March, 2023

Employee Retention Credit

A Legitimate Tax Credit Now Surrounded with Aggressive Advertising, Too Good to be True Pitches and Downright Fraud

Written by the Dental Accounting Group

The Legitimate

The Employee Retention Credit (ERC) is a legitimate tax credit brought about by the CARES Act of March 2020 and initially applied to wages paid from March 13, 2020 to December 31, 2020.

Initially, in 2020 you could not qualify for both the ERC and the PPP forgivable loan program. However, under the Taxpayer Certainty and Disaster Tax Relief Act of 2020, enacted December 27, 2020, the law was changed to allow taxpayers to claim both the PPP loan and the ERC.

For 2020, one of two criteria must be met. Either a full or partial suspension of operations due to a government order due to COVID-19 during any quarter (for dental practices in Washington this was March 19, 2020 – May 18, 2020 when elective dental procedures were halted) or a more than 50% drop in collections in any calendar quarter for 2020 compared to the same quarter in 2019.

Based on our experience, a large majority of Washington State dentists qualified under the more than 50% revenue reduction criteria for the 2nd quarter of 2020 (April 1-June 30) which automatically qualified them for Q3 2020 as well. Most maxed out their 2020 ERC benefits with their Q2 and Q3 payrolls and did not qualify for additional ERC benefits in Q4 2020.

The 2020 credit itself is equal to 50% of qualifying wages not exceeding $10,000 per employee for the year, or otherwise stated, a maximum of a $5,000 per employee. However, as an offset to this dollar-for-dollar credit, the employer must also file an amended return to report the ERC refund as income and pay tax on the additional income.

For example: A dentist qualifies for a $50,000 Employee Retention Credit for the second quarter of 2020. That is a $50,000 savings (dollar-for-dollar). However, the dentist must also file an amended income tax return to reduce the employer payroll tax expense by that same amount. Let's assume a 24% income tax bracket. Credit Savings: $50,000; additional income tax due from amended return filing equals $12,000 ($50,000 x 24%); net savings; $38,000.

2021 brought new less stringent rules to the ERC

The Employee Retention Credit was expanded in 2021 in a more generous package. The revenue reduction test was reduced to 20% and the credit was increased to $7,000 per employee per quarter. The revenue reduction test compares 2021 calendar quarter revenue to the same quarter in 2019. The required revenue reduction threshold dropped to more than 20% versus the 2020

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requirement of a more than 50% drop. The Relief Act of 2021 added an alternative quarter election rule giving employers the ability to look at the prior calendar quarter vs using 2019 when testing their revenue reduction.

For the third and fourth calendar quarters of 2021, the American Rescue Plan Act of 2021 amended the credit to make it available to "recovery startup businesses," employers who otherwise do not meet eligibility criteria (full or partial suspension or decline in gross receipts).

Lastly, the availability of the credit in the fourth quarter of 2021 is limited only to a recovery startup business. For all other businesses, the credit was no longer available past the third quarter of 2021.

Our observation is that not many dentists would qualify based on 2021.That said, if you struggled in 2021 for any reason – you should compare quarter by quarter 2021 to 2019 to see if you might qualify. For those that do qualify, the $5,000 maximum credit per employee was increased to **$7,000 per quarter - versus the "annual" credit of $5,000 allowed in 2020.**

The Potentially Illegitimate

Employee Retention Credit Mills have popped up over the last number of months with aggressive advertising and equally aggressive tactics. The Internal Revenue Service is quite skeptical of these mills and the veracity of their output; to the extent that the IRS has issued numerous cautionary notices and the criminal division of the IRS has become involved.

Some of the aggressive tactics include arguing that supply-chain issues have hurt a company's ability to generate revenue – which may be very true for some industries – but a difficult case at best to argue with private practice dentistry.

RED FLAGS:

- Sounds too good to be true
- The credit company takes a hefty commission
- The credit company does not sign the amended tax returns involved
- And/or the credit company refers you to a third-party tax preparer or CPA (a stranger to you) to sign the returns
- The credit company does not gather all of the necessary document which would include
  - 2019, 2020 and 2021 Profit and Loss Statement by quarter
  - Form 941 (Federal Employment Tax) for all quarters involved
  - Detailed PPP filings to identify wages upon which the ERC may not be based
  - Applicable federal income tax return for any years in which a claim is made
  - The company indicates that they will determine the credit, but you must determine your eligibility.
- The credit company doesn't perform a cost benefit analysis (their fees and increased taxes versus the potential refund)

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A worst-case scenario could be filing for a large credit – let's say $100,000. The credit company takes 40% or $40,000 as a commission. In addition, you pay federal income tax of $18,000 (30% of $60,000). Later, the IRS audits and finds your claim lacking and demands their $100,000 back, but you only have $42,000 of the proceeds. The IRS might also want penalties and interest – which may be significant.

If you are a Washington State Dentist and have not had your numbers evaluated for a possible Employee Retention Credit – we encourage you to do so. The 2020 tax year has a statute of limitations that runs into 2024 – so still plenty of time for your claim.

We highly recommend that you work with your CPA or other trusted tax advisor/preparer. If they do not perform this service, have them help you find a credible CPA/Tax Advisor that can and who will coordinate with your CPA/Tax Preparer and sign any related tax returns.

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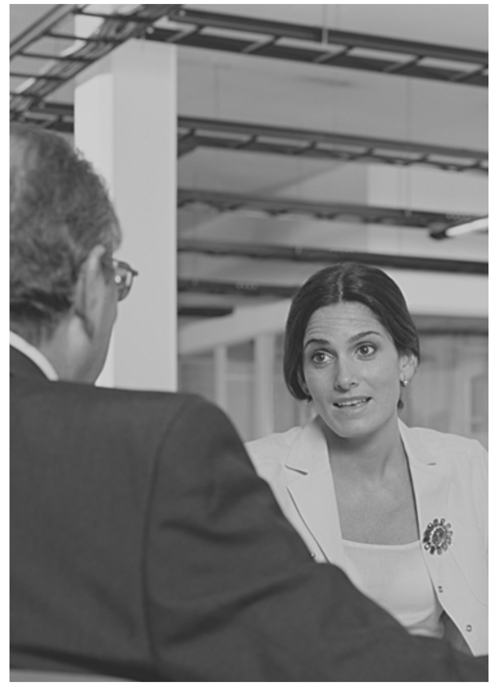

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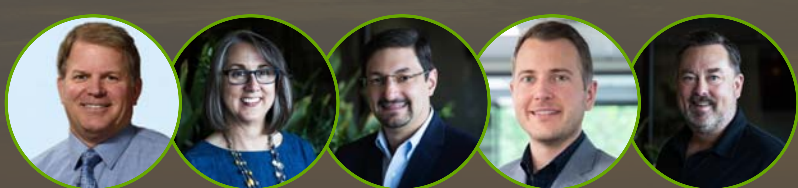

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