Make the most of the Employee Retention Credit

The Employee Retention Credit (ERC), which was created to encourage employers to keep their workforces intact during the COVID-19 pandemic, has been with us for a year. But questions about it remain for many employers. With the new American Rescue Plan Act (ARPA) extending the credit and expanding eligibility — and the credit worth as much as $28,000 per employee for 2021 — employers should brush up on the details.

Credit history

The CARES Act, which was enacted in March of 2020, 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.

The Consolidated Appropriations Act (CAA), which was enacted in December of 2020, extended the credit for eligible employers that continue to pay wages during COVID-19 closures or recorded reduced revenue through June 30, 2021. That wasn't the only change the law made to the ERC, though.

The CAA increased the amount of the credit 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 quarter per employee.

The CAA also expanded eligibility by reducing 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. The CAA also provided that employers that receive PPP loans still qualify for the ERC for qualified wages not paid with forgiven PPP funds. (This provides an incentive for PPP borrowers to maximize the nonpayroll costs for which they claim loan forgiveness.)

ARPA changes

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; 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 — beyond the suspension of operations or decline in gross receipts — to eligibility. 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 as qualified wages 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”

In early March 2021, prior to passage of the ARPA, 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.

A complicated calculation

The precise amount of your ERC will vary depending on the period, your number of employees and other factors. We can help ensure that you properly calculate your credit and don’t leave money on the table.