



A Guide to the 2021 Employee Retention Credit

*As Amended by the Consolidated Appropriations Act
and American Rescue Plan*

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The Employee Retention Credit



In March of 2020, the CARES Act created the ERC, a refundable payroll tax credit for eligible employers. The ERC was designed to provide financial support to businesses that kept employees on their payroll despite experiencing economic hardship. However, there was one big exception. Employers that received a PPP loan were not eligible for the ERC.

That changed at the end of December, when the Appropriations Act was signed into law. The Appropriations Act extended the ERC, originally set to expire at the end of 2020, into the first and second quarters of 2021. It also expanded eligibility for the credit to include employers that received a PPP loan, with the caveat that any wages used for PPP loan forgiveness cannot also be used for the ERC. This change was retroactive to the effective date of the CARES Act, meaning any employer that received a PPP loan should evaluate its eligibility for the ERC in both 2020 and 2021.

The Rescue Plan extends the ERC through the third and fourth quarters of 2021.

Different rules apply to the ERC available for 2020 and the ERC available for 2021. This guide distinguishes between the two periods by referring to the "2020 ERC" and the "2021 ERC," respectively. Where applicable, differences between the 2020 ERC and the 2021 ERC are discussed.

The ERC—The Basics

Eligible employers can claim a refundable credit against payroll taxes equal to a percentage of qualified wages paid with respect to each employee. In 2020, the credit is available for wages paid by eligible employers from March 13, 2020 through and including December 31, 2020. In 2021, eligible employers can claim the credit for wages paid from January 1, 2021 through and including December 31, 2021.

From March 13, 2020 through June 30, 2021, the credit is claimed against the employer portion of Social Security tax. From July 1 through December 31, 2021, the credit is claimed against the employer portion of Medicare tax.

An eligible employer is any employer, including a tax-exempt organization, that was carrying on a trade or business during calendar year 2020 and meets one of the following economic hardship criteria during the calendar quarter:

1. The operation of the business is fully or partially suspended due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings because of COVID-19; or
2. The employer experiences a significant decline in gross receipts.

The 2020 ERC is equal to 50% of qualified wages up to a maximum of \$10,000 in qualified wages per employee for all calendar quarters (for a maximum credit of \$5,000 per employee). The 2021 ERC is equal to 70% of qualified wages up to a maximum of \$10,000 in qualified wages per employee per calendar quarter (for a maximum credit of \$28,000 per employee).

The ERC—Gross Receipts

What constitutes a “significant decline in gross receipts” differs for the 2020 ERC and the 2021 ERC. A significant decline in gross receipts for the 2020 ERC is the period that:

- begins with the first calendar quarter in 2020 for which gross receipts are less than 50% of gross receipts for the same calendar quarter in 2019; and
- ends with the calendar quarter following the first calendar quarter for which gross receipts are greater than 80% of gross receipts for the same calendar quarter in 2019.

For the 2021 ERC, an employer experiences a significant decline in gross receipts if its gross receipts for the relevant calendar quarter in 2021 are less than 80% of gross receipts for the same calendar quarter in 2019. Also, for the 2021 ERC only, employers can elect to determine their eligibility by comparing their gross receipts for the immediately preceding calendar quarter to the corresponding quarter in 2019. For example, an employer could elect to determine eligibility for the first quarter of 2021 by comparing its gross receipts for the fourth quarter of 2020 to the fourth quarter of 2019.

For employers other than tax-exempt organizations, gross receipts include total sales (net of returns and allowances) and amounts received for services. In addition, gross receipts include any income from investments and incidental or outside sources. Gross receipts generally are not reduced by cost of goods sold but generally are reduced by the taxpayer’s adjusted basis in capital assets sold. Gross receipts do not include the repayment of a loan or amounts received with respect to sales tax if the tax is legally imposed on the purchaser and the taxpayer merely collects and remits the sales tax to the taxing authority.

Gross receipts for tax-exempt employers include gross receipts from all operations, not only from activities that constitute unrelated trades or businesses. Gross receipts include (1) the organization’s investment income; (2) the gross amount received as contributions, gifts, grants, and similar amounts; and (3) the gross amount received as dues or assessments from members or affiliated organizations.

The ERC—Qualified Wages

Qualified wages are wages subject to Social Security tax and paid during a calendar quarter in which the employer (1) experiences a significant decline in gross receipts; or (2) has operations that are fully or partially suspended by a government COVID-19 order, but only during the period the order is in force. Allocable health plan expenses also can be treated as wages when computing the credit. Qualified health plan expenses are amounts paid by an employer to provide and maintain a group health plan, but only to the extent those amounts are excluded from employees' gross income. The IRS has issued guidance on qualified health plan expenses and how to allocate those expenses to qualified wages.

