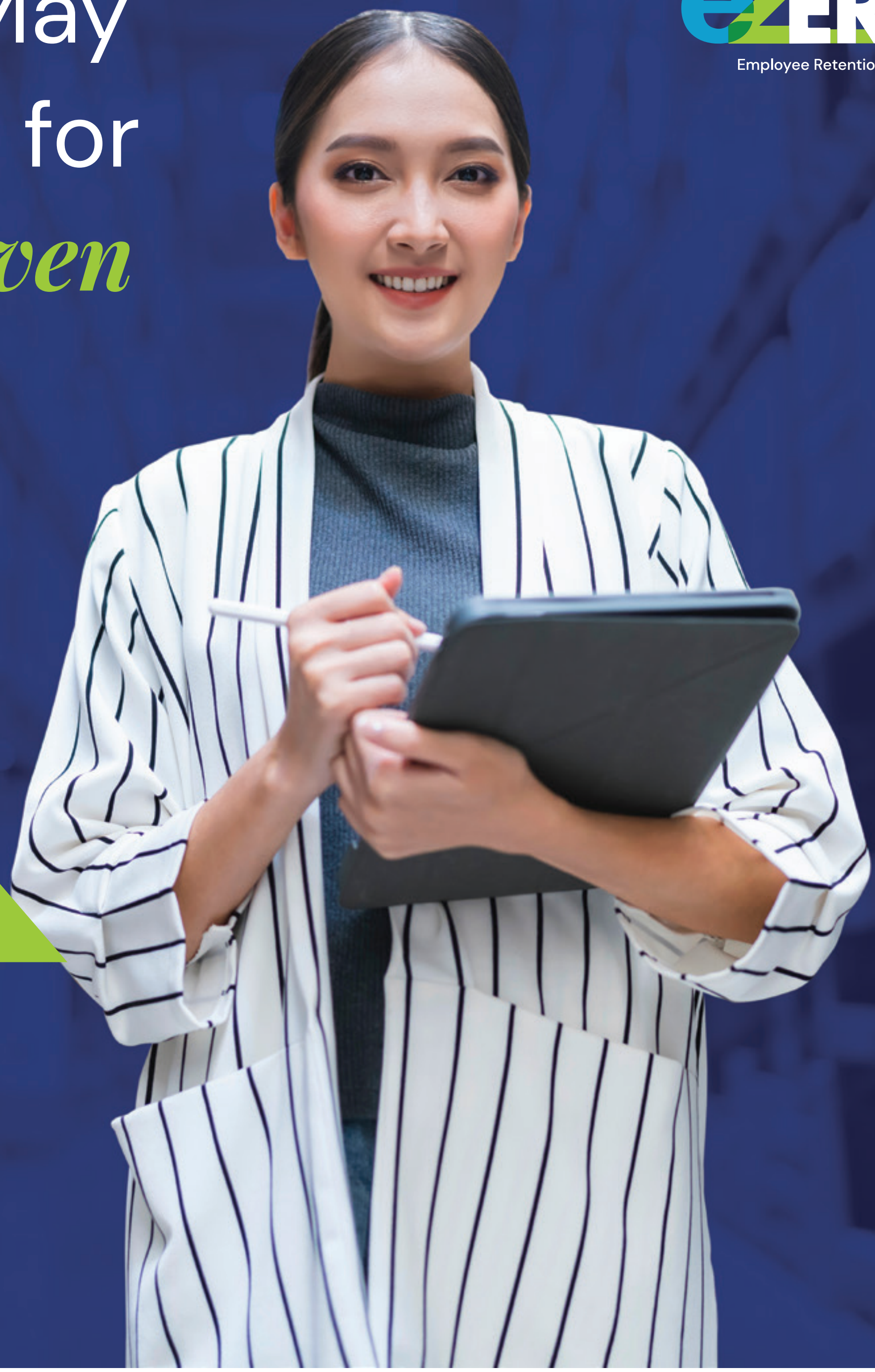
How You May be Eligible for the ERC *Even Without a Decline* in Revenue

Employee Retention Credit



One of the most common misconceptions concerning eligibility for the Employee Retention Credit ("ERC") relates to whether a business must have experienced a decline in revenue to be eligible for the ERC.

A Few Initial ***Key Points*** to Understand...

No Significant Decline in Gross Receipts?

