



PRIVATE EQUITY FUNDS MAXIMIZE ROI WITH EMPLOYEE RETENTION CREDIT

By David Wong and Chris Bard

Private equity (PE) funds looking to maximize their return on investment (ROI) may generate cash by claiming the recently enhanced employee retention credit (ERC) for their eligible portfolio companies. The ERC is a refundable tax credit first introduced as part of 2020's coronavirus relief law, known as the CARES Act, that provides employers a credit up to \$33,000 per employee for "qualified wages." It has made the difference for many firms between losing and making money during the pandemic. For example, an eligible portfolio company with 31 employees could receive over \$1 million from the U.S. Treasury for its ERC, whether it has any federal income tax liability or not.

While the ERC may be lucrative, navigating the qualification and calculation considerations for PE portfolio companies can be complex. Below we summarize ERC eligibility requirements and benefits and provide insight into the various considerations PE firms and portfolio companies should evaluate as they determine whether and to what extent they qualify for the credit.

ELIGIBILITY REQUIREMENTS

To be eligible for the ERC, an employer must meet *at least one* of the following tests:

Governmental order test: The employer's operations were fully or partially suspended due to a governmental order related to COVID-19; or

Gross receipts test:

- ▶ **2020:** The employer incurred a decline in gross receipts of more than 50% during a 2020 calendar quarter compared to the same calendar quarter during 2019. Eligibility ends at the conclusion of the quarter in which the company's decline in gross receipts is less than 20%.
- ▶ **2021:** The employer incurred a decline in gross receipts of more than 20% during a 2021 calendar quarter compared to the same calendar quarter during 2019. There is an optional one-quarter look-back to compare the gross receipts for the preceding quarter to the same quarter in 2019.

BDO INSIGHT:

To determine employer eligibility, all entities that are treated as a single employer under the IRC Section 52(a) or (b) controlled group rules or are otherwise aggregated under IRC Section 414(m) and (o) are considered one employer for purposes of the ERC rules. Due to the ownership structures of PE portfolio companies, special considerations must be evaluated on a facts-and-circumstances basis to determine whether other portfolio companies directly or indirectly owned or controlled by the fund may need to be considered in determining eligibility for the ERC.

ERC BENEFIT

The ERC is calculated differently for 2020 and 2021. For each of these calendar years, the ERC equals a percentage of up to \$10,000 of “qualified wage” and allocable health plan expenditures paid to employees during the eligibility periods, namely, March 13, 2020 to December 31, 2020 and January 1, 2021 to December 31, 2021 (“qualified ERC costs”). The amount of the ERC allowed for each employee is capped as shown below.

| | % of Qualified ERC Costs | Cap Per Employee |
|------|--------------------------|------------------|
| 2020 | 50% | \$5,000 |
| 2021 | 70% | \$28,000 |

The definition of “qualified wages” for ERC purposes depends on the employer’s average headcount in 2019 and varies for the 2020 and 2021 ERC calculation.

For 2020:

- ▶ If an eligible employer had **100 or fewer** full-time employees in 2019, then qualified wages include both wages and health plan costs paid to all employees during the period of eligibility.
- ▶ For eligible employers with **more than 100** full-time employees in 2019, qualified wages include wages and health plan costs paid to employees who are not performing services due to COVID-19 during the period of eligibility.

For 2021:

- ▶ If an eligible employer had **500 or fewer** full-time employees in 2019, then qualified wages include both wages and health plan costs paid to all employees during the period of eligibility.
- ▶ For eligible employers with **more than 500** full-time employees in 2019, qualified wages include wages and health plan costs paid to employees who are not performing services due to COVID-19 during the period of eligibility.

BDO INSIGHT:

To determine the number of full-time employees, PE portfolio companies should consult with their tax advisor or BDO to determine whether the aggregation considerations referred to above need to be evaluated. Depending on each portfolio company’s relationship with its PE sponsor, a facts-and-circumstances evaluation will determine whether the portfolio company may or may not have to include employees of other portfolio companies under common control by the fund in its full-time employee count. This is important if a portfolio company’s full-time employee count is under 100 or 500 in 2019 when calculating its ERC for 2020 and 2021, but aggregating additional employees of portfolio companies under common control by the fund could increase the count above the 100 and 500 full-time employee thresholds, requiring a different calculating methodology to determine qualified wages.

WHY BDO?

The employee retention credit may provide significant opportunities for your fund or company. Evaluating whether and when the government order or gross receipts test is met or the aggregation rules apply, what wage and health-plan expenses qualify, and the amount of the ERC require a nuanced and complicated analysis. This article does not address every potential situation and factor to be considered, and professional advice may be needed.

BDO has deep expertise working with PE firms and their portfolio companies to identify and document ERCs in a manner that maximizes ROI, maximizing the benefit and minimizing the costs, including interruptions to your business.

TECHNOLOGY

BDO has a dedicated technology solution, Credit Connect, to assist employers in capturing and documenting their employee time and therefore their qualified wages. The software provides a secure and confidential way to survey employees and determine and document qualified wages, thereby helping to provide contemporaneous support for the ERC.

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