



October 8, 2020

The Honorable David J. Kautter
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Request for Guidance Related to the Employee Retention Credit Provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act

Dear Messrs. Kautter and Rettig:

The American Institute of CPAs (AICPA) appreciates the efforts by the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) to provide guidance to taxpayers affected by the Coronavirus Disease 2019 pandemic (commonly known as “Coronavirus” or “COVID-19”) through various notices, news releases, and accompanying frequently asked questions (FAQs).

In response to the pandemic, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act.¹ On April 17, 2020, the AICPA submitted a letter identifying areas in need of guidance related to the employee retention credit (ERC) provisions of the CARES Act. This letter is a request for additional clarity and guidance.

Recommendations

1. Provide authoritative guidance that addresses the mutually exclusive nature of Paycheck Protection Program (PPP) loans and the ERC in mergers and acquisitions. Section 2301(j) of the CARES Act generally provides that if an employer otherwise eligible for the ERC receives a PPP loan, the employer is not eligible for the ERC. In addition, IRS FAQ #78 prohibits employers, including an aggregated group as defined in Section 2301(d) of the CARES Act, that receive a PPP loan from claiming an ERC. However, the FAQ does not consider that the PPP loan recipient may acquire, or be acquired by, a business that is eligible for or already claimed an ERC.

Due to COVID-19, many businesses are facing financial difficulty, and their only option to remain viable may be to merge with or be acquired by another entity. This scenario is common in many industries, and one example is the healthcare industry. Small health clinics in underserved communities have been heavily affected by COVID-19. These clinics experienced increased costs for telehealth technology and personal protective

¹ P.L. 116-136.

equipment and reduced revenue due to providing less patient care. If these clinics were to close due to financial difficulty, the already underserved community would be left with no healthcare options. In order to ensure health care services are available for the community, a health care entity will often acquire the assets or stock of the financially distressed clinic. The clinic would then become part of the health care entity's aggregated group for purposes of the ERC. In these situations, it is common that one party to the transaction received a PPP loan while the other party claimed the ERC.

According to FAQ #78, if the health care entity (the buyer) claimed the ERC prior to the acquisition and the clinic (the target) received a PPP loan, the health care entity would become ineligible for the ERC already claimed. The health care entity would be required to repay the ERC and could be subjected to penalties and interest related to claiming a credit that it was not entitled to receive. The credit repayment would effectively increase the cost of the acquisition, which may make the acquisition unviable.

The same result will occur in situations where the buyer received a PPP loan and the target claimed an ERC. According to FAQ #78, the target business would be required to repay the previously claimed ERC when it becomes part of the buyer's aggregated group. It is unclear whether penalties would apply for having claimed a credit for which, due to subsequent actions, it has become ineligible.

This issue is important in the current economic landscape and the position taken in FAQ #78 will have long lasting effects on mergers and acquisitions. Transactions that occur through the end of the statute of limitations for the period in which the ERC is claimed could be affected. A merger or acquisition that occurs in 2023 could result in a business becoming ineligible for the ERC retroactively to 2020.

As a result, we recommend that Treasury and the IRS provide authoritative guidance stating that an otherwise eligible employer does not become ineligible with respect to qualified wages, within the meaning of Section 2301(c)(3) of the CARES Act, paid or incurred prior to the date of the merger or acquisition, including asset and stock acquisitions. An eligible employer within the meaning of Section 2301(c)(2) of the CARES Act should be allowed to claim an ERC on qualified wages paid or incurred prior to becoming a member of an aggregated group that includes a member that received a PPP loan. This treatment is consistent with the principle behind Internal Revenue Code (IRC or Code) section 410(b)(6)(C)² rules that apply for qualified plan discrimination and coverage tests.

The AICPA also recommends that the guidance state that qualified wages should not include wages included as payroll costs for forgiveness of the PPP loan.

² Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.

2. Provide guidance stating that intermediate entities (e.g., entities in the middle of a supply chain) are considered partially suspended due to a shutdown in situations where their business customers are closed due to a governmental order.

IRS FAQ #32 states that if the customers of an essential business are subject to a stay-at-home order and do not patronize the business during the stay-at-home order, the essential business is not considered to have a suspension of operations. FAQ #32 is limited in scope as it is targeted at essential service businesses that do not have their normal volume of business customers due to a stay-at-home order which has reduced their *individual* customer traffic. However, other IRS FAQs (e.g. FAQ #31)³ related to the ERC provide that when the operations of an essential service company are adversely affected because a supplier is closed by a shut-down order, the essential service company may be considered partially suspended.

