 456-457

- Customers stay home due to government orders, and business has reduction in demand
- Workplace is closed, but continued business operations are comparable to pre-closure operations
- Mask wearing, one-way aisles, etc. will not have more than a nominal effect on business operations
- Employers continue operations through telework

22

May Be Partially Suspended

P. 457

- Suppliers cannot make deliveries of critical goods or materials
- More than a nominal portion is closed or suspended
- Modifications have more than a nominal effect
- Significant delay (more than 2 weeks) to move operations to telework

23

Ex. 12.4 Temp. Closure

P. 457

- Processed Foods, Inc. operates a facility that usually operates 24 hours/day
- Local health department says business must clean workplace once every 24 hours
- Business operations reduced by 5 hours each day to comply with the order

24

Ex. 12.5 Partial Closure

P. 457

- Stuff for All, Corp. is a large retailer
- Governmental order closes the storefront for two quarters in 2020
- Customers could pick-up orders
- Storefront is more than nominal

25

Example – Partial Suspension

P. 457

- Stuff for All, Corp. is a large retailer.
- Government order closes the storefront for two quarters in 2020.
- Customers could have pick-up orders.

26

Ex. 12.6 Open with Restrictions

P. 458

- Governmental order revised to allow storefront traffic, but customers had to socially distance and store had to enforce occupancy caps
- Customers sometimes had to wait in short lines to enter business
- No more than nominal effect

27

Suspension v. Decline in Gross Receipts P. 458**PLANNING POINTER****Suspension vs. Decline in Gross Receipts**

If the employer can establish a significant decline in gross receipts, no suspension is required. The employer does not have to establish that the decline was COVID-19-related. Qualifying under the decline in gross receipts test (discussed next) may result in a larger credit because the employer can consider all wages paid during the quarter, not just the wages paid during the shutdown period.

28

Decline in Gross Receipts Test

P. 458

- Eligible in **2020** for any quarter where gross receipts were **< 50%** of gross receipts for the **same calendar quarter in 2019**.
- Eligibility period ends with the earlier of January 1, 2021, or **first calendar quarter following** 1st calendar quarter where gross receipts **> 80% of gross receipts** for same quarter in 2019.

29

Ex. 12.7 Applying the Test

PP. 458-459

- Comfort Shoes had a **reduction in customers** in early 2020, while it improved retail website.
- **48% decline in Q1, 83% in Q2**, and 92% in Q3
- **Significant decline in Q1 and Q2**
- Not Quarter 3

30

New Businesses

P. 459

- Practitioner Note
- Special rules apply to new businesses
- See Notice 2021-20
- **Started After February 15th, 2020**

31

Definition of Gross Receipts

P. 459

- Non-tax exempt: I.R.C. § 448(c)
 - Tax-exempt: I.R.C. § 6033
 - Gross receipts includes **all gross receipts**, not just those from **Unrelated trade or business income**.
- Practitioner Note – Gross Receipts, Col.1
- Forgiven loan proceeds, grants are **not included** in gross receipts

32

Calculating the 2020 ERC

P. 459

- For 2020, the maximum ERC is **50% of qualified wages** (including allocable **health plan expenses**) that an eligible employer paid in a calendar quarter.
- The **maximum** qualified wages that can be taken into account for the 2020 ERC is **\$10,000 per employee for all quarters**.
- The **maximum 2020 ERC is \$5,000 per employee**.

