Tax Notes

The Employee Retention Credit – A New and Improved Taxpayer Opportunity

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The Consolidated Appropriations Act, 2021 (the Act) brought big headlines including a new round of PPP loans, full expensing for business meals, and new stimulus checks. A much overlooked opportunity, however, is the major expansion of the Employee Retention Credit (ERC).

When originally introduced under the 2020 CARES Act, the ERC was understandably not much discussed. Businesses could only choose one: the PPP loan or the ERC. The PPP benefit was almost always larger. But that limitation has now been retroactively removed, opening up a potential pool of money for businesses that qualify. Further, the ERC will continue into 2021, with wider eligibility and a far larger maximum credit. Below, we examine the changes, eligibility and how to navigate the pitfalls.

What is the ERC?

The ERC is a credit against Social Security taxes owed by an employer. To the extent the credit amount exceeds the amount of Social Security tax due on the wages paid, it is refundable. Businesses are eligible if they are closed (fully or partially) because of a government order related to COVID-19 or have experienced a significant decline in gross receipts. In 2021, added to those qualifying as eligible employers, are government-run colleges, universities and health care providers.

How is the ERC calculated?

In 2020, the ERC equaled 50% of each employee's qualified wages, up to a maximum of $10,000 of wages. As such, the credit is capped at $5,000 per employee. The ERC was set to expire at the end of 2020, but has been extended to the first two quarters of 2021. In 2021, the ERC equals 70% of each employee's qualified wages, up to a maximum of $10,000 of wages ***per quarter***. Thus, the 2021 cap per employee is a $14,000 credit.

While employers of all sizes qualify for the credit, it applies differently depending on the number of full-time employees the business averaged in 2019 (computed on a monthly basis). For businesses over 100 employees (500 in 2021), qualified wages are only those paid to employees not providing services. Health plan expenses may be included in determining qualified wages, including for employees who have been furloughed and are receiving no wages other than health plan benefits.

Does Any Business that Experienced a Shutdown Get the ERC?

While the Act removed the limitation on a business receiving both the PPP and the ERC, there are limitations. Importantly, the ERC cannot be taken for wages which are covered (i.e., forgiven) expenses as part of a PPP loan. The earliest date qualified wages could have been paid is March 13, 2020; depending on its facts, a business could still be qualified today.

PKFOD Observation: Knowing how long your business qualified for the ERC is always important, but particularly so in making sure that wages used for the ERC do not overlap with wages for PPP forgiveness applications.

The two qualification tests have different timeframes regarding employer eligibility for the credit:

- **Operations were fully or partially suspended on orders from a governmental authority due to COVID-19 (COVID-19 Shutdown)** – You no longer qualify when the relevant order is lifted. A partial suspension is broadly construed and includes any reduction in operations which has more than a nominal effect on business. However, a business with an office that has been closed but which can continue all of its operations via telework does not qualify. It is possible to qualify under this test for all of 2020 – for example, a restaurant that has not been able to be at full capacity because of government orders – but other businesses may qualify for a more limited period.

- **For 2020, your business experienced a 50% reduction in gross receipts for a calendar quarter in 2020 as compared to the same calendar quarter in 2019 (Gross Receipts Decline)** – Once a business qualifies, it continues to do so until your gross receipts for a calendar quarter in 2020 are 80% of the gross receipts in the same calendar quarter in 2019 – that is the last quarter of qualification.

  For 2021, the reduction in gross receipts required is only 20% in the quarter, compared to the same calendar quarter in 2019. For 2021, businesses may also choose to use gross receipts in the immediately preceding quarter (i.e., Q1 2021 qualification can be determined by comparing Q4 2020 to Q4 2019).

Gross receipts are specifically defined for nonprofit and for-profit businesses.

How is the ERC Claimed?

The ERC can be claimed on a taxpayer's quarterly employment tax return (Form 941 or similar). For those businesses only now retroactively eligible, they can either file Form 941-X to amend prior quarters or claim the entire credit on the Form 941 for Q4 2020. In addition, taxpayers are able to file a Form 7200 to receive an advanced credit any time before 30 days after the end of a quarter (i.e., before the due date of the taxpayer's quarterly employment tax return, which is 30 days after the end of a quarter). In 2021, Form 7200 can only be used by businesses under a small business cap.

What Should I Do Now?

If you initially ignored the ERC because your business received a PPP loan, now is the time to assess whether you qualified in 2020. Then, you must compare the wages qualifying for the ERC with the wages being used for the PPP forgiveness application. Can you hit the maximum ERC without overlapping with covered wages on your application? Given the relatively small cap on the ERC in 2020, this may be possible; if not, some consideration of using non-payroll expenses on the PPP forgiveness application may be in order. If you're considering a second draw PPP loan for 2021, now is also the time to consider tracking non-payroll expenses if you'll also be eligible for the ERC.

Contact Us

If you have questions about the employee retention credit, contact your client service partner or:

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