In certain industries, an essential service company may be in the middle of a supply chain. For example, the essential service company may receive supplies from original equipment manufacturers and assemble some of the supplies into parts. They then furnish the parts to a separate (unrelated) company for use in a final product or for sale to individual customers. In some jurisdictions, an essential service company may have customers that are not individuals, (e.g., retail facilities or manufacturing entities), but were ordered shut down. The essential service company may be substantially affected by the shut-down of the customer (supplier) because they cannot forward their product to the last step in an assembly or delivery chain (to its customer) because a governmental order closed the company next in line in the delivery chain. The intermediate entity's business should be considered partially suspended since the loss of their business customer is as damaging to the business as the loss of one of its suppliers.

3. Provide guidance on how to apply the provisions of CARES Act Section 2301(c)(3)(A)(i), which states that the credit is only available for wages with respect to employees who are not providing services in a calendar quarter in which the eligible employer experiences a significant decline in gross receipts or has a full or partial suspension of operations due to a government order.

There are specific rules for determining qualified wages for employers with more than 100 full-time employees. Per IRS FAQs #52 and #54, qualified wages only include amounts paid to employees for the time that they do not provide services after March 12, 2020 and before January 1, 2021 during a quarter in which the employer's operations are fully or partially suspended due to a governmental order or in which the employer experiences a significant decline in gross receipts. It is unclear if the employee must be associated with a specific activity that has experienced the requisite decline in gross receipts.

Provide guidance allowing an eligible employer with a significant decline in gross receipts to treat a portion of an employee's wages as qualified wages for the time that they are paid but

³ <https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-determining-when-an-employers-trade-or-business-operations-are-considered-to-be-fully-or-partially-suspended-due-to-a-governmental-order-faqs>.

not working as many hours as they did pre-COVID due to the decline in the employer's gross receipts. We suggest permitting the employer to use the reduction in revenue for a given department (where appropriate) or a comparison of current activity to 2019's activity to determine the level of productivity of the employees.

Example

Company A, a consulting company with more than 100 full-time employees, had a significant decline in gross receipts for the second quarter of 2020. During the quarter, all of Company A's employees were paid their full wages in the second quarter although only a few of its employees were able to work as many hours as they had worked pre-COVID. In May of 2020, governmental order restrictions were partially but not fully lifted. Employees in certain departments were working at 30% capacity in April, 40% capacity in May and 50% capacity in June. Company A should be permitted to treat the time these departments' employees were paid but not working as many hours as they had worked pre-COVID, as qualified wages because the company experienced a significant decline in gross receipts for the quarter (e.g. 70% in April, 60% in May, and 50% in June).

Example

Employer A with more than 100 full-time employees, has two entities in its controlled group: 1) a hospital; and 2) a restaurant. In the aggregate, the controlled group has experienced a significant decline in gross receipts in the 2nd quarter of 2020 due to the substantial limitation of restaurant services and limitations placed on performing elective procedures at the hospital. Some of the hospital's employees (e.g., accounts payable or receivable clerks, receptionists, food service workers) were paid although they were not providing services at normal capacity for a few months, or were providing a reduced level of services compared to normal operations. Other hospital employees in different departments worked at normal capacity. Restaurant workers and employees who were directly or indirectly involved with elective surgery patients were not able to work at normal capacity and were likely affected by the restrictions applying to the hospital.

Guidance is needed regarding whether Employer A is permitted to include, as qualified wages, the wages of all of the employees of the hospital and the restaurant who are working (not furloughed) but not able to provide full services (i.e., not able to work at a normal capacity) because of the significant decline in gross receipts (whether or not the specific services provided were directly or indirectly limited as a result the governmental order).

4. Provide guidance stating that prepaid income and payments from the Higher Education Emergency Relief Fund are excluded from the definition of gross receipts for tax-exempt employers. IRS FAQ #46 addresses the definition of gross receipts for tax-exempt employers related to determining whether they have a significant decline in gross receipts. Per FAQ #46,

gross receipts from all operations are included in the definition of gross receipts (including amounts received by the organization from total sales (net of returns and allowances) and all amounts received for services). However, including prepaid income (e.g., ticket sales for future performances that are cancelled and for which refunds are made) in gross receipts calculated on a quarterly basis can skew the quarterly results.

In addition, the Higher Education Emergency Relief Fund provides funding to institutions to provide emergency financial aid grants to students. Institutions are responsible for determining how grants will be distributed to students, how the amount of each student grant is calculated, and the development of any instructions or directions that are provided to students about the grant. In these cases, the educational institution acts as a distributor of the funds and is not entitled to utilize them for their own purposes.

Taxpayers that are considered conduits for tax purposes do not treat funds received in a fiduciary capacity as income. Entities should be treated consistently for purposes of the ERC and the amounts that universities are paying as agents for the Department of Education should be excluded from the definition of gross receipts. Therefore, an exclusion of prepaid income and the Higher Education Emergency Relief Fund from gross receipts is necessary.

