In the vault with KPMG

Employee retention credit

Liz L'Hommedieu:

Hi everyone. Welcome to today's podcast. I'm Liz L'Hommedieu, a principal in KPMG's Banking and Capital Markets Tax practice. And today, I'm joined by three of my banking colleagues, and we're going to talk about the employee retention tax credit, which is getting a lot of interest in the banking industry right now. I'd like to introduce Mike George and Stacy Janssen, both managing directors, and Sally Hawkins, a senior manager, all members of KPMG's Banking and Capital Markets Tax practice. Welcome team. As I mentioned, we're going to talk about the employee retention credit or ERC. So diving in, why don't we start with the basics? Sally, can you talk just about what is the employee retention credit and why is it getting so much attention now?

Sally Hawkins:

The employee retention credit is a credit that rewards companies for retaining their employees during COVID-19. Even when things got rough, they did the right thing and continued to pay their employees even when they couldn't perform all their tasks that they normally did pre-COVID-19. It is aimed at rewarding companies that continue to pay their employees. It's getting a lot of attention now because there's a cash benefit for the employee retention credit, even for companies that are in net operating losses. And the most important part here is that the clock is ticking to be able to claim the employee retention credit for the 2020 tax year. We're running up on about nine months until the statute closes. There's a little bit more time for the 2021 tax year, but unfortunately, the credits do take about 6 to 12 months to be able to be processed. Therefore, I think the earlier you can get your credit claims in, the sooner you'll be in line to actually get the refund.

Liz L'Hommedieu:

Okay. So we're looking at a four-year statute of limitations. And so for those that early part of 2020, the statute runs out early in 2024, so that's why folks are looking at this now if they haven't claimed it to get that claim in on time.

Sally Hawkins:

Correct. The statute for 2020 closes on April 15, 2024 for the 2021 tax year. It begins to close on April 15, 2025.

Liz L'Hommedieu:

That makes sense why we're starting to see some attention around this right now. Sally, can you talk to us about what is the benefit? What are the credit amounts, and what are the different rules for different sizes of banks?

Sally Hawkins:

There are a maximum benefit for 2020 of about $5,000 per person. And that's based on a $10,000 of eligible wages in 2021, the benefit became much more lucrative and it's a maximum of $7,000 a person per quarter for 2021. And that would only be for the first three quarters. Unfortunately, the ERC went away for Q4 but that would still be based on that $10,000 of eligible wages. And I think within here, what's important to note is that there's a concept of a small employer and a large employer. If you're a small employer, you would get the credit for each person even if they were working. Whereas if you're a large employer, your credit amount is going to be limited to what you've paid people who are unable to work.

So that could be the time when say a bank branch was closed or you had an early closure and you paid employees their normal salaries, even if they weren't providing services or if you had additional COVID-19 PTO that you allocated to employees for quarantine or illness or childcare, even if this was mandated by state law or by the FFCRA. Getting back to the small employer, that would be someone who has less than a hundred people in 2020 or less than 500 people in 2021, you would get that credit per person again assuming that you would qualify for the ERC in the respective quarter or in the respective year.

For example, if in Q1 of 2021 you paid someone say $3,500 a month, which is equivalent to the low $40,000 a year in salary, and if you qualified in Q1 of 2021 as an eligible employer, you could get $7,000 of credit for that person if you are a small employer. So, on a larger scale, if you had 500 people and you just for 2021 capped out at that, 500 thresholds to be a small employer in 2021 and each person maxed out on those $10,000 in wages, that would almost be about $3.5 million of ERC just for that quarter. If you were to qualify in all three quarters and you had 500 people, and again, you were an eligible employer, that would be about $10.5 million. So, there's a benefit for any size of company, but I think what we want to point out here is that sometimes the smaller that you are, the more benefit there could be if we did determine that you qualified.

Liz L'Hommedieu:

Agreed. That definitely sounds like some lucrative benefits. Why don't you talk us through how it is that a bank qualifies?

Sally Hawkins:

There are two different ways to qualify, and of course, we'll go into a little bit more detail on each after this. The first test is a gross receipts test, and this really just measures those financial impacts that companies may have experienced during COVID-19. The second test is a partial suspension test. So really what this gauges is the operational impacts that COVID-19 restrictions might have had on your operations as an employer. And the good news is that you do not need to meet both tests in any given quarter to qualify. It is one test or the other. Also, each quarter is measured individually. If you could meet a gross receipts test in one quarter and the next quarter you can meet that partial suspension test and they're both equal, you would receive the same benefit if you would meet one or two of those two tests.

Liz L'Hommedieu:

Great, thanks Sally. And what is the gross receipts test? Mike, can you talk to us about it?

Mike George:

One of the ways to be an eligible employer is through the significant reduction in gross receipts test. And the way I like to describe it is you're comparing post-COVID-19 to pre-COVID-19. So for 2020, you would meet the decline in gross receipts test if your receipts for a particular quarter in 2020 are 50 percent less than what they were in the same calendar quarter in 2019. So again, you're comparing pre-COVID-19 to post-COVID-19 for 2021, there was a law change and it became a little bit easier to qualify under the gross receipts test in 2021. You would be looking for a 20 percent reduction in gross receipts from the quarter in 2021 when comparing it to 2019. This is a quarterly test, so it's possible you qualify for certain quarters and not others. But again, it's a pretty straight way to assess your qualifications for the credit.

Liz L'Hommedieu:

What's typically included in gross receipts and how are you seeing banks qualify for this?

