

The Employee Retention Tax Credit Under the American Rescue Plan Act

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This article has been updated to incorporate additional guidance provided by IRS Notice 2021-23 dated 04/02/2021.

The [American Rescue Plan Act of 2021 \(ARPA\)](#) makes some material changes to the employee retention tax credit (ERC). The ERC was originally enacted under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and later expanded and extended under the Consolidated Appropriations Act of 2020 (CAA). To understand the changes to the credit made by ARPA, it is easier to compare the ERC under each of these three laws, since each law deals primarily with only a specific time period.

Time Periods Covered by Each Act

CARES Act

Wages paid between March 13, 2020 through Dec. 31, 2020.

CAA

Wages paid between Jan. 1, 2021 through June 30, 2021.

ARPA

Wages paid between July 1, 2021 through Dec. 31, 2021.

Amount of Credit

CARES Act

50% of the qualified wages paid to the employee, plus the cost to provide health benefits to the employee.

CAA

Effective Jan. 1, 2021, the credit amount is increased to 70% of qualified wages, which includes the cost to continue providing health benefits.

ARPA

Retains 70% credit for qualified wages paid between July 1, 2021 and Dec. 31, 2021, which includes the cost to provide health benefits.

Eligibility Requirements for the Credit

CARES Act

For wages paid when business operations that are either fully or partially suspended by a COVID-19 lockdown order; or, for any quarter in 2020, if gross receipts are less than 50% of gross receipts for the same quarter in 2019.

CAA

Effective Jan. 1, 2021, for wages paid when business operations that are either fully or partially suspended by a COVID-19 lockdown order; or, for any quarter in 2021, if gross receipts are less than 80% of gross receipts compared to the same quarter in 2019. There is an election to use the prior quarter's gross receipts for purposes of determining if the company's gross receipts were less than 80% of gross receipts compared to the same quarter in 2019. [IRS Notice 2021-23](#) (04/02/2021) provides that this election to use the prior quarter's gross receipts is exercised by claiming the employee retention credit for the quarter using the alternative quarter to calculate gross received. Notice 2021-23 also confirms that this election may be exercised to use the 4th quarter 2020 gross receipts to determine eligibility to claim the credit for the 1st quarter of 2021. Notice 2021-23 states that a company must maintain documentation to support the determination of the decline in gross receipts.

ARPA

Same as CAA but provides two changes. First, the election to use the prior quarter's gross receipts for purposes of determining if the company's gross receipts were less than 80% of gross receipts compared to the same quarter in 2019 is extended to the third and fourth quarters of 2021. Under this election, a company could use its second quarter 2021 gross receipts compared to its second quarter 2019 gross receipts to determine credit eligibility for the third quarter, and could use its third quarter 2021 gross receipts to determine credit eligibility for the fourth quarter 2021.

Second, ARPA allows a Recovery Startup Business (RSB) to take the credit (subject to a maximum credit of \$50,000 per quarter) even if neither of the above conditions occur. An RSB is a business which: (a) began business on or after Feb. 15, 2020; (b) has no more than \$1,000,000 in average annual gross receipts over the prior three years; and, (c) is not otherwise eligible for the credit because the business was not shut down per a COVID-19 lockdown order and did not have a significant reduction in gross receipts compared to the same quarter in 2019.

Since the credit for an RSB is effective for wages paid between July 1 and Dec. 31 2021, this essentially provides a potential incentive of up to \$100,000 (\$50,000 maximum credit per quarter for the third and fourth quarters of 2021) for new companies to begin business; however, the IRS may apply the aggregation rules under the credit to disallow the credit to a new company that shares

common ownership with a company that was in business before Feb. 15, 2020. Consequently, if a new business is created by the owners of a business in existence prior to Feb. 15, 2021, they may not be eligible for this credit, since under the aggregation rules, the new business would be treated as the same employer as the existing business, and would not be eligible for the RSB credit (since it would be treated as being in business prior to Feb. 15, 2020).

Maximum Credit Amount

CARES Act

The credit is capped at \$5,000 for all qualified wages paid between March 13, 2020 and Dec. 31, 2020 (the credit amount allowed for \$10,000 in qualified wages × 50% credit rate).

CAA

The credit rate cap is increased to \$7,000 *per quarter* for qualified wages paid between Jan. 1, 2021 and June 30, 2021 (the credit for \$10,000 in qualified wages × 70%).

ARPA

The credit continues to be capped at \$7,000 per quarter for qualified wages paid between July 1, 2021 and Dec. 31, 2021. However, ARPA adds a separate \$50,000 per quarter maximum aggregate credit per quarter for an RSB (as discussed above).

Credit Eligibility Whether or Not an Employee is Working

CARES Act

For a company that had more than 100 employees in 2019, no credit is available for wages paid to an employee performing services for the employer (either teleworking, or working at the workplace, even though at reduced capacity due to reduction in business). To determine this 100-employee threshold, the employees of all affiliated companies sharing more than the 50% common ownership are aggregated. On the other hand, a company that had 100 or less employees in 2019 is eligible for the credit, even if its employees were working.

