Employee Retention Tax Credit Expanded and Extended by New COVID-19 Stimulus: Does Your Business Qualify for the ERTC Now?

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The Coronavirus Aid, Relief and Economic Security (CARES Act), signed into law on March 27, established the Employee Retention Tax Credit (ERTC), which entitled eligible employers to a refundable tax credit against certain federal employment taxes. On December 27, the president signed the Consolidated Appropriations Act (CAA) into law, which included a $900 billion coronavirus relief package. Among the provisions of the CAA were significant changes to the ERTC that provided an increased credit amount in 2021, relaxed the eligibility requirements, and retroactively allowed Paycheck Protection Program loan recipients to be eligible for the credit.

This article provides an overview of the ERTC, with specific attention to the changes made under the CAA. A chart at the conclusion of this article highlights the CAA changes to the ERTC versus the original CARES Act provisions.

The Benefit

Beginning March 12, 2020, the CARES Act enabled eligible employers to take a credit against applicable employment taxes for any calendar quarter of 2020 in an amount equal to 50 percent of the first $10,000 of "qualified wages" per quarter for each employee. However, the maximum amount of qualified wages that could be taken into account for any employee for all quarters was also $10,000, so the maximum credit per employee was $5,000 in total. The CAA extended the credit for the first and second quarters of 2021 and increased the credit amount to 70 percent of the first $10,000 of qualified wages paid after January 1, 2021 per quarter. Additionally, the CAA removes the annual $10,000 qualified wage cap. Any amount of the credit that exceeds the employment tax liability for such quarter is treated as an overpayment of tax and

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refunded to the employer.

Who is Eligible?

To qualify for the ERTC, one of the following must occur during the period for which the credit is claimed: (1) the operation of an employer's business for the period the ERTC is taken must be fully or partially suspended due to government orders limiting commerce, travel, or group meetings due to COVID-19; or (2) there must be a significant decline in gross receipts for such period.

Suspension of business: Section 2301(b)(2)(A)(ii) of the CARES Act provides that, if an employer's operations are "fully or partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes)" due to COVID-19, the employer is an "eligible employer" for the ERTC. IRS guidance defines "orders from an appropriate governmental authority" as "[o]rders, proclamations, or decrees from the Federal government, or any State or local government … if they limit commerce, travel, or group meetings due to COVID-19 in a manner that affects an employer's operation of its trade or business, including orders that limit hours of operation".[1] Statements from a governmental official, including comments made during press conferences or in interviews with the media, do not rise to the level of a governmental order for purposes of the ERTC. IRS examples of governmental orders include the following: orders from a government official that all non-essential businesses must close for a specified period; an emergency shelter in place designation for all not employed by essential business; and, a curfew on residents that impacts the operating hours of a trade or business for a specified period.[2]

While a government order may limit commerce, travel, or group meetings, for example, by closing or restricting access to an employer's normal workplace, but does so in a manner that does not affect the employer's operation of its trade or business, this does not rise to the level of a suspension of business operations for ERTC purposes. IRS guidance provides the example of a software development company that maintains an office downtown but is

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required to close its office by government order. Because the ability for all employees to telework and regular teleworking prior to the COVID-19 shutdown, the business is able to continue in a comparable manner and is not considered fully or partially suspended. In contrast, IRS guidance has an example of a scientific research company that is deemed non-essential and is ordered to close its office. The research company performs its research both in a laboratory setting and through the use of computer modeling. While the computer modeling research operations could be conducted remotely, the laboratory-based research operations could not, and lab-based workers could only perform administrative tasks during the closure. This employer's business operations are considered to be partially suspended by the governmental order because the laboratory-based research business operations cannot continue in a comparable manner.

The IRS also provides some guidance on government orders that allow a business to remain open but with significant restrictions. The IRS provides that if an employer's business operations continue but are subject to modification (for example, to satisfy social distancing requirements), "such modification of operations is not considered to be a partial suspension of business operations due to a governmental order, unless the modification required by the governmental order has more than a nominal effect on the business operations under the facts and circumstances." (emphasis added) [3]. The IRS provides that a government order reducing the number of hours a business can operate is considered a partial suspension. [4] Additionally, IRS examples show that restaurants only allowed to resume outdoor dining, carryout and delivery services are considered partially suspended because closure of the indoor space has more than a nominal effect on operations. However, a large retailer that is required to limit the number of customers that may enter its store at one time for social distancing purposes, causing a small wait at times for customers seeking to enter the store, but is still able to accommodate all customers, is not considered to be partially suspended because the business modification, the capacity limitation, does not have more than a nominal effect on its operations.[5] IRS guidance also provides that, if a business operates in multiple jurisdictions and is only subject to

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a government order in some of the jurisdictions, if the government order in that jurisdiction rises to the level of a full or partial suspension of business operations, the entire business of the employer is considered partially suspended.

