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BLOG

CAA Benefits Alert: Employee Retention Credit Expanded

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The Consolidated Appropriation Act, 2021, signed into law on December 27, 2020 by President Trump (the Act), expands, extends, and makes technical corrections to the Employee Retention Tax Credit (ERTC) provisions of the CARES Act.

The ERTC provisions of the CARES Act allowed for a refundable payroll tax credit for employers who continued to pay their employees during the COVID-19 pandemic. The ERTC was equal to 50% of “qualified wages” paid from March 13, 2020 through December 31, 2020 up to $10,000, if the employer met either a reduced gross receipts requirement (the “Gross Receipts” requirement) or experienced a full or partial shutdown due to government orders related to COVID-19 (the “Full or Partial Shutdown” requirement). Under the CARES Act, an employer who met one of these requirements in a quarter could claim a maximum cumulative credit of $5,000 for each employee who was paid “qualified wages.” If an eligible employer had more than 100 employees, qualified wages only included amounts paid to employees who did not provide services. For eligible employers with 100 or fewer employees, qualified wages included amounts paid to all employees. Significantly, under the CARES Act, employers that received Paycheck Protection Program (PPP) loans were not eligible for the ERTC.

Retroactive Changes Effective in 2020

Retroactive to the effective date included in Section 2301 of the CARES Act, the ERTC is modified to provide that employers who receive a PPP loan may still qualify for the ERTC with respect to wages that are not paid with PPP loans. This means that employers who received a PPP loan in 2020, and paid wages in excess of the amount used for the basis of the PPP loan forgiveness, can obtain up to the maximum $5,000 per employee ERTC for 2020, assuming the other requirements for the credit are satisfied. Furthermore, as described below, in 2021, such employers may obtain the ERTC under the expanded and higher amounts provided for 2021, e.g., up to $14,000 in total.

For example, an employer with 50 employees that obtains a PPP loan for a covered period ending October 12, 2020 may use the wages paid in the last quarter of 2020 to claim the ERTC if the employer either experienced a Full or Partial Shutdown due to government orders related to the pandemic or met the Gross Receipts test. The Act also allows for the employer to elect not to have the new provisions apply, so that if the employer does not want to use the qualified wages for the ERTC, the wages may be used for purposes of the PPP loan forgiveness instead, thus giving the employer flexibility.

Also effective in 2020, the Act clarifies that group health plan expenses can be considered qualified wages even when no other wages are paid to the employee. This is helpful for employers who continue to provide medical benefits to employees on furlough even while paying no wages.

Changes to the ERTC Effective in 2021

The Act makes several very favorable changes to the ERTC that are effective January 1, 2021 through June 30, 2021, thus allowing an additional six months of credit relief for employers experiencing the negative effects of the pandemic. During the extension period, the ERTC is increased from 50% to 70% of qualified wages and the cumulative limit of qualified wages is increased from $10,000 per year to $10,000 *per quarter*. Thus, compared to the maximum 2020 ERTC under the CARES Act of $5,000 per employee (50% x $10,000), the 2021 maximum potential ERTC per employee is $14,000 (70% x $10,000 if eligible in both the first and second quarters of 2021). The Act also contains a more generous method for determining the qualified wage base. The CARES Act limited the qualified wages eligible for the ERTC to those paid during a 30-day period occurring prior to the quarter in which the qualified wages were paid. The 30-day limit is now removed under the Act, allowing the ERTC to be based on higher relative wages. For example, an employee who is normally paid $2,000 per month, could receive a raise that increases the employee's qualified wages to $3,500 per month and the entire amount of the employee's new qualified wage base would be eligible for the credit (subject to the $10,000 per quarter cap).

In addition, the Act increases the employee threshold level, for including the wages of employees who provide services, to 500. Thus, for 2021, eligible employers with up to 500 employees are eligible for the credit even if the employees are still providing services.

The Act also makes it easier for employers to qualify for the ERTC based on the Gross Receipts test by reducing the year-over-year gross receipts decline from 50% to 20% and providing a safe harbor that allows employers to use prior-quarter gross receipts from 2019 to determine eligibility. Thus, an employer with only a 20% decrease in gross receipts from the applicable 2019 quarter will be eligible for the credit.

Businesses with 500 or fewer employees may apply for an *advanced* credit at any point during the quarter based on wages paid in the same quarter in 2019. Thus, smaller employers will be eligible to apply for the credit prior to paying wages for the quarter. In addition, the Act permits new employers who were not in existence for all or part of 2019 to claim the ERTC. The Act also clarifies that an eligible employer who utilizes a professional employer organization or other third-party payor for purposes of reporting and paying federal employment taxes will be liable for an improperly claimed ERTC and must require the third-party payor to accurately report the credit.

Tax-Exempt Employer Guidance

Finally, the Act clarifies the determination of gross receipts for certain tax-exempt organizations for purposes of the Gross Receipts test by referencing Section 6033 of the Internal Revenue Code, thus providing relief for those organizations. The clarified definition generally requires the inclusion of the total amounts an organization earns in a fiscal/calendar year from all sources without subtracting any expenses.

How to Take the Retention Credit

The Retention Credit may be taken in several ways in accordance with guidance provided by the IRS, including reducing required deposits of Federal employment taxes, taking the credit on Form 941, or applying for the credit on Form 7200. Because the Retention Credit is applied against Federal employment taxes, tax-exempt organizations can take full advantage.

Winston Takeaway: Employers receiving PPP loans have a new opportunity to take the retention credit in addition to receiving loan forgiveness for 2020 or 2021. Such employers will need to make an election to not use qualified wages for the credit, in accordance with guidelines provided by the Secretary, if the wages are to be used for PPP loan forgiveness.

This article is part of our "Unpacking the Employee Benefits Provisions in the Consolidated Appropriations Act, 2021" series. Click here for other CAA-related articles. Please contact a member of the Winston & Strawn Employee Benefits and Executive Compensation Practice Group or your Winston relationship attorney for further information.

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David Rogers

Jessica Diedrich

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