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Make the Most of the Employee Retention Credit

The Employee Retention Credit (ERC) was created in March 2020 under the CARES Act to encourage employers to keep their workforces intact during the COVID-19 pandemic. Since then, both the Consolidated Appropriations Act (CAA) and the American Rescue Plan Act (ARPA) have extended opportunities to use the ERC and expanded eligibility for it. But questions linger for many employers. With the credit worth as much as \$28,000 per employee for 2021, employers should brush up on the details.

CARES Act

The CARES Act generally made the ERC available to employers whose:

- Operations were fully or partially suspended due to a COVID-19-related government shutdown order, or
- Gross receipts dropped more than 50% compared to the same quarter in the previous year (until gross receipts exceed 80% of gross receipts in the earlier quarter)

The credit originally equaled 50% of “qualified wages” (including health care benefits) up to \$10,000 per eligible employee from March 13, 2020, through December 31, 2020. As a result, the maximum benefit for 2020 is \$5,000 per employee.

Consolidated Appropriations Act

The CAA, which was enacted in December of 2020, extended the credit for eligible employers that continued to pay wages during COVID-19 closures or recorded reduced revenue through June 30, 2021. But that wasn’t the only change made to the ERC.

The CAA also increased the credit amount to 70% of qualified wages, beginning January 1, 2021, and raised the limit on per-employee qualified wages from \$10,000 per year to \$10,000 per quarter. In other words, you can obtain a credit as high as \$7,000 per employee per quarter.

The CAA also expanded eligibility by lowering the requisite year-over-year gross receipt reduction from 50% to only 20%. And it raised the threshold for determining whether a business is a “large employer” (and therefore subject to a stricter standard when computing the qualified wage base) from 100 to 500 employees.

Under the CARES Act, Paycheck Protection Program (PPP) loan borrowers weren't allowed to claim ERCs. But the CAA provided that employers that receive PPP loans still qualify for the ERC if the qualified wages are not paid with forgiven PPP funds. This provides an incentive for PPP borrowers to maximize the nonpayroll costs for which they claim loan forgiveness.

American Rescue Plan Act

The ARPA, also called the COVID-19 Stimulus Package or American Rescue Plan, was signed into law by President Biden on March 11, 2021, providing \$1.9 trillion in economic stimulus focused on speeding up the U.S. recovery from the economic and health effects of the COVID-19 pandemic and the ongoing recession.

Among other provisions, the ARPA extends the ERC through the end of 2021. It also makes some changes that apply solely to the third and fourth quarters of the year. For example, the credit will be applied against an employer's share of Medicare taxes, rather than Social Security taxes, and excess credits continue to be refundable.

The new law expands the pool of employers who can take advantage of the credit by establishing a third path to eligibility, beyond the suspension of operations or decline in gross receipts. Now, so-called "recovery startup businesses" may also qualify for the ERC.

A recovery startup business generally is an employer that:

- Began operating after February 15, 2020, and
- Has average annual gross receipts of less than or equal to \$1 million

While these employers can claim the credit without suspended operations or reduced receipts, it's limited to \$50,000 total per quarter.

The ARPA also targets extra relief at "severely financially distressed employers," meaning those with less than 10% of gross receipts for 2021 when compared to the same period in 2019. Such employers can count qualified wages as any wages paid to an employee during any calendar quarter — regardless of employer size. Otherwise, the ARPA continues to distinguish between large employers and small employers for purposes of determining qualified wages.

For large employers that averaged more than 500 full-time employees during 2019 (or 2020 if the employer didn't exist in 2019), qualified wages are those paid to an employee who isn't providing services because of the circumstances that made the employer eligible for the ERC. For smaller employers, qualified wages include wages paid (regardless of whether the employee was working) during the period of suspended operations or the calendar quarter in which the gross receipts test was satisfied.

Qualified wages can't include wages used to compute other credits, loan forgiveness, or certain grants received from the Small Business Administration. This applies to all eligible employers.

Note that the ARPA extends the statute of limitations for the IRS to evaluate ERC claims. The IRS will have five years, as opposed to the typical three years, from the date the original return for the calendar quarter for which the credit is computed is deemed filed.

IRS Guidance on “Partial Suspension of Operations”

Prior to passage of the ARPA in March 2021, the IRS issued additional guidance on the ERC. Among other things, it provides some help for determining whether operations were partially suspended because of a COVID-19-related government order.

The IRS has previously stated that “more than a nominal portion” of operations had to be suspended. In Notice 2021-20, it explained that this criterion is met when:

- Gross receipts from the suspended operations are 10% or more of total gross receipts
- Hours of service performed by employees in the suspended operations are 10% or more of total hours of service, or
- Modifications to operations result in a reduction of 10% or more of the employer’s ability to provide goods or services

The notice provides additional guidance, but it’s applicable only for the ERC in 2020.

California Conformity

California does not conform to the federal ERC. Employers claiming the federal ERC must reduce the wage expense deduction on their federal return for the wages claimed as a credit. Because California does not conform to the ERC and does not have an equivalent retention credit, California allows a full wage expense deduction. Employers will have an increased wage expense deduction on their California return.

A Complicated Calculation

The precise amount of your ERC will vary depending on the period, your number of employees, and other factors. Contact your Seiler tax advisor for guidance on how to ensure that you properly calculate your credit.

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