As such, to be considered a partial suspension, it appears the government order must cause an employer's business to not be able to perform some significant business function or cause the business to be unable to provide service to a significant number of customers that the business otherwise would be able to provide if restrictions were not in place. A limitation on the number of customers allowed in an business at a time that ultimately will not limit the employer's ability to provide service to the same number of customers will not be considered a partial suspension of business operations.

Significant decline in gross receipts: The IRS provides that "gross receipts" for ERTC purposes means "gross receipts of the taxable year and generally includes total sales (net of returns and allowances) and all amounts received for services. In addition, gross receipts include any income from investments, and from incidental or outside sources."[6] For tax-exempt entities, similarly, "gross receipts" includes receipts from all operations.[7]

Under the CARES Act, a significant decline in gross receipts for purposes of the ERTC began with the first calendar quarter in 2020 in which an employer's gross receipts were less than 50 percent of its gross receipts for the same calendar quarter in 2019. The period for which an employer had a significant decline in gross receipts ended 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.[8]

The CAA materially modified the determination of a significant decline in gross receipts. Effective January 1, 2020, if gross receipts are less than 80% of the gross receipts for the same quarter in 2019, the employer will have a significant decline in gross receipts and qualify for the ERTC for that period.[9] As such, many employers that are not subject to a business suspension order may qualify for the ERTC in 2021 because the bar for a significant decline in gross

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receipts was lowered from more than a 50% decline to more than a 20% decline.

Nonprofits and government entities. Under the CARES Act eligible nonprofits could take the ERTC under the same rules as eligible for-profit entities. However, the ERTC was not available to any federal, state, or local governmental entity or agency thereof. The CAA expanded eligibility for the ERTC to certain government entities.

Effective January 1, 2021, the ERTC will be available to government run colleges, universities, and any government organization with the principal purpose or function of providing medical or hospital care. Additionally, Internal Revenue Code Section 501(c)(1) corporations are now eligible for the ERTC. Section 501(c)(1) corporations are certain corporations organized under an act of Congress and exempt from federal income taxes.[10]

What are "Qualified Wages"?

Under the CARES Act, the ERTC is 50% of the first $10,000 of "qualified wages" paid by an eligible employer to each employee of such employer per quarter. Qualified wages include wages and compensation, as defined in Sections 3121(a) and 3231(e) of the Internal Revenue Code, respectfully. Also included in qualified wages are an eligible employer's qualified health plan expenses that are allocable to such wages. The determination of applicable qualified health plan expenses is materially the same as qualified health plan expenses for the Family and Medical Leave Tax Credit under the Families First Coronavirus Response Act, such expenses are discussed in detail in one of our prior articles.

The CARES Act also required that qualified wages be paid during a period of suspension of business operations or decline in gross receipts and provided limitations based on the average number of full-time employees employed during 2019.[11] For an employer averaging more than 100 full-time employees in 2019, eligible wages only included payments to employees not providing services to the employer during the business suspension or reduction in gross receipts. For employers averaging 100 or less full-time employees in 2019, qualified wages included payments to all employees during

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such period regardless of whether they were providing services or not. The CARES Act also provided that qualified wages could not exceed the amount employees would have been paid for working an equivalent duration during the 30 days immediately preceding the period such wages and other compensation were eligible for the ERTC. As such, raises or other additional compensation paid to an eligible employee during the pay period the employer was eligible for the ERTC was disregarded in calculating the ERTC for that employee.

The CAA did not modify the $10,000 per employee per quarter limitation or requirement that wages be paid during the qualifying period. However, effective January 1, 2021, the 100 average full-time employee threshold was increased by the CAA to 500 or fewer average full-time employees in 2019.[12] As such, employers with between 500 and 101 average full-time employees in 2019, that previously only received an ERTC against payments made to employees not providing services, will receive an ERTC for 2021 against payments made to employees regardless of whether or not they are providing services during the suspension of business operations or reduction in gross receipts period. The CAA also struck the limitation on wage and compensation increases prior to the eligible period. As such, any additional compensation given to an eligible employee during the 2021 ERTC periods shall be included in the calculation of qualified wages for the ERTC.

What Taxes Does the Credit Offset?

The ERTC can be used to offset applicable taxes under Section 3111(a) of the Internal Revenue Code and any taxes under Section 3221(a) that is attributable to the rate under Section 3111(a). Section 3111(a) covers the employer's 6.2% federal social security tax and Section 3221(a) covers the similar tax on employers under the Railroad Retirement Act.