You can still qualify. The "full or partial suspension of operations" (or "FPSO") test is not a financial statement test. Therefore, **a business is not required to have any decline in gross receipts** to evidence the existence of a FPSO. Congress created this test recognizing that: (1) gross receipts do not always tell the full picture of a business' COVID hardship; and (2) even profitable businesses may have had to make tough employee retention decisions due to COVID-19-related changes to their business. For example, a company may be successful in one line of business and not another, causing total revenue to increase while certain business lines suffer or diminish. The ERC was designed to encourage the retention of employees in both profitable and non-profitable businesses.

Deemed an Essential Business?

No problem. The Internal Revenue Service ("IRS") explicitly states that an essential business may be eligible under the FPSO test. The FPSO test looks for a **full or partial** suspension of business operations. Hence, a full closure or shutdown is not required.

Not Materially Impacted by Government Orders?

That's OK. The IRS carefully chose the words "more than nominal" to identify a situation where operational modifications and restrictions could result in a FPSO. The IRS did not use "substantial," "material," or other similar thresholds which may have suggested that a major impact be identified. Therefore, operational disruptions that are slightly more than inconsequential may substantiate ERC eligibility.

Despite the key points set forth above (which were established in the IRS' Notice 2021-20), we still find an **overwhelming number of businesses (and their CPAs) that mistakenly conclude that they are ineligible for the ERC** because their revenues did not suffer a quarter-over-quarter decline.

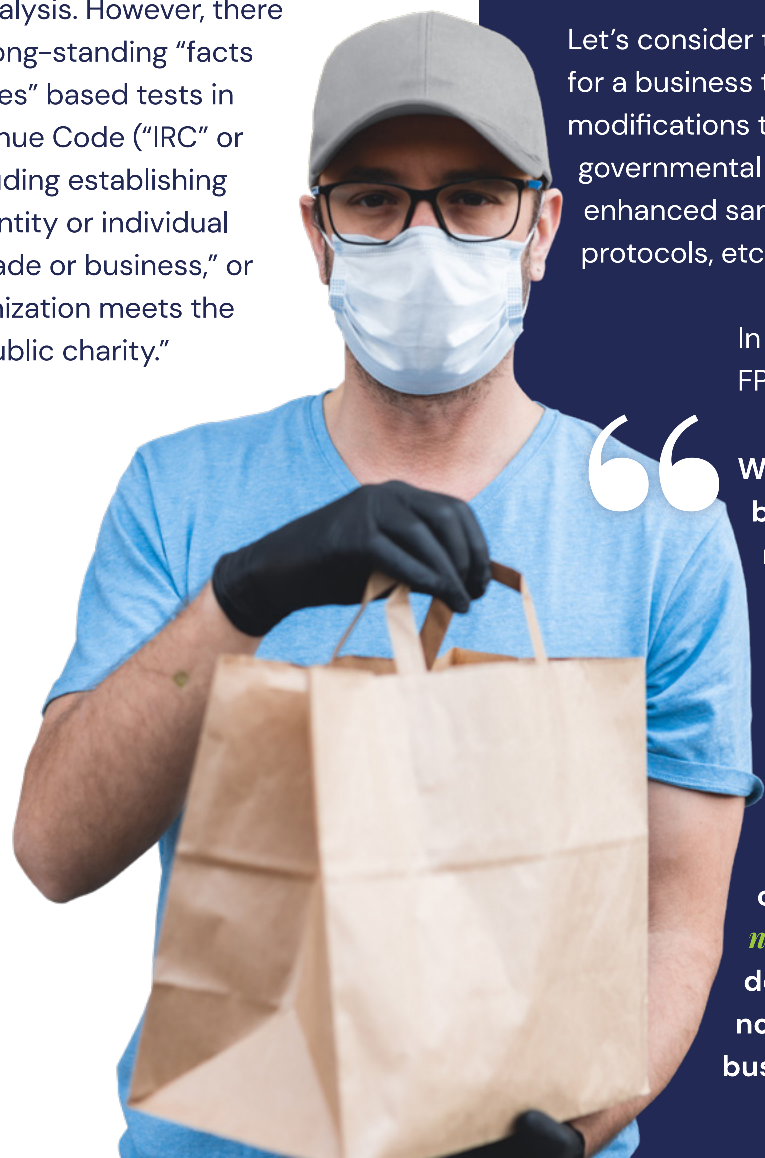
Why is that this case? Please see the next page.

THE CPA'S FPSO CONUNDRUM

Objective *Versus* Subjective Test

CPAs and taxpayers are generally more comfortable with empirical, quantitative, and objective tests. Frankly, identifying a "significant decline in gross receipts" (or "SDGR") is relatively simple and involves an exercise grounded in basic accounting. The results of this accounting exercise lead to definitive, objective conclusions.

