TaxNewsFlash

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IRS clarifies position on employee retention credit supply chain disruptions (generic legal advice memorandum)

The IRS released a generic legal advice memorandum (GLAM)[1] clarifying its position on the intersection of supply chain disruptions and full or partial suspensions of business for purposes of the employee retention credit (ERC).

The GLAM goes through five scenarios for determining whether the operation of an employer's trade or business was fully or partially suspended due to governmental orders such that the employer satisfies the definition of an "eligible employer." In each scenario presented, the IRS does not conclude in favor of the taxpayer's ERC eligibility.

Read GLAM 2023-005 [PDF 103 KB] (release date of July 21, 2023, and dated June 30, 2023)

This summary highlights some of the more significant clarifications.

Background

The ERC is a refundable tax credit for businesses and tax-exempt organizations. The credit is available to eligible employers that paid qualified wages to some or all employees after March 12, 2020, and before January 1, 2022. Eligibility and credit amount vary depending on the relevant year, number of employees (2019 full-time employees), and type of business.

Generally, eligible employers include businesses and tax-exempt organizations that (1) were fully or partially shut down by a government order due to the COVID-19 pandemic during 2020 or the first three calendar quarters of 2021, (2) experienced the required decline in gross receipts during the eligibility periods during 2020 or the first three calendar quarters of 2021, **or** (3) qualified as a recovery startup business for the third or fourth quarters of 2021.

[1] A generic legal advice memorandum constitutes internal IRS legal advice by the Office of Chief Counsel to assist IRS service personnel in administering their duties. It is not binding law and cannot be used or cited as precedent.

Further, eligible employers must have paid qualified wages to claim the credit.

Supply chain disruptions

Many businesses were not directly fully or partially shut down by a government order but were effectively fully or partially shut down when suppliers were shut down by government order. Recognizing this business dynamic and issue of downstream disruptions "due to" government orders in this scenario, Q&A #12 of IRS Notice 2021-20 [PDF 477 KB], detailed a path for an employer to claim a full or partial suspension due to a governmental order when such an order impacts a supplier as follows:

- The supplier was unable to deliver the critical goods or materials due to full or partial suspension of its business due to a governmental order;
- The employer was unable to obtain critical goods or materials from a supplier or an alternate supplier; and
- The employer suffered a full or partial suspension of its business due to the government order related supply side disruption.

GLAM 2023-005 clarifications

The scenarios in GLAM 2023-005 shared some commonalities among the varying situations presented, including failures to:

- Identify an actual government order suspending the supplier's operations
- Demonstrate that the lack of supplies from a supplier caused a more than nominal impact on its own operations
- Establish that the entity was not able to obtain critical goods or materials from an alternate supplier

The GLAM explores substantiation and clarifies several points, including, but not limited to:

- General statements from a supplier that COVID-19 impacted their business and general news/social media postings noting the same are not enough. The supplier and/or employer need to identify a government order from an appropriate government authority.
- There is no supply chain disruption if there is an alternate supplier even when that alternate supplier charges substantially more for the supplies.
- Reliance upon shipping port bottlenecks without a specific government order as well as an employer's full or partial suspension due to such an order does not qualify.
- Residual supply chain delays once a government order has been lifted do not qualify for ERC purposes.
- Residual supply disruptions due to government orders do not support a full or partial suspension of operations during a subsequent quarter for which the governmental orders have been lifted.
- Limited shortages of product for a retail business that sells a wide variety of products, are not sufficient to support a claim for full or partial suspension of operations if the employer was still able to source a wide variety of products for customers (even if the supplies were more expensive) and was not forced to partially suspend operations.

KPMG observation

GLAM 2023-005 is generally consistent with Q&A #12 of IRS Notice 2021-20 but does express a narrower view overall. The GLAM is useful for some employers to determine whether there is a supply side suspension for purposes of the ERC going forward. However, reality is complicated, and the framework of the examples set forth in the GLAM will often fall short in capturing specific situations. Nonetheless, it is helpful for employers going forward to see the IRS's position on such matters. Note that a GLAM does not establish precedent.

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