Qualified wages do not include sick and family leave wages for which an employer has received payroll tax credits under the Families First Coronavirus Response Act, wages paid to certain related individuals, or wages taken into account for various other tax credits. As discussed below, qualified wages also do not include wages used for PPP loan forgiveness. Finally, the Rescue Plan clarifies that for the third and fourth quarters of 2021, qualified wages do not include wages used in connection with a Shuttered Venue Operator Grant or a Restaurant Revitalization Grant.

The definition of qualified wages is more restrictive for large employers. Qualified wages for large employers include only wages paid when the employee is not providing services. For the 2020 ERC, a large employer is an employer that averaged more than 100 full-time employees during 2019. In addition, for the 2020 ERC only, qualified wages taken into account for an employee of a large employer cannot exceed the amount the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period of the employer's economic hardship (the 30-day rule).

For the 2021 ERC, a large employer is an employer that averaged more than 500 full-time employees during 2019. In addition, the 30-day rule is eliminated for the 2021 ERC. Employers that are not large employers can count all wages paid during the period of economic hardship as qualified wages.

The Rescue Plan created a special rule for "severely financially distressed employers," which applies to qualified wages paid in the third and fourth quarters of 2021 only. A severely financially distressed employer is an employer whose gross receipts for the relevant calendar quarter in 2021 are less than 10% of gross receipts for the same calendar quarter in 2019. Large employers that qualify as a severely financially distressed employer can count all wages paid to employees as qualified wages rather than only wages paid to employees when they do not provide services.

A full-time employee for any month is defined under the ERC as any employee who is employed on average at least 30 hours of service per week.

The ERC—Other Eligibility Considerations

Self-employed individuals are not eligible for the ERC with respect to their own self-employment earnings. However, self-employed individuals who employ other individuals in their business may be eligible for the ERC with respect to wages paid to employees.

Governmental employers, including the federal government, state and local governments, and governmental agencies and instrumentalities, are not eligible for the 2020 ERC. Certain governmental instrumentalities, including 501(c)(1) organizations, colleges and universities, and entities providing medical or hospital care, are eligible for the 2021 ERC.

For the third and fourth quarters of 2021, the Rescue Plan expanded eligibility for the ERC to “recovery startup businesses.” A recovery startup business is any employer that began carrying on any trade or business after February 15, 2020. Guidance on additional eligibility requirements is expected. The credit allowed for recovery startup businesses for any calendar quarter cannot exceed \$50,000.

Aggregation rules require certain related employers and affiliated service groups to be treated as a single employer for all aspects of the ERC. For example, these employers are treated as a single employer for purposes of determining the employer’s eligibility, i.e., whether the employer’s operations were fully or partially suspended due to COVID-19 orders from the government, or whether the employer has a significant decline in gross receipts, and whether the employer qualifies as a large employer. The IRS has issued guidance on which related employers must be treated as a single employer.

The ERC—Claiming the Credit

Because the ERC is a payroll tax credit, it is claimed on an employer’s payroll tax return. For most employers, this is Form 941, which is filed quarterly. IRS guidance about the 2020 ERC permits employers to benefit from the ERC in advance of filing Form 941 by reducing their employment tax deposits in anticipation of the credit. To the extent the credit exceeds the amount the employer is required to deposit, the employer can claim an advance credit by filing [Form 7200](#). For the 2021 ERC, only employers with an average of 500 or fewer full-time employees in 2019 may request an advance payment of the credit by filing Form 7200.

Employers that did not claim the credit in a prior quarter and later determine they were eligible can file [Form 941-X](#) for the prior quarter. This includes PPP borrowers who are now eligible for the 2020 ERC if they otherwise meet the eligibility criteria.

If you work with a third-party payroll provider to file payroll tax returns, you should reach out to your provider to determine how they are implementing the ERC and what information they need.

Employers claiming the ERC must keep the following records for at least four years:

- Documentation showing how they calculated the amount of the ERC, including calculation of the amount of qualified health plan expenses included in the credit;
- Documentation showing eligibility for the ERC based on a suspension of business operations or a decline in gross receipts;
- Amount of all advances received and copies of completed Form(s) 7200 filed with the IRS; and
- If the employer uses more than one third-party payer or also files its own returns for some wages, documentation showing which wages related to the ERC were paid by which third-party payer or the employer.

The ERC—2020 to 2021 Comparison

As noted, there are several differences between the 2020 ERC and the 2021 ERC. In addition, a few changes made by the Rescue Plan apply only to the third and fourth quarters of 2021. The chart below compares the major aspects of the ERC across these periods.

