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Employee Retention Tax Credit

The Employee Retention Credit (ERC) was first created by the CARES Act in March of 2020 and is a payroll tax credit claimed by the employer for retaining employees during COVID-19.

The Consolidated Appropriations Act of 2021 (CAA), contains some important new points on the ERC.

First we will outline first the main points from the CARES Act in 2020, then the changes that went into effect for 2021.

Original Legislation from March 2020

- The ERC is a refundable payroll tax credit of up to $5,000 per employee.
- **Qualification Factor:** The ERC is available to employers who have either (a) been partially or fully closed by an order from a governmental authority due to COVID-19. OR (b) whose gross revenue for a quarter in 2020 was less than 50% of what they were for the same quarter in 2019.
- **Eligible Wages:** Eligible employee wages refers to wages paid: (a) during the shutdown OR (b) during the quarter which experienced the decline in gross revenue, plus the successive quarters until gross receipts is back up to 50% of the same quarter in 2019.
    - **Example (for scenario B):** in Quarter 3 of 2020 you only had gross revenue of 45% compared to the same quarter in 2019, that means it is a qualifying month to take the credit. Now let's say employees didn't make enough to be able to take the full $5,000 credit, you can also add quarter 4, assuming you didn't reach 50% of gross revenue compared to quarter 4 in 2019.
- **Maximum Credit:** The 2020 calculation for the ERC is 50% of eligible employee wages, with a wage cap of $10,000.00 per employee for the year. Effectively, this caps the maximum credit at $5,000 per employee.
    - **Example:** If an employees' pay was $20,000.00 per year, the maximum you can count is $10,000.00, 50% of that is $5,000.00, so your credit will be $5,000.00.
- **FTE Limit*:** Wages paid by an employer with more than 100 average Full-Time Equivalent Employees (FTE's) for 2019, are only eligible if the employee was paid but did not work, either because the business was fully or partially shutdown. For those with 100 or fewer FTE's, they could claim the credit regardless if the employee worked or not, as long they meet the above criteria.

  * For ERC purposes, an FTE is any employee who works +30 hours per week or +130 hours per month. Not to be confused with Full-Time Equivalent employees which often uses the same acronym
- An employer can claim the ERC, either by reducing their payments to the IRS on Social Security, Medicare and Federal income tax (collectively called 941 taxes), and it will be reported on the 941. Or by filing Form 7200 to request an immediate refund of the credit.

Note: If you want to apply now retroactive for 2020, it will have to be done on an amended 941 return.

Changes that Apply Retro for 2020

- Originally employers were not allowed to take both PPP and the ERC credit, this restriction was removed with the CAA act. More importantly, this also applies retroactively to 2020, so you can now claim ERC for 2020, if you meet the above-mentioned criteria. However, you cannot use the same wages already used for the PPP forgiveness application (or you plan on doing so).
  - **Example:** If you used the wages of May and June to apply for PPP forgiveness, you cannot use the wages of those 2 months for the ERC credit.
- The CAA also modified the definition of qualified wages to include employee health insurance paid for by the employer.

Changes that Apply Only for 2021

- CAA extended ERC to June 30, 2021. American Rescue Plan extends it to the end of 2021.
- **Qualifying Factor:** The reduction in gross quarterly receipts eligibility requirement, was reduced from 50% to 20%. The quarter in 2021 is compared to the same quarter in 2019 (unless the business did not exist at that time, at which pint you can compare to 2020). Employers also have more flexibility in choosing which quarter to use for comparison.
- **Pending IRS Clarification:** The IRS also said, that for 2021, they will allow to use the prior quarter to decide eligibility.
  - **Example:** for quarter 1, 2021, since you typically don't know mid-quarter if you going to qualify after the quarter, you will be able to use quarter 4, 2020 as the test so if your quarter 4 2020 is 20% less than quarter 4, 2019, you can quality for quarter 1 2021. However, the IRS clearly said they will issue further guidance on this.
- **Eligible Wages:** The amount of the qualifying wages was increased from 50% to 70%. The annual limit was changed from $10,000 per year to $10,000 per quarter, and of that, you can calculate 70% credit.
- **Maximum Credit:** The maximum credit is $7,000 per employee per quarter, since it applies for the first 2 quarters, the maximum annual credit for 2021 is $14,000.00 per employee. (this can be in addition of the $5,000 from 2020).
- The "FTE" threshold for counting qualified wages was increased from 100 to 500 FTE's. (As a reminder, it's based on 2019).
- As opposed to the previous rules, employers can now increase the ERC during a quarter by providing bonuses or additional salary, thereby increasing the credit.
- Employers may request an advance payment of the credit up to 70% of the average quarterly payroll in 2019.

More Information On Gross Decline

- **For 2020:** the gross receipts decline is defined by the IRS as outlined below. (not as mentioned in the webinar, that the successive quarters also has to have a decline of 50%)

- **Calculating Significant Decline in Gross Recipts:** A significant decline in gross receipts is calculated by determining the first calendar quarter in 2020 (if any) in which an employer's gross receipts are less than 50 percent of its gross receipts for the same calendar quarter in 2019. If the gross receipts decline to that extent, the employer also must later determine if there is a later calendar quarter in 2020 in which the employer's 2020 quarterly gross receipts are greater than 80 percent of its gross receipts for the same calendar quarter in 2019. If so, the significant decline in gross receipts ends with the first calendar quarter that follows the first calendar quarter in which the employer's 2020 quarterly gross receipts are greater than 80 percent of its gross receipts for the same calendar quarter in 2019, or with the first calendar quarter of 2021.

  - **Example:** Employer 1's gross receipts were $100,000, $190,000, and $230,000 in the first, second, and third calendar quarters of 2020, respectively. Its gross receipts were $210,000, $230,000, and $250,000 in the first, second, and third calendar quarters of 2019, respectively. Thus, Employer 1's 2020 first, second, and third quarter gross receipts were approximately 48 percent, 83 percent, and 92 percent of its 2019 first, second, and third quarter gross receipts, respectively. Accordingly, Employer 1 had a significant decline in gross receipts commencing on the first day of the first calendar quarter of 2020 (the calendar quarter in which gross receipts were less than 50 percent of the same quarter in 2019) and ending on the first day of the third calendar quarter of 2020 (the quarter following the quarter for which the gross receipts were more than 80 percent of the same quarter in 2019). Thus, Employer 1 is entitled to a retention credit with respect to the first and second calendar quarters.