

Employee Retention Credit – IRS Addresses Shutdown of Supplier

The Employee Retention Credit (ERC) is a hot topic. Even though it only existed for parts of 2020 and 2021, the opportunity to amend the Forms 941 to claim this credit is still here.

There are specific rules that have to be met in order to qualify for this credit. The basic rules for ERC can be found in IRS Notices 2021-20, 2021-23, 2021-49, and 2021-63. IRS did a pretty good job of explaining the rules in a Question-and-Answer format when it wrote these Notices.

There are many companies promoting the ERC and sending out telephone calls, emails, text messages, etc. Some of these companies are basically stating that EVERY BUSINESS is entitled to this credit. These companies often focus on a “shutdown” provision that, basically, stating “the inability to get one or more supply is sufficient to qualifying a business for the ERC.” This interpretation is NOT the way the law is written.

On July 21, 2023, IRS released a Chief Counsel Memorandum which discusses the inability to get supplies and whether this qualifies the business for the ERC. Below are the scenarios (as written by IRS) mentioned in the CCM. We recommend reading the CCM in full.

SCENARIO 1: Employer A was not subject to any governmental orders limiting commerce, travel, or group meetings due to COVID-19 at any time. However, during 2020 and 2021, Employer A experienced several delays in receiving critical goods from Supplier 1. At all times during 2020 and 2021, Employer A continued to operate because Employer A had a surplus of the critical goods normally provided by Supplier 1. Employer A assumed that Supplier 1’s delay in delivering critical goods was caused by COVID-19. Employer A inquired and Supplier 1 vaguely confirmed that the delay was due to COVID-19. Supplier 1 did not provide a governmental order from an appropriate governmental authority and Employer A was unable to locate one.

CONCLUSION SCENARIO 1 – Employer A does not meet the definition of eligible employer provided under section III.D., Q/A-12 of Notice 2021-20 because Employer A cannot demonstrate that a governmental order applicable to Supplier 1 fully or partially suspended Supplier 1’s trade or business operations. Even if Employer A received or could locate the governmental orders applicable to Supplier 1, Employer A did not have to cease operations because Employer A had a reserve of critical goods allowing Employer A to continue operations; thus, Employer A did not experience a full or partial suspension of operations due to an inability to obtain Supplier 1’s critical goods. The relevant inquiry is whether Employer A’s trade or business operations could continue; since Employer A was able to continue its own business operations despite the supply chain disruption, it was not subject to a full or partial suspension of operations.

SCENARIO 2: Employer B was not subject to any governmental orders limiting commerce, travel, or group meetings due to COVID-19 at any time. However, certain critical goods from Supplier 2 were stuck at port in State X. Employer B assumed the bottleneck at the port was a result of COVID-19. Employer B could not identify any specific governmental order applicable to Supplier 2 or any specific governmental order that caused the bottleneck at the port. Some news sources stated that COVID-19 was the reason for the bottleneck, while others cited reasons such as increases in consumer spending and aging infrastructure. In addition, Supplier 2 mentioned to Employer B that other critical goods that were not stuck at port would be delayed due to a truck driver shortage. Employer B saw some discussion on social media that the truck driver shortage was because drivers were out sick due to COVID-19.

CONCLUSION SCENARIO 2: Employer B does not meet the definition of an eligible employer under section III.D., Q/A-12 of Notice 2021-20 because Employer B cannot demonstrate that a governmental order applicable to Supplier 2 fully or partially suspended Supplier 2’s trade or business operations. In addition, while COVID-19 may have been a contributing factor to the bottleneck at the port or the truck driver shortage, Employer B could not substantiate that any specific governmental order caused a bottleneck at the port. Even if Employer B could identify governmental orders applicable to the bottleneck, Employer B must substantiate that the bottleneck and thus the suspension of Supplier 2 was due to the orders.

SCENARIO 3: Employer C and Supplier 3 are located in a jurisdiction that issued governmental orders suspending both of their business operations for the duration of April 2020. Employer C and Supplier 3’s jurisdiction lifted all orders related to COVID in May 2020. For the remainder of 2020 and 2021, Employer C experienced a delay in receiving critical goods from Supplier 3. Supplier 3 does not provide a reason for the

delay, but Employer C assumes the delay is due to the governmental order in place in April 2020.

