

Maximizing Cash Savings by Pairing the R&D Payroll Tax Credit with COVID-19 Payroll Tax Relief



Qualified businesses that are eligible to claim the research and development (R&D) credit to offset an employer's FICA payroll taxes may be able to increase their cash benefit by combining the payroll tax credit with recent COVID-19 payroll tax relief incentives. Qualified taxpayers can claim both the R&D payroll tax credit and the credits available under the Families First Coronavirus Response Act (FFCRA) and the employee retention credit under the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Unlike the R&D credit payroll offset, which carries forward to future quarters, the employee retention and FFCRA credits in excess of the employer's FICA contribution result in cash refunds to the employer.

The R&D Payroll Tax Credit

The Protecting Americans from Tax Hikes of 2015 (PATH Act) allows Qualified Small Businesses to utilize up to \$250,000 of R&D tax credit to offset employers' required FICA payroll tax contribution to Social Security for tax years beginning after December 31, 2015. A Qualified Small Business is any corporation (including S corporations) or partnership with gross receipts of less than \$5 million for the current tax year, and no history of gross receipts that extends beyond the five years ending with the current year (e.g., for the 2020 credit the business can have no gross receipts prior to the 2015 tax year).

COVID-19 Tax Credits

FFCRA Sick Leave Credits

The FFCRA, enacted on March 18, 2020, provides tax credits to reimburse employers for the costs of providing mandatory paid sick leave and paid family and medical leave to employees unable to work because of the coronavirus (COVID-19) for employers with less than 500 employees. The maximum per employee credit related to the paid sick leave ranges from \$2,000 to \$5,110 and the maximum per employee credit for family and medical leave is \$10,000. These employers are exempt from paying Social Security taxes on wages paid to employees for COVID-19 related sick leave or emergency family leave wages due. To obtain the credit for these wages and the employer share of Medicare taxes, the employer offsets its share of Social Security taxes for the calendar quarter. FFCRA requires that the credit allowed for any calendar quarter shall not exceed applicable employment taxes first reduced by the veteran employment tax credit under Sec. 3111(e) and the payroll credit for R&D under Sec. 3111(f). Any unused FFCRA credits are refunded to the employer.

CARES Act Employee Retention Credit

The CARES Act, enacted on March 27, 2020 provides qualified employers a refundable employee retention credit for qualified wages paid to employees between March 13 and December 31, 2020. A qualified employer must either have 2020 operations that were fully or partially suspended in the calendar quarter as a result of orders from a government authority, or have experienced a 50% reduction in gross receipts in a 2020 calendar quarter as compared to the same quarter in 2019. For employers with greater than 100 employees, the tax credit is 50% of qualified wages up to \$10,000 paid to employees who are not performing services (maximum credit of \$5,000 per employee). For employers with 100 or fewer employees, the tax credit is 50% of qualified wages up to \$10,000 paid to any and all employees (maximum credit of \$5,000 per employee). Section 2301 of the CARES Act requires that the credit allowed for any calendar quarter not exceed the applicable employment taxes reduced by the veteran employment tax credit under Sec. 3111(e), the payroll credit for R&D under Sec. 3111(f) and FFCRA Secs. 7001 and 7003. Taxpayers who received a Paycheck Protection Program (PPP) loan under the CARES Act are not eligible to also claim this credit.

The CARES Act also allows employers to defer the employer portion of Social Security (6.2%) payroll taxes beginning March 27, 2020, ending December 31, 2020. Taxpayers must pay 50% of the deferred taxes by December 31, 2021, with the remainder due by December 31, 2022.

Other Considerations

Eligible employers should consider the impact the refundable employee retention credit may have on their 2020 federal income tax return. If an employer claims the refundable credit, the amount of the credit does not reduce the employer's federal income tax deduction for payroll taxes, employee wages or health plan expenses. However, the credit must be included in gross income for federal income tax purposes. In addition, employers taking the refundable credit provided in the legislation may not also take the Sec. 45S credit for employer paid family and medical leave for the same wages.

Finally, companies that take advantage of SBA loans and are not eligible for certain COVID-19 employee retention tax relief can still use R&D credits to offset FICA if they meet the criteria noted above.

The Takeaway

Qualified companies can maximize cash savings by offsetting FICA with R&D payroll credits first and then applying the refundable FFCRA sick leave credits and the CARES Act employee retention credit. In order to obtain the greatest tax benefit, companies should not overlook the value of R&D payroll tax credit as they evaluate payroll relief options related to the COVID-19 legislation. Andersen's R&D and Credit Incentives team can assist your company in determining eligible tax credits and claiming cash refunds.

For further information please contact your Andersen advisor.