CAA

Effective Jan. 1, 2021, this threshold was raised to a company that had more than 500 employees in 2019, so that for the first two quarters of 2021, a company that had 500 or fewer employees in 2019 will be eligible for the credit, even if its employees are working. The same aggregation rules to include employees of related companies sharing more than 50% common ownership under the CARES Act remain in effect.

ARPA

Continues the 500-employee threshold as in CAA, but adds a new category, a *Severely Financially Distressed Employer* (SFDE). This is a company whose gross receipts for the quarter are less than 10% of gross receipts for the same quarter in 2019 (i.e., a reduction in gross receipts of more than 90%). A SFDE is allowed the credit if its employees are performing services, even if it had more than 500 employees in 2019. This would potentially apply to companies in severely distressed industries,

such as the cruise, hospitality, and entertainment industries. Because the effective date of ARPA is July 1, 2021, however, a SFDE will only be eligible to claim the credit for the second two quarters of 2021. Furthermore, because of the election to allow a company to calculate credit eligibility by testing gross receipts for the prior quarter, a company could use its second quarter 2021 gross receipts compared to its second quarter 2019 gross receipts to determine whether it qualifies as an SFDE (and use third quarter 2021 gross receipts to test whether it qualifies as an SFDE for the fourth quarter).

Paycheck Protection Program (PPP) Loans

CARES Act

Under the original credit rule, a company that received a PPP loan was not eligible to claim the employee retention tax credit.

CAA

The credit prohibition for PPP borrowers was repealed retroactively, and allowed the credit for wages that were not paid with the proceeds of a PPP loan. Conversely, the credit is not allowed for wages paid with the proceeds of a PPP loan.

ARPA

Same as CAA, but also adds that the credit is not allowed for wages paid with the proceeds of entertainment venue grants or restaurant revitalization grants.

Government Entities

CARES Act

Government entities were prohibited from claiming the credit.

CAA

Medical facilities, colleges, and universities operated by government entities are eligible to claim the credit for wages paid to employees of these businesses. However, there is no provision relaxing the aggregation rule, which requires a business to aggregate the employees for all entities under common control. As a result, government-owned medical facilities, colleges, and universities may not pass the 500 or fewer employee threshold and would only be allowed the credit for wages paid to furloughed employees. Another potential obstacle for a government-owned medical facility, college, or university to be able to claim the credit, is that if it is relying on a decline in gross receipts to qualify for the credit (less than 80% in gross receipts compared to the same quarter in 2019), such test must be applied based on all gross receipts of the government entity, not just gross receipts of the medical facility, college, or university.

ARPA

Same as CAA. IRS Notice 2021-23 clarifies that such educational institutions and medical facilities are classified as a "Trade or Business" a requirement for eligibility for the credit. It is noteworthy that there was no special provision allowing a governmental operated medical facility, college, or

university to opt out of the aggregation rule so that they would not have to count all persons employed by such government entity in applying the 500-employee threshold. As a result, this provision would only allow the credit for the very smallest of government-owned medical facilities, college, and universities.

Monetizing the Credit

CARES Act

The credit is applied against the employer's share of Social Security taxes, and is refundable, so that if the amount of the credit is greater than the employer's share of Social Security taxes, the difference is refunded in cash. The IRS issued guidance allowing a company to essentially pocket the amount of federal income tax withheld from wages paid to its employees to reimburse the company for the amount of the refund to which it would be entitled. This allowed a rapid monetization of the credit. IRS Notice 2021-23 allows a company to continue to monetize the credit in this manner for the first and second quarter of 2021. It is not clear if this means that this method of monetizing the credit will not be allowed for the third and fourth quarter of 2021. Notice 2021-23 states that further guidance will be issued for the third and fourth quarter of 2021.

CAA

Added a provision which limits the advance payment of the credit to a company that had 500 or less employees in 2019. The advance payment is limited to 70% of the average quarterly payroll for the same quarter in 2019. If the actual credit due to the company determined at the end of the quarter is less than the amount of the advance payment, the company would be obligated to repay the excess amount to the government. In Notice 2021-23 the IRS explains that average 2019 quarterly receipts is calculated by adding Line 4 from 2019 Form 943; Line 4c from 175 2019 Form 944, and lines 2 and 9 from its 2019 Form CT-1, and divide by four. A [Form 7200](#) is filed to obtain an advance payment of the ERC.

ARPA

The advance payment provision under CAA remains in the law through the end of 2021, allowing an advance payment of the credit limited to 70% of the average quarterly payroll for the same quarter in 2019, with the same requirement to repay any advance refunded credit in excess of the actual amount of the credit ultimately allowed.

Enforcement

CARES Act

No special enforcement provision.

CAA

No special enforcement provision.

ARPA

The ARPA includes a special five-year statute of limitations for the IRS to assess a deficiency for

claiming the employee retention tax credit. This is unusual, and may mean the IRS is expecting a vigorous enforcement program to prevent abuse of this credit.

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