The FPSO test, on the other hand, is explicitly a "facts and circumstances" based test, meaning that it is subjective in nature and may be open to interpretation ***and is therefore often difficult to confidently*** conclude. Many traditional CPAs do not often encounter, and are not often required to, apply such analysis. However, there are many other long-standing "facts and circumstances" based tests in the Internal Revenue Code ("IRC" or the "Code"), including establishing whether a legal entity or individual is operating a "trade or business," or whether an organization meets the definition of a "public charity."



Safe Harbor Rule

In connection with many facts and circumstances-based tests within the Code, the IRS often complements such tests with "safe harbors", a legal provision to reduce or eliminate liability and uncertainty in subjective tests by providing a supplemental definition of a test/rule that relies on quantitative, objective measurements.

Let's consider the IRS' clarification of a FPSO for a business that was required to make modifications to their operations due to a governmental order (i.e., social distancing, enhanced sanitation, COVID-19 infection protocols, etc.).

In providing one sub-definition of an FPSO, the IRS stated:

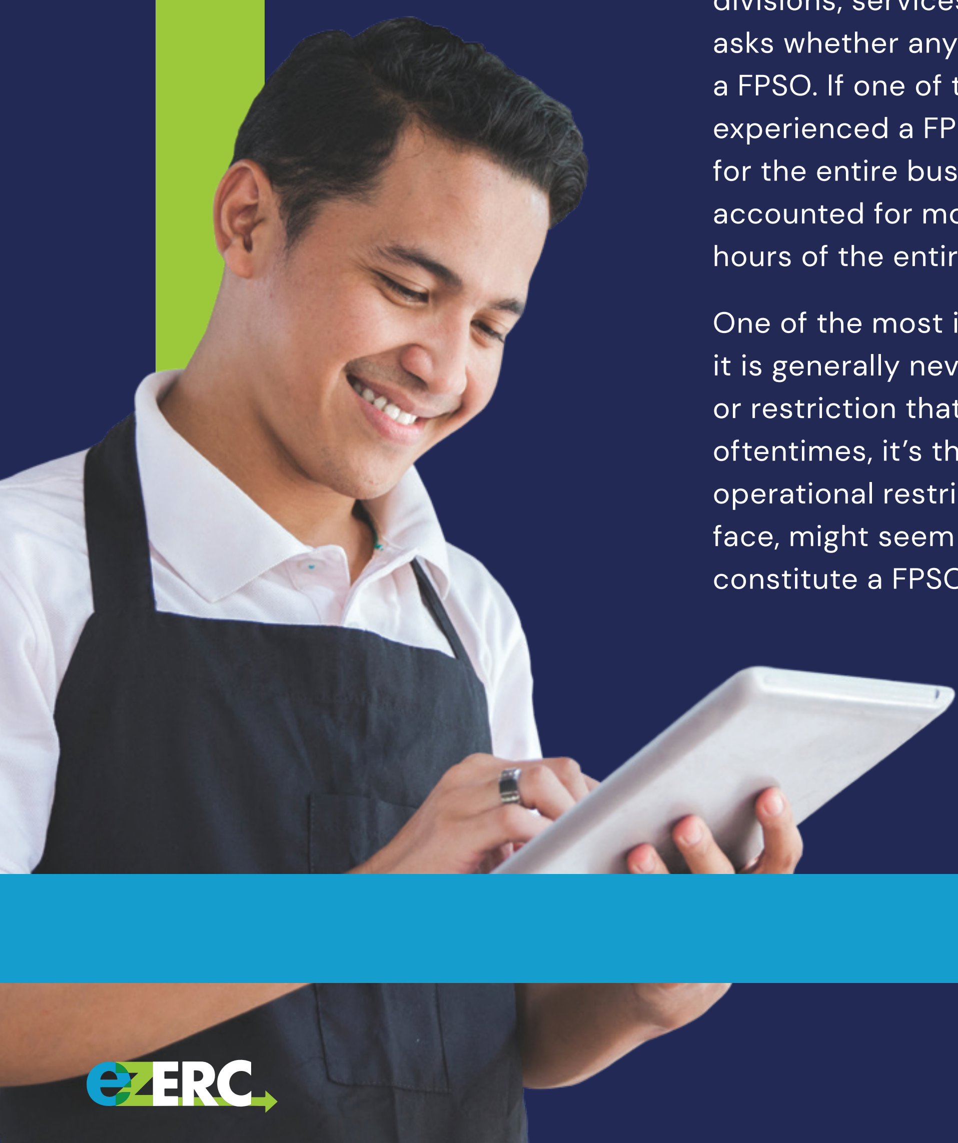
> **Whether a modification required by a governmental order has more than a nominal effect on the business operations is based on the *facts and circumstances*. A governmental order that results in a reduction in an employer's ability to provide goods or services in the normal course of the employer's business *of not less than 10 percent* will be deemed to have more than a nominal effect on the employer's business operations.**