Mike George:

For purposes of the ERC, gross receipts have the same meaning as when used under Section 448 (c) of the Internal Revenue Code. In that code section, the regulations list out several things, but it includes things such as sales service, income, income from investments, interest income, dividends, rents, royalties, etc. To just give a little bit of industry insight, the greatest receipt for banks in that list I just went through obviously would probably be interest income. And when you go back to the rules again, you're comparing 2019 to 2020, to your 2019 to 2021. So if you take a step back and you think, you know, what happened to interest rates between 2019 and 2021, they went down and they went down quite a bit. So, interest income for a number of our banks was impacted.

Again, the gross receipts test looks at the revenue side, not the expense side. So even though a bank's net interest income may have been flat or may have stayed stable or improved slightly, we're only looking at the revenue side. We had several banks qualify under the significant reduction in gross receipts test, and it was largely driven by the reduction in their interest revenue. So again, you would have to look at all your gross receipts, not just interest that some banks might have made up for the reduction in interest revenue just by increasing their volume or they could have had offsetting increases in fee income. I just wanted to raise this point because it's not inconceivable that banks had a reduction in gross receipts. And like I mentioned, we've seen some fact patterns where banks have met this reduction, and it was largely driven by the reduction in interest income.

Liz L'Hommedieu:

That makes sense. So, the other way to qualify then is operationally and through a partial shutdown. Stacy, do you have some examples of that?

Stacy Janssen:

As we have been talking to some of the banks across the country, all of them had to change the way they did business. Some of the more prevalent ones are that they would implement drive-through-only service, but they still paid all the staff regardless of if they were working the drive-through. Also, if they changed to appointment only (if they let people come into the branch), they still didn't cut any hours or pay for the staff that weren't getting to work full time since people weren't out and about as much. Some of the other options were they put their staff on an A/B shift model, so half the staff would work for two weeks while the other half of the staff would stay at home in case somebody got COVID-19 and ended up having to quarantine. This made it so they wouldn't have to shut the whole branch down, they would just switch to the B shift and the A shift would go home. Some other things that have been done were they would have to reduce the branch operating hours because they would have to disinfect because there was a COVID-19 outbreak or they were trying to hedge against a COVID-19 outbreak.

Liz L'Hommedieu:

Thanks, that's helpful. A branch didn't have to entirely shut down in order to qualify for the credit.

Stacy Janssen:

Correct. They just had to be more than nominally impacted.

Sally Hawkins:

I think to your point too, and what we typically see in terms of the impact are that a lot of times branches, as Stacy mentioned earlier, they'd go to a drive-through-only model. Or they would go to an appointment-only model or they would be open for reduced hours, and therefore, the branches weren't closed completely. And that's okay. The test here is that there was at least a partial suspension of operations and that had a nominal impact on your business. Typically, what we see is that the branches in terms of head counts, revenues, however you measure it, are more than a substantial portion of a bank's business. And therefore, I think when those are shut down or they're not able to operate as they normally would, that tends to lend itself to a partial suspension.

Liz L'Hommedieu:

I'd like to find out more about how a bank actually claims this credit. Sally, what does the bank do?

Sally Hawkins:

So the bank would claim this on their Form 941, which is their payroll tax filing. Essentially, you would be amending the Form 941, so you'd file a Form 941X to claim the employee retention credit.

Liz L'Hommedieu:

Does this impact taxable income when the bank gets the employment tax refunded?

Stacy Janssen:

It will, while the credit is very lucrative, you will have to pay tax on that.

Liz L'Hommedieu:

Okay. Mike, do you want to talk us through how this gets recorded?

Mike George:

As we talk through, this is not an income tax credit, but rather a payroll tax credit. So something in the accounting space we refer to as a non-income-based credit. And the good news is it's not recorded as an income tax expense in the financials, but instead, it's recorded above the line as a benefit to pretax earnings. So that excites a lot of our banks to kind of get a boost to earnings from this credit. There's a couple of different ways to account for the credit, there's some diversity in practice, but the punchline is since a portion of this credit would be refundable and if it exceeds your payroll taxes, it's determined to be a grant. And so US GAAP doesn't have specific guidance on how entities should account for grants. Like I mentioned, there is diversity in practice, but our accounting for income taxes handbook, and I believe the other firms as well walk through some different types of accounting. You can apply by an analogy. So some clients apply IAS 20, which is accounting for government grants. Some clients have applied Subtopic 450-30, which is gain contingencies, and then some clients have looked to revenue recognition standards to determine how to record it. But again, the key point is, it is recorded above the line and as pretax earnings.

Liz L'Hommedieu:

So there may be different ways to record that, but everyone should check with their financial statement auditors.

Let me recap what we've talked about. There's a lucrative credit out there, the ERC that applies to employment taxes paid. There's a couple different ways that banks can qualify both under a gross receipts method or under a partial shutdown of operations method. There are different rules and credit amounts depending on the different size of banks, but both can be extremely lucrative, and the statute runs at a little under a year for anyone trying to make a claim for 2020. I think that explains why we're seeing so much activity around this right now in the banking space. People are gearing up to see if they qualify and to get those claims in before a statute runs out. Well, I appreciate you talking us through this today and sharing your insights. It was a good discussion and I definitely learned some things. And to our audience, thank you for joining us today. This is Liz L'Hommedieu on behalf of KPMG's Banking and Capital Markets Tax practice. I look forward to talking again soon.