5. Provide guidance stating whether the aggregation rules apply to tax-exempt entities, and if so, how they apply. Section 2301(d) of the CARES Act provides that for purposes of the ERC, all persons treated as a single employer under subsection (a) or (b) of section 52, or subsection (m) or (o) of section 414, shall be treated as one employer. Section 52(a) provides for the aggregation of a controlled group of corporations. The term “controlled group of corporations” for this purpose is defined by reference to section 1563(a). Section 52(b) provides for the aggregation of trades or businesses under common control. Neither section 52(a) (including the provisions of section 1563 that are referenced in section 52(a)), section 52(b), nor the existing regulations under section 52(b) include specific discussion of the application of the section 52 aggregation rules to tax-exempt organizations. The regulations under section 52(b) are modeled on the regulations under section 414(c), which address the treatment of employees of trades or businesses under common control (whether or not incorporated) as employed by a single employer for purposes of various rules applicable to tax-qualified retirement plans. However, the original section 414(c) regulations contained no guidance on aggregating tax-exempt entities. The rules applicable to aggregating tax-exempt entities as a single employer for purposes of tax-qualified retirement plans was subsequently addressed with the publication of Treas. Reg. § 1.414(c)-5, which is effective for plan years beginning after December 31, 2008. However, no change to the regulations under section 52(b) were made in connection with the publication of Treas. Reg. § 1.414(c)-5.

It is not clear whether the aggregation rules of sections 52(a) and 52(b) apply to tax-exempt entities. The aggregation rules under these provisions is based on another party’s level of economic ownership of a particular entity (e.g., whether a partnership entity conducting a trade or business owns more than 50% of either a capital or profits interest of another partnership conducting a trade or business). Tax-exempt entities are not always organized in this manner,

and the concept of who owns an interest in the organization is not readily apparent. In these circumstances, the existing regulations under the section 52(a) and (b) aggregation rules would not apply.

The IRS should provide guidance regarding whether the operating rules for the ERC would apply separately to each legal entity that is exempt from tax (unless the tax-exempt entity forms an affiliated service group with another entity under the rules of section 414(m)) or if tax-exempt organizations are to be aggregated for purposes of the ERC. If tax-exempt organizations are to be aggregated, we request that IRS provide guidance on how to determine whether such organizations should be aggregated. For this purpose, the IRS could consider a rule similar to the rule provided in Treas. Reg. § 1.414(c)-5.

6. Provide a correction to FAQ #25 related to the aggregation rules to indicate that corporations must be aggregated with entities other than corporations. FAQ #25 discusses sections 52(a) and 52(b). The discussion of the section 52(b) aggregation rules indicates that they apply to partnerships, trusts, estates, or sole proprietorships in trades or businesses under common control. However, the FAQ implies that corporations are not subject to the aggregation rules of section 52(b). While section 52(a) applies to corporations, a corporation can be part of a trade or business aggregated under section 52(b) if it is part of a group that satisfies the control requirements set forth in the section 52 regulations. For example, if a partnership engaged in a trade or business owned more than 50% of a corporation engaged in a trade or business, the two entities would be aggregated under section 52(b).

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The AICPA is the world's largest member association representing the CPA profession, with more than 431,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please feel free to contact Deborah Walker, Chair, AICPA Employee Benefits Taxation Technical Resource Panel at (202) 257-5609, or dwalker@cbh.com; Kristin Esposito, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9241 or kristin.esposito@aicpa-cima.com; or me at (612) 397-3071 or chris.hesse@CLAconnect.com.

Sincerely,



Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

The Honorable David J. Kautter
The Honorable Charles P. Rettig
October 8, 2020
Page 7 of 7

cc: The Honorable Michael J. Desmond, Chief Counsel, Internal Revenue Service
Ms. Amber Salotto, Attorney Advisor, Department of the Treasury
Mr. William McNally, Associate Chief Counsel, Office of Chief Counsel, Employee Benefits, Exempt Organizations, and Employment Taxes, Internal Revenue Service
Ms. Janine Cook, Deputy Associate Chief Counsel, Office of Chief Counsel, Employee Benefits, Exempt Organizations and Employment Taxes, Internal Revenue Service
Ms. Rachel Leiser Levy, Associate Chief Counsel, Office of Chief Counsel, Employee Benefits, Exempt Organizations and Employment Taxes, Internal Revenue Service
Mr. Stephen Tackney, Deputy Associate Chief Counsel, Office of Chief Counsel, Employee Benefits, Exempt Organizations, and Employment Taxes, Internal Revenue Service
Ms. Melissa Duce, Senior Technician Reviewer, Office of Chief Counsel, Employment Tax, Internal Revenue Service
Ms. Lynne Camillo, Chief, Employment Tax Branch 2, Office of the Associate Chief Counsel, Employee Benefits, Exempt Organizations, and Employment Tax, Internal Revenue Service
Ms. Nellie Park, Office of Chief Counsel, Employee Benefits, Exempt Organizations, Internal Revenue Service
Mr. Danchai Mekadenaumporn, Attorney, Office of Chief Counsel, Employment Taxes, Internal Revenue Service