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Retroactively Claim the Employee Retention Tax Credit

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When Jim Lundy spoke to his clients in the asphalt business at the start of the COVID-19 pandemic, they were already committed to keeping as many employees as they could. Lundy is [a] construction services [tax] leader at the accounting firm Marcum LLP and specializes in heavy highway construction companies.

"Labor is the biggest constraint most of my construction clients are currently facing, so they were very concerned to keep their people when it looked like the economy was going off a cliff," he said. Then, the Employee Retention Tax Credit (ERTC) and Paycheck Protection Program (PPP) passed and provided some relief to help them do what they were already planning to do: keep their workers working.

The ERTC is a refundable tax credit against the employer's share of certain payroll taxes. To be eligible for the ERTC, a private-sector employer or tax-exempt organization must have fully or partially suspended operations during any calendar quarter of 2020 due to orders from an appropriate government authority related to COVID-19 or experienced a significant decline in gross receipts during the calendar quarter.

At first, Lundy thought PPP provided more support for his clients than ERTC—and initially businesses could only take advantage of one program or the other. But then, a tax law change late in 2020 allowed businesses to take advantage of both. For 2021, the conditions to qualify for the ERTC were adjusted from a 50% decline in revenue from pre-COVID levels to a 20% decline. Instead of being limited to companies with fewer than 100 employees, companies with up to 500 employees became eligible for the credit. The maximum credit amount was increased from an annual amount of 50% of qualified employee wages on the first $10,000 per employee in 2020 (a maximum of $5,000) to 70% of up to $10,000 of qualified employee wages per quarter ($7,000 per quarter). And companies no longer had to choose between PPP and ERTC, so long as wages paid with the PPP loan don't qualify for the ERTC.

Businesses that began operations after Feb. 15, 2020, and whose annual gross receipts are less than $1 million that are not eligible for the ERTC under the categories of suspension of operations or decline in gross receipts may be eligible for ERTC as a Recovery Startup Business. The ERTC for RSBs ended Dec. 31, 2021, one quarter later than for other businesses.

All of a sudden, the tax credit became an attractive option that has benefitted Lundy's clients to the tune of millions of dollars. "If a company has 500 employees and receives $7,000 per employee for each of the three quarters the ERTC was available in 2021, the company could conceivably receive credits up to $10,500,000," Lundy said.

Lundy said that although many of his asphalt clients ultimately experienced relatively minor annual drops in revenue, some did experience 20% drops quarter over quarter when comparing 2020 or 2021 to 2019. "And if they are down one quarter, they can still qualify retroactively for the ERTC," he said.

How to claim ERTC

Trevor Genereux, tax department director for Marcum's office in Hartford, Connecticut, said the first step to claim the ERTC retroactively is to file a 941-X to amend your payroll tax return for the quarter in which you qualify for the ERTC. "Subsequently, once they have amended their payroll tax return to claim the credit, they will also need to amend their 2020 or 2021 income tax returns to report the income," he said. "So if a company received $100,000 in ERTC credits in Q4 of 2020, they'll have to amend their 2020 income tax return to reduce their deduction for wages by that amount."

Lundy said companies have three years from when the initial return was due to do so. For example, a payroll tax return for Q2 2020 due at the end of July 2020 would need to be amended by July 2023.

Unlike PPP loans, the ERTC is taxable. "That doesn't outweigh the benefit of the ERTC, but it is a factor," Lundy said. Not only is the ERTC taxable, but recipients have to pay taxes on ERTC money before they know if they've received it.

"You have to have the money available to pay the tax on the ERTC," Genereux said, and it can take up to a year to receive the refund. "There is a cash flow consideration, but it's ultimately still worth it."

Lundy points out that the IRS is not requiring companies to pay interest for amended returns related to the ERTC since the rules have changed. "Normally if you amend a return and owe taxes, you have to pay interest."

Genereux said that although the IRS isn't analyzing the 941-Xs being filed, it reserves the right to examine them at a later point in time. "Make sure you have the documentation to support that you qualify and that you're following the guidelines on what can be claimed for each employee," he said. "Just because you get a refund check doesn't mean they won't audit you later."

"As essential workers, contractors aren't qualifying for the ERTC under the government shut-down and are instead qualifying based on gross receipts," Genereux said, "especially in the asphalt industry."

"The IRS will audit these at some point in time, so make sure to cross your Ts and dot your Is," Lundy said. "However, a lot of companies are entitled to these credits and they should be able to take advantage of them."