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THE HOFFMAN GROUP

Certified Public Accountants & Consultants

Claim the Employee Retention Tax Credit (ERTC)

Is your business eligible to claim the Employee Retention Tax Credit (ERTC)? If so, the benefits are substantial–up to $28,000 per employee for 2021.

The Employee Retention Tax Credit (ERTC) is a valuable tax break that was extended and modified by the American Rescue Plan Act (ARPA), enacted in March of 2021. Here's a rundown of the rules and which employers are eligible to claim the ERTC.

Background on the ERTC

Back in March of 2020, Congress originally enacted the ERTC in the CARES Act to encourage employers to hire and retain employees during the pandemic. At that time, the ERTC applied to wages paid after March 12, 2020, and before January 1, 2021. However, Congress later modified and extended the ERTC to apply to wages paid before July 1, 2021.

The ARPA again extended and modified the ERTC to apply to wages paid after June 30, 2021, and before January 1, 2022. Thus, an eligible employer can claim the refundable ERTC against "applicable employment taxes" equal to 70% of the qualified wages it pays

to employees in the third and fourth quarters of 2021. Except as discussed below, qualified wages are generally limited to $10,000 per employee per 2021 calendar quarter. Thus, the maximum ERTC amount available is generally $7,000 per employee per calendar quarter or $28,000 per employee in 2021.

Who Can Claim the ERTC?

For purposes of the ERTC, a qualified employer is eligible if it experiences a significant decline in gross receipts or a full or partial suspension of business due to a government order. Employers with up to 500 full-time employees can claim the credit without regard to whether the employees for whom the credit is claimed actually perform services. But, except as explained below, employers with more than 500 full-time employees can only claim the ERTC with respect to employees that don't perform services.

Employers who got a Payroll Protection Program loan in 2020 can still claim the ERTC. But the same wages can't be used both for seeking loan forgiveness or satisfying conditions of other COVID relief programs (such as the Restaurant Revitalization Fund program) in calculating the ERTC.

Modifications to the ERTC

Beginning in the third quarter of 2021, the following modifications apply to the ERTC:

Applicable employment taxes are the Medicare hospital taxes (1.45% of the wages) and the Railroad Retirement payroll tax that's attributable to the Medicare hospital tax rate. For the first and second quarters of 2021, "applicable employment taxes" were defined as the employer's share of Social Security or FICA tax (6.2% of the wages) and the Railroad Retirement Tax Act payroll tax that was attributable to the Social Security tax rate.

Recovery startup businesses are qualified employers and may claim the ERTC. These are generally defined as businesses that began operating after February 15, 2020, and that meet certain gross receipts requirements. These recovery startup businesses will be eligible for an increased maximum credit of $50,000 per quarter, even if they haven't experienced a significant decline in gross receipts or been subject to a full or partial suspension under a government order.

A "severely financially distressed" employer that has suffered a decline in quarterly gross receipts of 90% or more compared to the same quarter in 2019 can treat wages (up to $10,000) paid during those quarters as qualified wages. This allows an employer with over 500 employees under severe financial distress to treat those wages as qualified wages whether or not employees actually provide services.

The statute of limitations for assessments relating to the ERTC won't expire until five years after the date the original return claiming the credit is filed (or treated as filed).

Can Your Business Claim the ERTC?

If you have any questions related to your business claiming the ERTC, please contact us by emailing info@hoffmancpas.com.

Does Your Business Qualify for the R&D Credit?

What constitutes as "research and development" is more expansive than one might think, and you may already be performing tasks that qualify.

The research and development (R&D) tax incentive is one of the most lucrative credits the Internal Revenue Code provides, but it's commonly overlooked. What constitutes as "research and development" is more expansive than one might think, and many construction companies may already be performing tasks that qualify.

About the R&D Credit

The R&D credit was created in 1981 to encourage businesses to conduct research and development in the United States. The 2015 PATH Act permanently extended and expanded the provisions of the R&D tax credit, making it even more valuable.

The R&D credit isn't just for companies inventing new products. Businesses making improvements to processes, products, patents, techniques, formulas, and software applications can also benefit from the R&D tax credit.

The Internal Revenue Service has a four-part test to determine qualifying research activities:

1. Qualified purpose

The activity must be undertaken with the purpose of developing or enhancing a product or process' quality, functionality, reliability, cost-efficiency, or performance.

2. Technical in nature

The process of experimentation must rely on hard sciences such as physics, engineering, biology, chemistry, or computer science.

3. Technical uncertainty

The activity must be performed to eliminate a technical uncertainty about the improvement or development of a process or product, which includes computer software, formulas, techniques, and inventions.

4. Process of experimentation

The activities must include a process of experimentation taken to resolve or eliminate a technical uncertainty. This includes evaluating alternative approaches or solutions through simulation, modeling, systematic trial and error, or other methods.

Who Qualifies for the Credit?

If your organization pays employees to develop new or improved products, processes, techniques, inventions, formulas, or software, then you may be eligible. If you are financing activities to try to develop or improve any of the following, you may be eligible for R&D tax credits:

- Energy efficiency
- LEED qualification
- Structural systems
- Construction equipment
- Mechanical systems
- Building materials and their combinations and uses
- Electrical and lighting systems
- Integration and constructibility of building components
- Water systems
- Sanitary systems, including waste and wastewater treatment and disposal
- Plant performance or capacity
- Reclamation and remediation techniques
- Process design
- Structural boring techniques to allow construction in sensitive conditions
- Pilot plants
- Temporary structures used in the construction process
- Construction techniques
- Low-carbon technologies
- Flashing details
- Environmentally sustainable solutions

In addition, if you're at risk for the financing attempts to develop or improve construction and construction related components like those above by any of the following, you also are likely to be performing qualified activities:

- Project architects
- Engineers
- Design services advisors
- Electrical designers
- Mechanical designers
- HVAC fabricators
- Lean and Kaizen specialists
- Material scientists

To qualify, your efforts don't have to succeed, and you don't have to be trying to revolutionize the industry. Attempts to develop incremental, evolutionary product and process improvements are eligible as well.