	2020 ERC	Jan. 1 - Jun. 30, 2021	Jul. 1 - Dec. 31, 2021
Qualified Wages threshold	\$10,000 for all quarters	\$10,000 per quarter	\$10,000 per quarter
Credit calculation	50% of qualified wages	70% of qualified wages	70% of qualified wages
"Large" employer threshold	>100 FTEs in 2019	>500 FTEs in 2019	>500 FTEs in 2019
30-day rule for large employers	Yes	No	No
Governmental employers	Governmental employers, including governmental agencies and instrumentalities, are ineligible	501(c)(1) organizations, colleges and universities, and entities providing medical or hospital care are eligible	501(c)(1) organizations, colleges and universities, and entities providing medical or hospital care are eligible
Gross receipts decline	Begins with >50% decline compared to 2019 quarter	>20% decline compared to 2019 quarter	>20% decline compared to 2019 quarter
Election to use prior quarter gross receipts to determine eligibility?	No	Yes	Yes
PPP borrowers eligible?	Yes*	Yes*	Yes*
Period during which eligible employers can claim credit	Wages paid from 3/13/2020 – 12/31/2020	Wages paid from 1/1/2021 – 6/30/2021	Wages paid from 7/1/2021 – 12/31/2021
Tax against which credit is claimed	Employer portion of Social Security tax	Employer portion of Social Security tax	Employer portion of Medicare tax
Recovery startup businesses eligible?	No	No	Yes
Special rule for severely financially distressed employers?	No	No	Yes

*The same wages cannot be used for both PPP loan forgiveness and the ERC.



The ERC—IRS Guidance on Interaction with PPP Loans

IRS Guidance on the ERC and PPP Interaction

As noted, PPP borrowers are eligible for the ERC, but forgivable payroll costs do not include qualified wages used in determining the credit. This caveat initially created uncertainty for PPP borrowers who had already submitted a PPP loan forgiveness application when the Appropriations Act was signed into law. To ensure full forgiveness, many borrowers reported gross wages on their forgiveness application in excess of their loan amount. It was unclear whether gross wages included on a forgiveness application, but unnecessary for full forgiveness, were eligible for the 2020 ERC. Also, while many borrowers paid or incurred eligible non-payroll costs during the covered period, they often excluded those costs from their application to streamline the lender and SBA review processes.

On March 1, 2021, the IRS issued guidance on the 2020 ERC in the form of Notice 2021-20. Per the notice, PPP borrowers may use wages reported on a loan forgiveness application in excess of the amount necessary to support full forgiveness as qualified wages for the ERC. However, borrowers cannot use wages in an amount equal to other eligible non-payroll expenses (such as mortgage interest, rent, or utilities) that they did not include on their submitted application.

To understand the IRS guidance, let's consider two examples:

Example 1

Employer A received a PPP loan of \$200,000 and paid \$250,000 of wages that would qualify for the ERC in 2020. Employer A submitted a forgiveness application and reported the \$250,000 of qualified wages as PPP forgivable wages. Employer A did not report any other eligible expenses on its application. Employer A's entire loan was forgiven.

Employer A may not use \$200,000 of the qualified wages necessary for forgiveness for ERC purposes. However, Employer A may use the \$50,000 of qualified wages reported on the forgiveness application that were not necessary for full forgiveness.

Example 2

Employer B received a PPP loan of \$200,000. Employer B paid \$200,000 of qualified wages that would qualify for the ERC in 2020. Employer B also paid other eligible non-payroll expenses of \$70,000. Employer B submitted a forgiveness application and reported the \$200,000 of qualified wages to support the loan's forgiveness. Employer B did not report the other eligible expenses of \$70,000. Employer B's entire loan was forgiven.

Employer B may not use the \$200,000 of qualified wages for purposes of the ERC. Additionally, although Employer B could have reported \$70,000 of eligible expenses other than wages, no portion of this amount may be used for loan forgiveness to free up qualified wages for the ERC.

* * *

PPP borrowers that have not submitted a forgiveness application for their First Draw loan, or who are currently using proceeds from a Second Draw loan, should consider how they can maximize the benefit of both the PPP and the ERC. For example, borrowers should evaluate whether they have eligible non-payroll costs for which they could use PPP loan proceeds to maximize the wages available for the ERC, keeping in mind that at least 60% of the proceeds must be used for payroll costs.

Although this guide attempts to cover the major aspects of the ERC, it is not possible to address every circumstance. For more information, please work with your professional advisor or contact us at the email link below.

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