

Employee Retention Credit Further Expanded by the American Rescue Plan Act

Eligible employers that have not claimed the employee retention credit could be leaving tens of thousands of dollars of tax benefits on the table. The stakes are even higher under the recently enacted American Rescue Plan Act of 2021 ("ARPA"), which further expands the total amount and eligibility of the credit.

COVID-19 has changed business as usual for virtually every industry. The pandemic has taken a significant, and in some cases, existential, toll on the operations and finances of many businesses. In an effort to aid employers and keep employees on payroll, Congress created the employee retention credit as a fully refundable tax credit that gives eligible employers the ability to claim a credit against payroll taxes that they would otherwise owe for each of their employees. Since the employee retention credit was first enacted in March of 2020, Congress has expanded its parameters several times, most recently under the ARPA that was passed on March 11, 2021.

Amount of Credit

The employee retention credit is calculated as a percentage of "qualified wages" paid by the employer to each employee. The original rules covering periods in 2020 provided for a 50% tax credit against certain "qualified wages" paid by employers. The credit later was expanded to 70% for the first two quarters of 2021 under the Consolidated Appropriations Act, 2021. Under the new ARPA rules, the employee retention credit was also extended to cover all of 2021, rather than just the first two quarters. Accordingly, an eligible employer may be able to claim up to \$28,000 of credits in total per employee for 2021, in addition to the \$5,000 of credits in total per employee for 2020. This means that an eligible employer could receive a maximum of up to \$33,000 in total employee retention credits for *each* of its employees.

The rules for calculating the amount of "qualified wages" that can be applied against the credit are highly technical and depend in part on the number of employees of the employer. However, the ARPA provides more generous rules for severely financially distressed employers that experience a more than 90% decline in gross receipts, regardless of their number of employees. Employers are also prohibited from double counting wages that have been used for Paycheck Protection Program loans or certain other tax credits.

Eligibility

Eligibility for the employee retention credit is not generally limited to any particular industry, type, or size of business. For-profit companies and nonprofit organizations might all qualify, as long as they meet at least one of three eligibility tests:

1. ***Gross Receipts***: This test generally requires the employer's gross receipts to have declined by a certain percentage when compared to the receipts from the same quarter in 2019. For quarters in 2020, the decline must be greater than 50%, while for quarters in 2021, the decline must only be greater than 20%. Gross receipts generally include all sales, amounts received for services, and income from investments and outside sources. For a nonprofit, gross receipts are those reported on its Form 990 or 990-PF as gross amounts received from all sources.
2. ***Operations***: This test requires the operations of the employer to be fully or partially suspended in order to comply with a government order related to COVID-19. The government order must limit commerce, travel, or group meetings due to the pandemic. Any government-ordered modification to a business must also have more than a nominal effect on the operations of the business, which the IRS has interpreted to mean a 10% or greater impact on the employer's ability to provide goods or services in the normal course of its business.
3. ***Recovery Startup Business***: The ARPA rules created a new category of eligibility for "recovery startup businesses" that began operating after February 15, 2020 and whose gross receipts over a specified period do not exceed \$1 million. Such employers are eligible for up to \$50,000 in employee retention credits in each of Q3 and Q4 of 2021.

Claiming the Credit

The employee retention credit must be reported on an employer's federal employment tax return, typically the quarterly IRS Form 941. Employers can choose to reduce their deposits of the applicable federal employment taxes in the amount of the anticipated employee retention credit, which essentially allows for immediate funding of the credit. The employee retention credit is refundable, and certain employers may also be eligible to request an advance payment from the IRS, if the employer does not have sufficient employment taxes to cover the credit.

Notably, while the ARPA expanded the total amount of the employee retention credits that may potentially be available, it also restructured the credit so that in Q3 and Q4 of 2021, it is claimed only against the employer portion of the Medicare tax, which is 1.45% of wages. For all periods prior to this, the employee retention credit is claimed against the 6.2% employer portion of the Social Security tax.

Three Versions of the Rules

The following chart summarizes some key differences between the three versions of the employee retention credit rules, which apply for different periods during 2020 and 2021.

Time periods covered	March 13, 2020 to end of 2020	Q1-Q2 of 2021	Q3-Q4 of 2021
Legislation	Coronavirus Aid, Relief, and Economic Security (CARES) Act, enacted March 27, 2020	Consolidated Appropriations Act, 2021, enacted December 27, 2020	American Rescue Plan Act of 2021 (ARPA), enacted March 11, 2021
What are "qualified wages"?	<ul style="list-style-type: none"> - For employers with over 100 employees*, only wages for employees not performing services due to COVID-19 - Certain health plan expenses 	<ul style="list-style-type: none"> - For employers* with 500 or fewer employees, all wages - For employers with over 500 employees, only wages not performing services due to COVID-19 - Certain health plan expenses 	<ul style="list-style-type: none"> - Same rules as Q1-Q2 of 2021, <i>and</i> - For employers who experience a decline in gross receipts of greater than 90% during Q3 or Q4 of 2021 compared to the same quarter in 2019, all wages
Maximum amount of "qualified wages"	\$10,000 for the entire 2020 year	\$10,000 per calendar quarter in 2021	
Amount of credit	50% of qualified wages	70% of qualified wages	
Maximum total credit	\$5,000 for all of 2020	\$7,000 for each quarter in 2021, for an aggregate total of \$28,000 for all of 2021	
Tax the credit is claimed against	Refundable against the 6.2% employer portion of the Social Security (OASDI) tax		Refundable against the 1.45% employer portion of the Medicare (HI) tax
Eligibility test 1: gross receipts	Decline in gross receipts of greater than 50% during a 2020 calendar quarter compared to the same quarter in 2019	Decline in gross receipts of greater than 20% during a 2021 calendar quarter compared to the same quarter in 2019 (with an election to use an alternative quarter)	
Eligibility test 2: operations	Operation of trade or business is fully or partially suspended due to government orders limiting commerce, travel, or group meetings due to COVID-19		
Eligibility test 3: recovery startup business	N/A		Began business after Feb 15, 2020 and gross receipts over a specified period do not exceed \$1M

* Certain aggregation rules apply for employers who are in a controlled group (*i.e.*, under common control and treated as a single employer for certain purposes under the tax code).

The IRS has issued limited guidance on the employee retention credit in certain FAQs on its website and in Notice 2021-20. However, the IRS has not yet updated this guidance to address the subsequent amendments to the employee retention credit rules under the Consolidated Appropriations Act or the ARPA. Employers interested in claiming the employee retention credit should seek guidance in light of the complexity of and constant changes to the rules.

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