33

Qualified Wages for 2020

P. 459

- Limited to FICA wages paid **after March 12, 2020**, and before **January 1, 2021**
- Amounts paid to **maintain group health plan** if excluded from income
- Large employer – amounts paid to employee **not working b/c suspension**
- Small employer – amounts paid to **all employees b/c business suspended**
- **Cash tips** treated as wages or compensation

34

Ex. 12.8 2020 ERC Calculation

P. 460

- Stray Cat Consulting **4 employees**
- Significant decline in gross receipts Q2, Q3, Q4
- **Figure 12.3** payroll and ERC calculation
- \$10,000 limit applies to 2 employees
- **\$15,250 ERC**

35

No Wage Duplication

P. 460

- Practitioner Note
- Qualified wages do not include:
 - those taken into account for FFCRA credits
 - those taken into account for IRC § 45S (**paid family and medical leave credit**)
 - those counted as payroll costs necessary to obtain **PPP loan** forgiveness

36

ERC – Related Individuals

P. 461

- Rules “similar to the rules of I.R.C. § 51(i)(1)” Work Opportunity Credit apply
- **Can't count wages paid to certain relatives**
- **Entity attribution rules apply**

37

ERC – Related Individuals

P. 461

- A related individual is **any employee who has** of **any** of the following **relationships to the employer**, who is an individual:
 - A child or a descendant of a child
 - A brother, sister, stepbrother, or stepsister
 - The father or mother, or an ancestor of either
 - A stepfather or stepmother
 - A niece or nephew
 - An aunt or uncle
 - A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law

38

ERC – Related Individuals

P. 461

- For **corporations**, a related individual is any person that bears a relationship described above with an individual **owning, directly or indirectly, more than 50% in value** of the outstanding stock of the corporation.
- For an **entity other than a corporation**, a related individual is any person that bears a relationship described above with an individual **owning, directly or indirectly, more than 50% of the capital and profits interests** in the entity.
- For an **estate or trust**, then a related individual includes a grantor, beneficiary, or fiduciary of the estate or trust, or any person that bears a relationship described above with an individual who is a grantor, beneficiary, or fiduciary of the estate or trust.

39

ERC – Related Individuals

P. 461

- Indirect ownership is determined through the application of I.R.C. §267(c), which provides the following (among other) rules:
 - An individual shall be considered as owning the stock owned, **directly or indirectly**, by or for his family
 - The family of an individual includes only brothers and sisters (whole or half-blood), spouse, ancestors, and lineal descendants

40

ERC – Related Individuals

PP. 461-463

- Notice 2021-49 provides guidance
 - Ex. 12.9 **No ERC** for 80% owner of corp. and son employee
 - Ex. 12.10 **No ERC** for 100% owner of corp. and nonemployee son
 - Ex. 12.11 **Yes ERC** for 100% owner of corp. and spouse employee

41

ERC and PPP Loan Forgiveness

PP. 463-464

- **Wages count for ERC or PPP forgiveness – not both**
 - Eligible employer that received a PPP loan is **deemed to have made an election** not to take those wages into account for the ERC if include on forgiveness app.
 - Election only applies if wages were **necessary** for forgiveness.

42

Ex. 12.12 Include Only Wages for PPP Forgiveness P. 464

- Good Eats received a \$100,000 PPP loan.
- On its forgiveness application, it included \$100,000 in payroll costs that would qualify as wages.
- Good Eats also paid \$40,000 in nonpayroll costs but didn't include on its forgiveness application.
- Election to exclude \$100,000 from ERC.

43

Ex. 12.13 Including Wages and Nonpayroll P. 465

- Same facts but Good Eats included \$100,000 in payroll costs that would qualify as wages and \$40,000 nonpayroll costs.
- Only needed \$60,000 in payroll costs, so only \$60,000 deemed excluded from ERC.

44

ERC and the PPP, Col. 1

P. 465

PLANNING POINTER**Maximizing the ERC**

To maximize the ERC, employers should first allocate toward forgiveness any payroll expenses that are payroll costs for PPP forgiveness but are not qualified wages for purposes of the ERC. These expenses include employer contributions for employee retirement benefits and compensation of partners.

45

Tax Treatment of the ERC

P. 465

- The ERC is **not income to the employer**, but it requires the employer to reduce deduction for qualified wages, including qualified health plan expenses **in the amount of the ERC**.
- Employers **do not reduce the deduction** by the employer's share of the SS and Medicare taxes.