CONCLUSION SCENARIO 3: Employer C is an eligible employer in the second calendar quarter of 2020 because its business operations were fully or partially suspended due to a governmental order. However, only wages paid with respect to the period during which Employer C is fully or partially suspended due to a governmental order may be considered qualified wages. See section III.D., Q/A-22 of Notice 2021-20. Employer C does not meet the definition of an eligible employer under section III.D., Q/A-12 of Notice 2021-20 for any subsequent calendar quarter in 2020 or 2021 because Employer C cannot demonstrate that a governmental order applicable to Supplier 3 fully or partially suspended Supplier 3's trade or business operations. The residual delays caused by a governmental order in place during a prior calendar quarter will not constitute a governmental order in subsequent calendar quarters once the order has been lifted.

SCENARIO 4: Employer D was not subject to any governmental orders limiting commerce, travel, or group meetings due to COVID-19 at any time. During 2020 and 2021, Employer D could not obtain critical goods from Supplier 4. However, Employer D was able to obtain the goods from an alternate supplier. The critical goods from the alternate supplier cost 35% more than those from Supplier 4. Employer D could continue to operate its trade or business even though it was not as profitable as in 2019.

CONCLUSION SCENARIO 4: Employer D does not meet the definition of an eligible employer under section III.D., Q/A-12 of Notice 2021-20 because Employer D could continue to operate its trade or business. Employer D was not prevented from operating its trade or business at any point during 2020 or 2021. Incurring a higher cost for critical goods does not result in a full or partial suspension of operations.

SCENARIO 5: Employer E operates a large retail business selling a wide variety of products. Employer E was not subject to any governmental orders limiting commerce, travel, or group meetings due to COVID-19 in 2021. Due to various supply chain disruptions, Employer E was not able to stock a limited number of products and was forced to raise prices on other products that were in limited supply. However, at no time did the product shortage prevent Employer E from continuing to fully operate as a retail business during 2021.

CONCLUSION SCENARIO 5: Employer E does not meet the definition of an eligible employer under section III.D., Q/A-12 of Notice 2021-20 during calendar year 2021 because Employer E cannot demonstrate that a governmental order applicable to a supplier of critical goods or materials caused the supplier to suspend operations and that Employer E was unable to obtain critical goods and materials causing a full or partial suspension of Employer E's business operations. At all points during 2021, Employer E was able to operate its retail business. While a limited number of products were not available, Employer E was still able to offer a wide variety of products to its customers and Employer E was not forced to partially suspend operations.

Editorial Comment – Don't forget that the wages/health insurance expenses must be reduced on the income tax return by the credit amount FOR THE YEAR these expenses were incurred. AND don't forget IRS has previously stated a tax professional can rely on another preparer's work, but not blindly. In other words, the tax professional must reasonably know the tax rules and feel comfortable that the other preparer properly followed them. Therefore, it is not acceptable to amend the income tax return unless the tax profession feels comfortable that the business was properly eligible for the ERC and that the ERC was properly calculated.

Chief Counsel Memorandum AM-2023-005.

UPCOMING SEMINARS LISTED BELOW

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UPCOMING SEMINARS

Wisconsin Chapter of NATP, September 20 & 21, 2023. Mary and David are presenting Farm taxation on September 20; and Wisconsin tax topics on September 21. For more information, contact the Wisconsin Chapter of NATP.

Corporations and Partnership Workshops, various dates and cities, for NCPE. Mary and David are presenting one day of each of these two-day workshops. For more information, go to ncpeseminars.com.

Fiduciary (1041) and Federal Estate (706) Seminar, various dates and cities, for NCPE. Mary and David are presenting these two-day workshops. For more information, go to ncpeseminars.com.

Enrolled Agents of Greater Cleveland Chapter of OSSEA, October 18, at the Best Western, Strongsville. David is presenting 6 CE hours of education: Employee Retention Credit; Basis Rules for Property thru Gift, Inheritance, Remainder Interest; and Credits – Personal Credits. For more information, contact the organization.