While the first sentence above defines this test as being a facts and circumstances-based test, the second sentence provides a safe harbor test to help taxpayers wishing to use empirical data to support the notion that they have satisfied the FPSO test.

What is the general problem with the construct of this safe harbor? The IRS does not provide any details on what (or how) exactly to measure or quantify the reduction in an employer's ability to provide goods or services. *Sure*, revenues, service hours, widgets produced, meals served, etc., are all potential proxies; however, the absence of a defined numerator and denominator often makes this safe harbor far less objective than one may desire, especially your CPA.

To further complicate the matter, the IRS allows employers considering the ERC to first break their business into different "segments" (…think locations, divisions, services lines, business units, etc.) and then asks whether any segment of the business experienced a FPSO. If one of the company's "segments" experienced a FPSO, a FPSO is deemed to have existed for the entire business, so long as such segment accounted for more than 10% of the revenue or service hours of the entire business in 2019.

One of the most important things to remember is that it is generally never just one operational modification or restriction that is used to support a FPSO; oftentimes, it's the accumulation of several different operational restrictions or adjustments which, on their face, might seem inconsequential but in the aggregate constitute a FPSO.



How Can an ERC *Expert* Help?

It is prudent for a business that suffered any type of operational disruption during the COVID-19 pandemic, regardless of how meaningful it was to the financial performance of the business, to seek professional advice from an expert that is well-versed in the evaluation of a FPSO.

There are many tax, accounting, legal, payroll, and other specialty providers out there that can help navigate the muddied waters of a FPSO. However, in situations of uncertainty, particularly when a business cannot clearly identify some metric to use towards the FPSO safe harbor, ***it is strongly recommended to use a provider that can offer a sound legal analysis to complement any technical tax and accounting work that is required.***

It is important to note that the IRS has a longstanding "reasonable cause" standard that can protect taxpayers from penalties in situations where the taxpayer reasonably relies in good faith on the advice or opinion of a professional advisor. However, to meet this standard, a taxpayer must generally use an advisor they believe has appropriate knowledge in the pertinent area of tax law in question. Therefore, when taxpayers choose advisors that lack credentials, including the lack of meaningful prior experience advising clients on Federal tax matters, it could lead to an elevated risk that such taxpayers may not be protected by the reasonable cause standard and could be held liable for significant IRS penalties.

EZ-ERC *Says*...

If you have not done so already, challenge your current CPA, controller, or CFO, to further explore the ERC. If your business was subject to operational changes or restrictions due to COVID-19 Executive Orders, ***you are likely to qualify***. Remind them that it is ***absolutely okay*** if your business did not suffer a revenue decline and/or was deemed essential. Feel free to forward them this article if they don't believe it (***and have them read pages 27 through 44 of the IRS Notice 2021-20 in detail***)!

Pro *Vs.* Faux

In selecting an advisor, be sure to fully vet the experience and credentials of the team proposing to provide highly technical tax advice. Ensure that they are qualified and eligible to represent you in front of the IRS, if something is ever challenged. There are a lot of great advisors out there, but there are just as many opportunistic ERC pop-up shops out there that have never read the IRC, never signed a tax return, and are not comprised of CPAs or legal professionals. Be selective and ask many questions, and, if it feels appropriate, ask your provider to bring in the expertise of an external legal advisor.

EZ-ERC brings a ***leadership*** team of former Big 4 and top consulting professionals that are credentialed and tenured, with decades of experience in both advising taxpayers on complex tax transactions and tax positions, as well as representing clients in front of the IRS.

EZ-ERC's founder, now an ERC subject matter expert, has been entrenched in the COVID-19 ERC legislation since March of 2020 and brings as much experience to the table as is currently possible.

We would love to talk to business owners, CEOs, CFOs, controllers, and other key decision-makers to help demystify the 150+ pages of IRS guidance detailing the ERC.

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