46

Amending 2020 Returns to Claim ERC PP. 465-466

1. Determine **quarter(s) of eligibility**
2. Determine **qualified wages** (including allocable health care expenses paid)
3. **Eliminate wages** used on a successful **PPP forgiveness** application, those for which a FFCRA credit was taken, or (if basis of qualification was a shutdown) those wages attributable to period during which employees were working
4. **Eliminate unqualified employees** (related parties, those for whom a work opportunity credit was paid in 2020 quarter)
5. Calculate the **ERC by quarter**

47

Amending 2020 Returns to Claim ERC

P. 466

6. **Fill out and file** the Form 941-X, 943-X, or 944-X (and accompanying worksheets), as appropriate
7. Amend **2020 income tax return** as necessary to **reduce a prior deduction for qualified wages** in the amount of the ERC

Period of Limitations
3 years to file 941-X

Practitioner Note Amended Income Tax Return, Col. 2, (P. 465)
Amended return may cause penalties. May not be advantageous to file

48

Ex. 12.14 Amending 2020 Returns

PP. 466-472

Rolly's Roadhouse had a decline in gross receipts
 \$44,833 qualified wages (after allocated to PPP forgiveness)
 \$15,000 ERC
 Claim on amended 941-X – Figure 12.6

49

2021 Employee Retention Credit

P. 473

- Credit is significantly expanded for all quarters in 2021.

PRACTITIONER NOTE**Credit Significantly Enhanced**

As a result of the TCDTRA changes, many employers who did not qualify for the ERC in 2020 may now qualify for the newly expanded 2021 ERC. Additionally, the credit will generally be significantly larger. Tax practitioners should ensure that eligible employers are aware of this credit, even if the practitioner does not process payroll tax returns.

50

2021 Employee Retention Credit

P. 473

- **Eligible Employers** – added colleges and hospitals
- **Decline in Gross Receipts Test**
 - **80% threshold**
 - Employer qualifies if gross receipts for calendar quarter in 2021 are less than 80% of gross receipts (>20% decline) for same calendar quarter in 2019.
- **Alternate calculation** also available

51

2021 Credit Calculation

P. 474

- ERC credit is increased from 50% to 70% of qualified wages.
- Limit remains \$10,000, but is for each quarter, not across quarters.
- Eligible employer can claim up to \$28,000 credit per employee in 2021.
- Qualified Wages
 - Large employers expanded to > 500 (instead of >100).
- Severely Financially Distressed
 - In Q3 and Q4, large employers whose revenue is less than 10% of revenue for comparable 2019 quarter may count all wages, whether employees worked or not.
- Recovery Startups - \$50,000 limit per quarter

52

NOT QUALIFIED WAGES

P. 475

- Qualified wages for the ERC don't include wages taken into account for credits under I.R.C. §§ 41, 45A, 45P, 45S, 51, 1396, 3131, and 3132.
- Qualified wages also don't include wages that were used as payroll costs in connection with a Shuttered Venue Operator Grant or a restaurant revitalization grant. No PPP loan forgiveness and a credit for the same wages.

53

EX. 12.15 CALCULATING 2021 CREDIT PP. 475-476

- In 2021, SCC had significant decline in gross receipts for Q2, Q3, and Q4.
- Figure 12.6 payroll and credit calculation
- SCC is eligible for a \$46,200 credit (compared to \$15,250 in 2020).

54

Claiming the Credit

P. 476

- The ERC is a refundable credit against certain payroll taxes. For wages paid **before July 1, 2021**, the nonrefundable portion of the ERC was against the employer share of social security tax (6.2%).
- However, for wages paid after June 30, 2021, the nonrefundable portion of the ERC is against the employer share of Medicare tax (1.45%).
- Reduce employment tax deposits
- Advance credit – file Form 7200

55

2021 ERC – Extended Audit Period

P. 477

- ARPA includes a new 5-year statute of limitations for IRS to audit and assess a deficiency for claiming the ERC in quarters three and four of 2021.
- Prior quarters are subject to the standard 3-year audit rule.