Contact Us for Help

There are some gray areas about what constitutes a qualified business research activity. If you have questions about the research and development tax credit, please contact us today. Our Certified Public Accountants and consultants can help make sure you're taking full advantage of every tax savings opportunity available.

Accounting for Indirect Job Costs the Right Way

Don't struggle with job costing any longer! Here's what you should know to get a clearer picture of your company's profitability.

Construction companies that work on large projects often struggle with job costing. Full cost allocations are essential to gauging whether you're making money on each job. But some companies simply lump indirect job costs into overhead or fail to use meaningful cost drivers, thereby skewing their profit reports. Here's what you should know to avoid this pitfall and get a clearer picture of your company's profitability.

Indirect Job Costs vs. Overhead Costs

The Financial Accounting Standards Board defines job costs as "the sum of the applicable expenditures and charges directly or indirectly incurred in bringing [a job] to its existing condition and location." These may include direct costs, such as labor and materials, and indirect costs. The latter can be divided into two groups:

1. **Costs identified with more than one job.** These typically consist of benefits for frontline workers, workers' compensation insurance, and insurance to minimize the company's liability risks. This category also may include company vehicle costs, such as gasoline, maintenance and repair expenses, and equipment depreciation.
2. **Costs that are only indirectly related to jobs.** Common examples of these indirect costs include project manager salaries and benefits, cell phone bills, payroll service fees, and vehicle tracking and monitoring systems.

Indirect costs and overhead are often confused. The term "overhead" refers to costs related to running your company that you can't attribute directly or indirectly to a project. They tend to be consistent over time. It's important to not include overhead costs, such as office rent, when identifying indirect costs.

Using a Cost Driver

You can systematically allocate indirect job costs using a "cost driver." Two common cost drivers are labor hours and dollars.

For example, suppose liability insurance for an engineering firm costs $100,000 annually. That amount divided by 12 months is $8,333 a month. To follow the allocation process through to completion, you would tabulate the billable hours for each job on a monthly schedule. Then, perhaps with your accountant's help, you could divvy up that $8,333 each month to put those dollars onto that month's active jobs pro rata. Now that $100,000 is no longer overhead — those dollars are indirect job costs.

Once indirect costs are allocated and included in the reports given to managers tracking the progress of cash outflows to their jobs, your company's management team can discuss how to avert upcoming cash flow problems. This can buy you some time to make corrections.

Monitoring the Bottom Line

We can find meaningful methods of allocating job costs to help evaluate your company's profitability. Contact us for more information.

Tax Rules for Deducting Computer Software Costs

The tax rules for treating computer software costs can be complex. Here's a basic explanation.

Do you buy or lease computer software to use in your business? Do you develop computer software for use in your business, or for sale or lease to others? Then you should be aware of the complex rules that apply to determine the tax treatment of the expenses of buying, leasing or developing computer software.

Purchased Software

Some software costs are deemed to be costs of "purchased" software, meaning software that's either:

- Non-customized software available to the general public under a non-exclusive license

or

- Acquired from a contractor who is at economic risk should the software not perform

The entire cost of purchased software can be deducted in the year that it's placed into service. The cases in which the costs are ineligible for this immediate write-off are the few instances in which 100% bonus depreciation or Section 179 small business expensing isn't allowed or when a taxpayer has elected out of 100% bonus depreciation and hasn't made the election to apply Sec. 179 expensing. In those cases, the costs are amortized over the three-year period beginning with the month in which the software is placed in service. Note that the bonus depreciation rate will begin to be phased down for property placed in service after calendar year 2022.

If you buy the software as part of a hardware purchase in which the price of the software isn't separately stated, you must treat the software cost as part of the hardware cost. Therefore, you must depreciate the software under the same method and over the same period of years that you depreciate the hardware. Additionally, if you buy the software as part of your purchase of all or a substantial part of a business, the software must generally be amortized over 15 years.

Leased Software

You must deduct amounts you pay to rent leased software in the tax year they're paid, if you're a cash-method taxpayer, or the tax year for which the rentals are accrued, if you're an accrual-method taxpayer. However, deductions aren't generally permitted before the years to which the rentals are allocable. Also, if a lease involves total rentals of more than $250,000, special rules may apply.

Software Developed by Your Business

Some software is deemed to be "developed" (designed in-house or by a contractor who isn't at risk if the software doesn't perform). For tax years beginning before calendar year 2022, bonus depreciation applies to developed software to the extent described above. If bonus depreciation doesn't apply, the taxpayer can either deduct the development costs in the year paid or incurred or choose one of several alternative amortization periods over which to deduct the costs. For tax years beginning after calendar year 2021, generally the only allowable treatment will be to amortize the costs over the five-year period beginning with the midpoint of the tax year in which the expenditures are paid or incurred.

If following any of the above rules requires you to change your treatment of software costs, it will usually be necessary for you to obtain IRS consent to the change.

Contact Us for Assistance

We can assist you in applying the tax rules for treating computer software costs in the way that is most advantageous for you.

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