Can the ERTC Be Used in Connection With Other Stimulus Incentives?

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Under the CARES Act, the ERTC was unavailable to any employer who received a Paycheck Protection Program (PPP) loan, unless such loan was repaid by May 18, 2020. Any employer that was treated as part of a single employer under the aggregation rules (more than 50% common ownership) was also ineligible for the ERTC if any member of the employer's aggregated group received a PPP loan.[13] Also, if the employer received a Family and Medical Leave Tax Credit under the Families First Coronavirus Response Act, family and medical paid leave payments cannot count towards qualified wages for the ERTC.[14]

Under the CAA, an employer that receives a PPP loan is no longer prohibited from claiming the ERTC. However, wages and compensation paid with the proceeds of a PPP loan that have been forgiven do not count as qualified wages for the ERTC. This change is also retroactive to the effective date of the ERTC under the CARES Act, March 12, 2020. As a result, employers that received a PPP loan or are part of an aggregated group with a PPP loan recipient in 2020, paid qualified wages, and are otherwise eligible to claim the credit, should be able to claim the ERTC for the fourth quarter of 2020 and file amended 2020 federal employment tax returns to claim the ERTC for other eligible 2020 quarters.

We recommend employers that did not claim the ERTC due to a 2020 PPP loan should review ERTC eligibility to determine if they are eligible to claim the ERTC for 2020 employment tax periods.

How To Claim the ERTC

IRS guidance provides that eligible employers should report total qualified wages for the ERTC on their federal employment tax returns (usually Form 941- Employer's Quarterly Federal Tax Return). [15] Form 941 has been amended to include qualified wages for the ERTC (line 21) and qualified health plan expenses (line 22) on Part 3 of Form 941.[16] Additionally, the Instructions to Form 941 provide a worksheet to calculate the ERTC (Worksheet 1).[17] After calculating the non-refundable and refundable portions of the ERTC, the non-refundable portion (line 11c) and refundable portion (line 13d) are reported on Part 1 of Form 941 to determine the total employment tax due or overpayment to be refunded.

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The CARES Act also allowed employers to file Form 7200 to request advance payments of any refundable ERTC amount. The CAA provides that the Secretary of the Treasury will provide rules to allow an advance payment of the ERTC for employers with 500 or fewer employees in 2021 and provides that any advance payment will be determined based on 70% of average quarterly payroll of the employer for the same quarter in 2019.[18] It is assumed that any difference in the actual calculation of the ERTC on the Form 941 will either be repaid by the employer or be refunded. Because a small number of employers requested advanced payments of ERTCs in 2020, guidance on advanced payments could differ from what was provided for requesting advance payments of 2020 ERTCs.

ERTC Rules	Old Law (CARES Act)	New Law (CAA)
Period of ERTC Availability	For qualified wages paid after March 12, 2020 and before January 1, 2021.	Extended period to June 30, 2021. ERTC is available for wages paid after March 12, 2020 and before ***July 1, 2021***.
Amount of ERTC	***50%*** of qualified wages and health benefits for eligible employees.	For periods beginning January 1, 2021, ERTC is increased to ***70%*** of qualified wages and health benefits for eligible employees.

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Maximum ERTC Amount	Limited to first $10,000 of qualified wages per employee for all quarters. Maximum benefit is ***$5,000*** per employee for 2020.	Limited to first $10,000 of qualified wages per employee per quarter. Maximum credit of ***$7,000*** per employee available for both first and second quarters, making total maximum benefit ***$14,000*** for 2021.
Eligibility – significant reduction in gross receipts	Employers are eligible if business operations are suspended by government order or if gross receipts are ***less than 50%*** of gross receipts for same quarter in 2019.	Employers are eligible if business operations are suspended by government order or if gross receipts are ***less than 80%*** of gross receipts for same quarter in 2019.
Eligibility – government entities	***Not eligible***.	***Certain entities are eligible***. Government run colleges, universities, organizations providing medical or hospital care, and Section 501(c)(1) organizations are eligible.

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Employee Threshold	Employers with more than ***100*** full-time employees received no ERTC for wages paid to an employee performing services during the eligible period. Employers with ***100*** full-time employees or less were eligible for the credit, even if the employee was working.	Employers with more than ***500*** full-time employees receive no ERTC for wages paid to an employee performing services during the eligible period. Employers with ***500*** full-time employees or less are eligible for the credit, even if the employee was working.
Limitation for Pay Raises	No credit for pay rate increases made less than 30 days before ERTC period.	***Removed*** limitation on pay rate increases.
PPP Loan Eligibility	Employers that received a PPP loan were ***not eligible*** for the ERTC as well as employers affiliated (shared more than 50% common ownership) to any company that received a PPP loan.	Retroactive for 2020, employers that received a PPP loan are ***eligible*** to amend employment tax returns and claim ERTC credits for 2020 and claim ERTCs for eligible periods in 2021. However, the ERTC may not be claimed for wages paid with the proceeds of a PPP loan that have been forgiven.

