The Evolution of the Employee Retention Tax Credit

The pandemic has adversely affected many sectors of the U.S. economy, causing widespread job losses. At the start of the national emergency, Congress created a novel tax break — the Employee Retention Credit (ERC) — to entice employers to retain employees. But three different laws have created and changed the credit, which has led to significant confusion. Here's a summary of how the ERC has evolved over the last year from the CARES Act to the American Rescue Plan Act (ARPA).

New Tax Break under the CARES Act

The CARES Act, which was enacted in March 2020, introduced the ERC for employers that kept workers on their payrolls. It was designed to help curb layoffs during the COVID-19 pandemic.

Under the CARES Act, the tax credit amount equaled 50% of qualified employee wages paid by an eligible employer in an applicable 2020 calendar quarter. It was subject to an overall wage cap of $10,000 per eligible employee per year. Originally, the ERC only covered wages paid between March 13, 2020, and December 31, 2020.

Changes under the CAA

In December 2020, the Consolidated Appropriations Act (CAA) extended and greatly enhanced the ERC. Specifically, the CAA extended the covered wage period to include the first two calendar quarters of 2021, ending on June 30, 2021.

In addition, for the first two quarters of 2021 ending on June 30, the CAA:

- Increased the overall covered wage ceiling to 70% of qualified wages paid during the applicable quarter (versus 50% under the original CARES Act rules), and

- Increased the per-employee covered wage ceiling to $10,000 of qualified wages paid during the applicable *quarter* (versus a $10,000 *annual* ceiling under the original rules).

Important: For the first two quarters of 2021 ending on June 30, 2021, these changes effectively increase the maximum per-employee credit from $5,000 (50% x $10,000 of qualified wages) to $14,000 (70% x $10,000 of qualified wages x 2 quarters).

For the first two quarters of 2021 ending on June 30, the CAA included a liberalized employer eligibility rule based on a required more-than-20% decline in gross receipts, compared to the corresponding 2019 quarter (versus a required more-than-50% decline under the original CARES Act rules).

For the first two quarters of 2021 ending on June 30, the CAA also stipulated that for employers with 500 or more employees (versus 100 or more under the original rules), the ERC can only be claimed for qualified wages paid to employees who are unable to work due to a suspension of the employer's business or a lack of business. This change will allow more medium-sized employers to claim the credit in 2021.

In a retroactive change, the CAA stipulated that the ERC can be claimed for qualified wages paid with proceeds from Paycheck Protection Program (PPP) loans that aren't forgiven. This retroactive change goes back to the day the CARES Act was signed.

Another Extension and Expansion under the ARPA

The ARPA was enacted on March 11, 2021. The new law extends 1) the ERC from June 30, 2021, until December 31, 2021, and 2) the rate of the credit at 70% for this time period. Qualified wages are generally limited to $10,000 per employee per calendar quarter in 2021. So, the maximum ERC amount available is generally $7,000 per employee per calendar quarter or $28,000 per employee in 2021.

Employers who got a PPP loan in 2020 can still claim the ERC. But, when calculating the credit, the same wages can't be used both for seeking PPP loan forgiveness or satisfying conditions of other COVID-relief programs, such as the restaurant revitalization grants enacted as part of the ARPA. (See "Important Rules and Restrictions for 2021" below.)

Need Help?

The ERC provides struggling employers with a valuable tax break when they need it most. We can help you understand the rules and maximize your credit in 2020 and 2021.

Important Rules and Restrictions for 2021

A qualified employer is eligible for the Employee Retention Credit (ERC) if it experiences a significant decline in gross receipts or a full or partial suspension of business due to a governmental order. For 2021, small 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 discussed below, large employers (with more than 500 full-time employees) can only claim the credit with respect to employees that don't perform services.

An eligible employer can claim the refundable ERC against "applicable employment taxes" equal to 70% of the qualified wages it pays to employees in the third and fourth quarters of 2021.

Under the American Rescue Plan Act (ARPA), beginning in the third quarter of 2021, the following modifications will apply to the ERC:

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

- So-called "recovery startup businesses" are qualified employers. A recovery startup business is generally a business that began operating after February 15, 2020, and meets certain gross receipts requirements. A recovery startup business will be eligible for an increased maximum credit of $50,000 per quarter, even if the business hasn'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 who has suffered a decline in quarterly gross receipts of 90% or more compared to the same calendar quarter in 2019 will be able to treat all wages (up to the $10,000 limitation) paid during those quarters as qualified wages. This rule will allow a large employer (with over 500 employees) under severe financial distress to treat those wages as qualified wages regardless of whether its employees actually provide services.

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

Contact us for more information.

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