56

COMPARING THE PROVISIONS

PP. 477-478

Figure 12.9 compares ERC

- 2020
- Q1 and Q2 2021
- Q3 and Q4 2021

57

Issue 4: SICK LEAVE AND FAMILY LEAVE CREDITS

Sick and Family Leave Credits

P. 479

- From April 1, 2020, through December 31, 2020, the FFCRA provided for paid coronavirus-related leave through:
 - the Emergency Paid Sick Leave Act (EPSLA), which entitled workers to up to 80 hours of paid sick time when they were unable to work for certain reasons related to COVID-19, and
 - the Emergency Family and Medical Leave Expansion Act (Expanded FMLA), which entitled workers to certain paid family and medical leave.

59

Sick and Family Leave Credits

P. 479

- COVIDTRA extended the FFCRA leave credits through March 31, 2021. No longer mandatory
 - Through March 31, 2021, credits claimed in 2020 reduced the credits available in the first quarter of 2021.
- ARPA extended the credits through September 30, 2021 and expanded availability.

60

Sick and Family Leave Credits

PP. 479-480

- **Eligible Employers**
- Businesses and tax-exempt w/ fewer than 500. Not government.
- **Wages**
- Compensation
- **No double benefit**
- Practitioner Note – for family leave and sick leave to care for someone else limited to 2/3 regular pay, max \$200/day

41

Sick Leave Credits

PP. 480-481

- 80 hours/\$511 per day if employee can't work b/c employee is ill
- 80 hours/\$200 day if employee can't work b/c caring for someone else

Family Leave Credits

\$200/day capped at \$10,000

Ex. 12.16 two limits apply

Additions to the Credits

Medicare tax, health insurance coverage

Tax Treatment

Include in gross income

42

Q2 and Q3 2021 Credits

P. 482

- ARPA resets and expands
- **New category of sick leave beginning April 1**
 - the time the employee is seeking or awaiting the results of a diagnostic test for a medical diagnosis of, COVID-19 (and the employee has been exposed to COVID-19 or the employee's employer has requested such test or diagnosis), or
 - the employee is obtaining immunizations related to COVID-19 or recovering from an injury, disability, illness, or condition related to such immunization (or caring for someone else who meets this criteria).

43

Additional Amounts

P. 483

- Qualified sick and family leave wages taken by employees prior to April 1, 2021, were only subject to the employer's share of Medicare tax (and **not** the employer's share of social security tax); therefore, the employer was entitled to receive credits to offset only the Medicare tax for those periods.
- Under I.R.C. §§ 3132 and 3133, qualified family and sick leave wages are subject to the employer's share of social security tax and Medicare tax, but the **credit is increased by the employer's share of social security and Medicare taxes imposed** on the qualified family leave wages.

64

Tax Treatment

P. 484

- In the third and fourth quarters of 2021, eligible employers must **include the full amount of the credits received** for qualified leave wages **in income**.
- Qualified leave wages and health care expenses generally remain deductible.

65

Sick and Family Leave Credits

PP. 484-487

- Interaction w/ other credits – **no double benefit**
- **Extended limitation period – 5 years**
- Documenting eligibility – **keep records 6 years**
- Self-Employed – **comparable credits**
- **Figure 12.10 Comparison** of sick and family leave credits
- 2020 Q2, Q3, Q4
- 2021 Q1
- 2021 Q2, Q3

66

Issue 5: COBRA PREMIUM ASSISTANCE CREDITS

COBRA Premium Assistance Credit PP. 488-489

- ARPA premium assistance and corresponding tax credit
- 100% reduction in premium
- Loss of coverage because of reduced hours or involuntary termination
- April 1 through September 30, 2021
- Refundable payroll credit
- Reduce employment tax deposits, request an advance
- Included in gross income of recipient

68

Discussion