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We continue to follow these developments closely and will provide updates as both the federal and state governments continue to decipher how best to aid taxpayers during this difficult time.

For more information as to how the spread of COVID-19 creates tax implications, please contact any attorney in Frost Brown Todd's Tax practice group.

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[1] COVID-19-Related Employee Retention Credits: Determining What Types of Governmental Orders May be Taken into Account for Purposes of the Employee Retention Credit FAQs, Question 28. <https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-determining-what-types-of-governmental-orders-may-be-taken-into-account-for-purposes-of-the-employee-retention-credit-faqs>

[2] Id.

[3] COVID-19-Related Employee Retention Credits: Determining When an Employer's Trade or Business Operations are Considered to be Fully or Partially Suspended Due to a Governmental Order FAQs, Question 34. <https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-determining-when-an-employers-trade-or-business-operations-are-considered-to-be-fully-or-partially-suspended-due-to-a-governmental-order-faqs>

[4] Id., Question 35.

[5] Id., Question 34.

[6] COVID-19-Related Employee Retention Credits: Determining When an Employer is Considered to have a Significant Decline in Gross Receipts and Maximum Amount of an Eligible Employer's Employee Retention Credit FAQs. Question, 40 <https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-determining-when-an-employer-is-considered-to-have-a-significant-decline-in-gross-receipts-and-maximum-amount-of-an-eligible-employers-employee-retention#determining-when-employer-considered-have-significant-decline-in-gross-receipts>

[7] Id., Question 46.

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[8] If an employer started a business in 2019 and did not have gross receipts in a comparable quarter in 2019, the employer may use the closest 2019 quarter for which receipts exist to the comparable 2019 quarter to compare against the 2020 quarter. For example, an employer that started a business in the third quarter of 2019 should use that quarter as the base period to determine whether it experienced a significant decline in gross receipts for the first three quarters in 2020 and should use the fourth quarter of 2019 for comparison to the fourth quarter of 2020 to determine whether it experienced a significant decline in gross receipts for that quarter. Id., Question 44.

[9] For employers not in business in 2019, the CAA provides that the gross receipts test compares 2020 calendar quarters to similar quarters in 2021.

[10] Section 501(l) of the Internal Revenue Code describes lists the following organizations as 501(c)(1) organizations: (1) The Central Liquidity Facility established under title III of the Federal Credit Union Act (12 U.S.C. 1795 et seq.); (2) The Resolution Trust Corporation established under section 21A of the Federal Home Loan Bank Act; (3)The Resolution Funding Corporation established under section 21B of the Federal Home Loan Bank Act; and, (4) The Patient-Centered Outcomes Research Institute established under section 1181(b) of the Social Security Act. Examples include Fannie Mae, FDIC, Federal Home Loan Banks and Federal Credit Unions.

[11] Section 2301(c)(3)(A) of the CARES Act provides that "full-time employee" has the meaning provided in Section 4980H of the Internal Revenue Code. Section 4890H(c)(4) defines a "full-time employee" as "with respect to any month, an employee who is employed on average at least 30 hours of service per week."

[12] For employers not in business in 2019, the CAA provides such employers can use the average number of full-time employees in 2020 for purposes of determining the employee threshold number.

[13] COVID-19-Related Employee Retention Credits: Interaction with Other Credit and Relief Provisions FAQs, Question 80. < https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-interaction-with-other-credit-and-relief-

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provisions-faqs>

[14] Additionally, several other non-COVID-19 stimulus credits are restricted for employer receiving ERTCs. Wages attributable to ERTCs may not be used to calculate the employer wage credit under Sections 45A (Indian employment credit), 45P (employer wage credit for employees who are active military service members), 45S (employee credit for paid family and medical leave), 51 (Work Opportunity Tax Credit), and 1396 (Empowerment zone employment credit). The CAA expands the limitations by restricting the benefit under Section 41 (Research Credit) as well.

[15] COVID-19-Related Employee Retention Credits: How to Claim the Employee Retention Credit FAQs. Question 72. < https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-how-to-claim-the-employee-retention-credit-faqs>

[16] https://www.irs.gov/pub/irs-pdf/f941.pdf

[17] https://www.irs.gov/pub/irs-pdf/i941.pdf

[18] For employers not in existence in 2019, use 70% of 2020 quarterly payroll figures.

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