

Enhanced Opportunities to Benefit from the Employee Retention Credit

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The Employee Retention Credit (ERC) was established by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) on March 27, 2020, to encourage businesses to keep employees on their payroll during the pandemic. Business owners may be able to benefit from the significant improvements that were made to the ERC under the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (the Relief Act), which was enacted late last year as part of the 2021 Consolidated Appropriations Act, and under the American Rescue Plan Act of 2021 (ARPA), which was signed into law by President Biden on March 11, 2021. The Relief Act and ARPA extended the ERC through December 31, 2021, and increased the maximum amount of the per-employee tax credit. Additionally, the Relief Act addressed whether Paycheck Protection Program (PPP) loan recipients may qualify for the ERC. Furthermore, in early March, the IRS issued much needed guidance in Notice 2021-20 clarifying how PPP loan recipients can claim the ERC. As a result of the Relief Act and ARPA, the availability and amount of the ERC in 2021 and 2020 is materially different; accordingly, businesses, including PPP loan recipients, are well advised to consult with their tax advisers to determine the nature, amount, and availability of the ERC for which they qualify.

Amount of Tax Credit Available

The ERC offsets the eligible employer's portion of payroll taxes. The ERC is considered fully refundable because the eligible employer may get a refund if the amount of the ERC is more than the applicable employment taxes owed by the eligible employer. Beginning in the third quarter of 2021, applicable employment taxes are the employer's share of Medicare taxes, which is 1.45 percent of wages. In contrast, the applicable employment taxes for 2020 as well as the first and second quarters of 2021 are the employer's share of Social Security taxes, which is 6.2 percent of wages.

Under the CARES Act, the ERC provides a refundable 50 percent payroll tax credit for up to \$10,000 in qualified wages (providing for a maximum credit of \$5,000 per employee) for eligible employers during the period beginning March 13, 2020, and ending December 31, 2020 (the 2020 Relevant Period). Qualified wages include the eligible employer's qualified health plan expenses that are properly allocable to the wages.

Under the Relief Act, the ERC was extended for wages (including qualified health plan costs) paid through June 30, 2021, and

significantly increased the benefit amount for 2021 to a maximum ERC of \$7,000 per employee (70 percent of \$10,000 in qualified wages), per quarter.

ARPA further extended the ERC for wages (including qualified health plan costs) paid from June 30, 2021, through December 31, 2021. Thus, eligible employers can claim the refundable ERC against applicable employment taxes equal to 70 percent of the qualified wages it pays to employees in the third and fourth quarters of 2021 (in addition to the first and second quarters permitted by the Relief Act). Therefore, the maximum ERC available is \$7,000 per employee per calendar quarter, or \$28,000 per employee in 2021.

Eligibility Requirements

Under the CARES Act, an “eligible employer” is defined as any employer operating a trade or business if (i) their operations were fully or partially suspended in 2020 due to a COVID-19-related governmental shutdown order limiting commerce, travel, or group meetings, or (ii) they suffered a greater than 50 percent reduction in quarterly receipts as compared to the same quarterly period in 2019.

Effective January 1, 2021, the Relief Act provides that employers are eligible for the ERC if they operate a trade or business during the period beginning January 1, 2021, and ending June 30, 2021, and experience (i) a full or partial suspension of the operation of their business because of governmental orders, or (ii) at least a 20 percent decline in gross receipts in a calendar quarter in 2021, as compared to the same calendar quarter in 2019.

ARPA extended the ERC for the third and fourth quarters of 2021. The eligibility requirements are the same as under the Relief Act (i.e., an employer is eligible if it has been subject to a full or partial shutdown or has experienced at least a 20 percent decline in gross receipts in 2021). ARPA also added another category of eligibility for the ERC for an employer that is a “recovery startup business.” A recovery startup business is any business that began operations after February 15, 2020, whose average annual gross receipts do not exceed \$1 million and the business does not otherwise qualify for the ERC. A recovery start-up business will be eligible for an increased maximum credit of \$50,000 per quarter, even if the business has not (i) experienced a significant decline in gross receipts or (ii) been subject to a full or partial suspension under a government order.

