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# Global Tax Alert

News from EY Americas Tax

## US CARES Act has implications for companies doing business in Puerto Rico

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The United States (US) *Coronavirus Aid, Relief, and Economic Security Act* (the CARES Act), signed into law by President Trump on 27 March 2020 in response to the COVID-19 emergency, includes provisions that directly affect companies doing business in Puerto Rico.

### Employee retention tax credit

CARES Act Section 2301 creates a new employee retention credit (the retention credit) for wages paid from 13 March 2020 to 31 December 2020, by employers that are subject to closure or significant economic downturn due to COVID-19. The credit amount takes into account up to 50% of qualified wages, up to US\$10,000. Thus, the maximum retention credit amount is US\$5,000 per employee.

The retention credit applies to:

- ▶ The employer's share of Social Security tax of the *Federal Insurance Contributions Act* (FICA) under Internal Revenue Code (IRC) Section 3111(a) (6.2% of wages)
- ▶ The portion of the employer's and employee representative's share of the Railroad Retirement Tax (RRTA) under IRC Sections 3211(a) and 3221(a) that corresponds to the 6.2% Social Security tax of the FICA rate due

If the retention credit exceeds the employer's Social Security or RRTA tax liability for the quarter, the excess may be refunded to the employer.

To be eligible for the retention credit, an employer must carry on a trade or business in 2020 that experiences one of the two following COVID-19-related occurrences: (1) operations were fully or partially suspended on orders from a governmental authority due to COVID-19 (COVID-19 shutdown), or (2) the business experienced a 50% reduction in gross receipts for a calendar quarter as compared to the same calendar quarter in the prior year (gross receipts decline).

The gross receipts test is governed by certain rules under the US IRC, which evaluate gross receipts on an aggregated basis, combining parents and subsidiaries, brother and sister entities, combined groups, and affiliated service groups.

Employers that receive a Paycheck Protection Program loan are not eligible for the retention credit.

For employers of more than 100 employees, qualified wages are wages (as defined under the FICA) paid for services an employee is not providing due to a COVID-19 shutdown or gross receipts decline. The wages taken into account for such employers are limited to the amount the employee would have been paid for an equivalent amount of work in the 30 days immediately preceding the period for which the employee is paid.

For employers of 100 or fewer employees, qualified wages are wages paid to any employee during a COVID-19 shutdown or during a calendar quarter of gross receipts decline, without regard to whether the employee is providing services. In determining how many employees are employed, the average number of full-time employees during 2019, as determined under IRC Section 4980H, applies.

The retention credit is subject to numerous rules to prevent double-dipping. An employer's deduction for wages must be reduced by the amount of the retention credit.

### Social Security tax payment deferral

CARES Act Section 2302 delays the timing of required federal tax deposits for certain employer payroll taxes and self-employment taxes incurred between 27 March 2020 (the date of enactment) and 31 December 2020. Amounts will be considered timely paid if 50% of the deferred amount is paid by 31 December 2021, and the remainder is paid by 31 December 2022.

Applicable employment taxes include:

- The employer's share of Old-Age, Survivors, and Disability Insurance Tax (Social Security) under IRC Section 3111(a), which is 6.2% of wages up to the wage base (US\$137,700 in 2020)

- The portion of the employer's and employee representative's share of Tier 1 *Railroad Retirement Tax Act* (RTTA) tax under IRC Sections 3211(a) and 3221(a) that corresponds to the 6.2% Social Security tax rate due
- For self-employed individuals, the equivalent amount of *Self-Employment Contributions Act* (SECA) tax due on net earnings from self-employment under IRC Section 1401(a) (i.e., 50% of the 12.4% tax), which would similarly be exempt from estimated tax payments

There is no dollar cap on the wages that are counted in calculating the taxes that may be deferred.

The payroll tax deferral does not apply to federal income tax withholding, the Hospital Insurance (Medicare) tax, or the employee's portion of Social Security tax. In addition, the payroll tax deferral is not available to a taxpayer that obtains a *Small Business Act* loan under the Paycheck Protection Program established by the CARES Act if the loan is later forgiven.

### Paycheck Protection Program

CARES Act Section 1102 allows small businesses (except those receiving Medicaid expenditures) that employ fewer than 500 employees to receive a loan under the *Small Business Act* until 31 December 2020. Loan proceeds can be used for payments such as payroll support, mortgage payments, rent, utilities and debt obligations. The CARES Act authorized US\$349 billion for this program and included several lending incentives, including: a maximum interest rate of 4%; no prepayment fees due from borrowers; increased government guarantee of the loan to 100% through 31 December 2020; and complete deferment of loan payments for at least six months (but not more than a year). The program cannot be used in conjunction with the retention credit and if the employer has opted into the payroll tax deferral, it must stop those deferrals effective on the date that the loan under the Paycheck Protection Program is forgiven.

### Implications

The provisions of the FICA or Social Security apply in Puerto Rico. Employers in Puerto Rico that are levied Social Security tax under FICA stand to benefit from the employee retention tax credit and social security tax payment deferral. Employers should evaluate the provisions and requirements under these incentives in the context of their operations in Puerto Rico in conjunction with the rest of their operations in the US by its overall affiliated group.

The CARES Act provisions highlighted in this Tax Alert should not be regarded as the only provisions that could apply to businesses operating in Puerto Rico. Also, there are various requirements and conditions that must be present for the incentives to apply. For example, employers need to evaluate, among other key factors, the definitions of what constitutes gross receipts, full-time employees and wages for purposes of determining eligibility for the employee retention credit.

The staff of the US Joint Committee on Taxation, on 22 April, released a description of certain provisions of the CARES Act and specifically explains that employers in the US territories may claim the credit by filing their quarterly federal employment tax returns. The US Internal Revenue Service most recently issued an updated FAQ (FAQ.22) on this same issue of eligibility of employers in US territories.

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