On March 1, 2021, the IRS issued Notice 2021-20, which provided sought-after guidance on eligible employer requirements. The IRS explained that “an employer that operates an essential business is not considered to have a full or partial suspension of operations if the governmental order allows all of the employer’s operations to remain open. However, an employer that operates an essential business may be considered to have a partial suspension of operations if, under the facts and circumstances, more than a nominal portion of its business operations are suspended by a governmental order,” and therefore qualifies for the credit. So, if a business has essential and nonessential operations that are more than nominal portions, the employer may be considered to have a partial suspension if the order restricts the nonessential portion of the business even if the essential portion is unaffected. For purposes of the ERC, the IRS has provided that business operations will be more than a nominal portion if the gross receipts from that operation is not less than 10 percent of total gross receipts, or if the hours of service performed by employees in that portion are not less than 10 percent of the total service hours performed.

Qualified Wages

Under the CARES Act, if an eligible employer averaged more than 100 full-time employees during 2019, qualified wages for the 2020 Relevant Period are those wages paid by the eligible employer with respect to which an employee is not providing services. If an eligible employer averaged 100 or fewer full-time employees in 2019, qualified wages are the wages paid to any employee, including those performing services.

Effective January 1, 2021, the Relief Act increased the operative employee threshold established under the CARES Act from 100 full-time employees to 500 full-time employees in 2019. Accordingly, for purposes of the ERC, only those employers that averaged more than 500 full-time employees in 2019 will be limited to claim as “gross wages” the wages paid to only those employees not performing services during 2021.

ARPA further modified the ERC by providing that for the third and fourth quarters of 2021, certain severely financially distressed large employers may include as gross wages the wages paid to all employees (as opposed to only non-service performing employees). A severely distressed large employer is an employer with more than 500 full-time employees that has gross receipts during such 2021 calendar quarter of less than 10 percent of the gross receipts it had for the same calendar quarter in 2019.

ERC and PPP Eligibility

Under the CARES Act, the recipient of a PPP loan was prohibited from claiming the ERC. The Relief Act retroactively repealed such prohibition and permits the ERC to be claimed, subject to certain limitations.

As a result of the passage of the Relief Act, there was uncertainty regarding the interplay between the PPP and the ERC and how to navigate the simultaneous use of PPP loan forgiveness and the ERC. In early March 2021, the IRS responded by issuing guidance in Notice 2021-20. The notice clarified that payroll costs that were paid for and forgiven with PPP loans are not “qualifying wages” for purposes of the ERC. An eligible employer is deemed to make an election not to consider qualified wages reported on the employer’s PPP Loan Forgiveness Application for purposes of claiming the ERC. The deemed election out of ERC applies to the minimum amount of wages necessary to achieve PPP loan forgiveness. The IRS provides numerous examples applying the new guidance to a variety of situations, including when an employer reports wages that are more than the amount necessary for loan forgiveness. By “specifically identifying” and segregating PPP payroll costs from wages that constitute “qualified wages” for purposes of the ERC, a business can benefit from both PPP and the ERC.

Notice 2021-20 addresses additional ERC topics that are not addressed in this summary. The IRS also released Notice 2021-23, which amplifies the guidance in Notice 2021-20. Notice 2021-23 does not address the ERC for the third and fourth quarters of 2021, but the IRS along with Treasury plan to issue additional guidance for those two quarters.

Monetizing the ERC

An eligible employer claims the ERC (along with its qualified wages) on its federal employment tax return(s). In anticipation of receiving the ERC, eligible employers can (i) reduce their deposits of federal employment taxes, including withheld taxes, that would otherwise be required up to the amount of the anticipated credit, and (ii) request an advance of the amount of the anticipated credit to the extent it exceeds the reduced federal employment tax deposits by filing Form 7200. For the 2020 Relevant Period, no restriction exists with respect to eligible employers claiming an advance payment, nor is there a maximum advance amount other than the amount of the ERC eligible to be claimed, subject to the requirement that an eligible employer reduce its payroll tax deposits in anticipation of the credit before requesting an advance. However, in 2021, only small employers (i.e., employers with an average of 500 or fewer full-time employees in 2019) may request advance payment of the credit in an amount not to exceed 70 percent of the average quarterly wages paid in calendar year 2019. Advances are not available in 2021 for large employers with more than 500 full-time employees in 2019. Notice 2021-23 confirmed that the requirement to reduce deposits in anticipation of the credit before requesting an advance continues to apply to 2021 eligible small employers.

To retroactively claim the ERC for a past calendar quarter in which an employer may have been entitled to the credit but elected not to take it, employers can amend their quarterly payroll tax filings by filing Form 941-X to claim the ERC. This is particularly relevant to PPP loan borrowers who were thought to be ineligible up until the retroactive repeal enacted by the Relief Act.

The foregoing is a mere summary of certain authorities relevant to the ERC. Please contact us for additional information regarding the ERC and the opportunities it may present for you.