



January 11, 2021

Employee Retention Tax Credit – Updates and What to Know for Your Business

On Dec. 20, 2020, the House and Senate passed H.R. 133, the Consolidated Appropriations Act of 2021 (“CAA”), which includes a significant expansion of the Employee Retention Tax Credit (“ERTC”) through June 30.

The ERTC was first enacted on March 27, 2020, pursuant to the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), which provided eligible employers with a refundable tax credit for up to \$5,000 per employee, for qualified wages paid from March 13, 2020, through the end of the year.

Brownstein previously released an [ERTC Q&A Guide](#) summarizing the CARES Act provisions and IRS and Department of the Treasury guidance. This document is intended to provide an update of the CAA’s changes to the ERTC and to provide clarity on the ERTC where it has otherwise been lacking (e.g., coordination of ERTC and Paycheck Protection Program loans).

Table of Contents

I. General Rules of the Employee Retention Tax Credit	3
1. What is the amount of the ERTC?	3
2. Who is eligible?	3
3. What “orders from an appropriate governmental authority” may be taken into account for purposes of the credits?	4
4. What constitutes fully or partially suspended operations?	4
5. What is a significant decline in gross receipts?	5
6. How are significant declines in gross receipts determined for new or acquired businesses?	7
7. What are qualified wages?	8
8. What are qualified health plan expenses?	11
9. Which employers are aggregated and treated as a single employer for purposes of the credits?	12

II. Administration of the ERTC	12
1. How is the ERTC refundable?	12
2. How does an employer claim the credit?	14
3. How do I receive my credit?	14
4. May an employer reduce its federal employment tax deposit by the qualified wages that it has paid without incurring a failure to deposit penalty?	15
5. Can an employer paying qualified wages fund its payment of qualified wages before receiving the credits by reducing its federal employment tax deposits?	15

III. Interaction of the ERTC with Other Provisions	16
1. May an employer receive both the tax credits for the qualified leave wages under the FFCRA and the ERTC under the CARES Act?	16
2. How does the ERTC interact with Paycheck Protection Program (“PPP”) loans?	17
3. Will there be additional guidance forthcoming?	18

I. General Rules of the Employee Retention Tax Credit

1. What is the amount of the ERTC?

The CAA provides a refundable tax credit, capped at \$7,000 per employee per calendar quarter, for 70% of qualified wages up to \$10,000 paid per calendar quarter to employees, from Jan. 1, 2021, through June 30, 2021 (“2021 ERTC”).

The CARES Act provided a refundable tax credit, capped at \$5,000 per employee, for 50% of qualified wages up to \$10,000 paid to employees from March 13, 2020, through Dec. 31, 2020 (“2020 ERTC”).

Example: Employer pays \$10,000 in qualified wages to Employee in each of Q2 2020, Q3 2020, Q4 2020, Q1 2021 and Q2 2021.

Period	Qualified Wages	Credit
Q2 2020	\$10,000	\$5,000
Q3 2020	\$10,000	\$0
Q4 2020	\$10,000	\$0
Q1 2021	\$10,000	\$7,000
Q2 2021	\$10,000	\$7,000

2. Who is eligible?

The ERTC is available to “Eligible Employers” and such term has different meanings based on the date in question.

For March 13, 2020, through Dec. 31, 2020, 2020 ERTC eligibility is for employers that carry on a trade or business, and tax-exempt organizations, which either (i) was partially or fully suspended due to COVID-19 orders from an appropriate governmental authority, or (ii) experienced a significant decline in gross receipts. Government and state entities and political subdivisions thereof are not eligible for the 2020 ERTC.

For Jan. 1, 2021, through June 30, 2021, 2021 ERTC eligibility generally follows the same rules as for the 2020 ERTC, but an exception to the general prohibition on government and state employers is provided for tax-exempt public colleges, universities and hospitals.

Self-employed individuals are not eligible for the ERTC with respect to their own self-employment earnings. However, a self-employed individual who employs others in its trade or business may qualify for the ERTC with respect to qualifying wages paid to such employees.

3. What “orders from an appropriate governmental authority” may be taken into account for purposes of the credits?

Orders from the federal government, or any state or local government with jurisdiction over an employer, qualify if they limit commerce, travel or group meetings due to COVID-19 in a way that affects an employer’s operation of its trade or business (e.g., hours of operation).

However, general statements from a governmental official, or a declaration of a state of emergency, is not sufficient to rise to the level of a governmental order if it does not limit commerce, travel or group meetings due to COVID-19 in some manner. Further, a COVID-19 declaration that limits commerce, travel or group meetings, but does so in a manner that does not affect the employer’s operation of its trade or business, does not rise to the level of a governmental order for purposes of the ERTC.

Example: A state governor issues an order that all non-essential businesses must close from March 20, 2020, until April 30, 2020. The order provides a list of non-essential businesses. Employers that provide essential services may remain open. The governor’s order is a governmental order limiting the operations of non-essential businesses, entitling employers with non-essential businesses to claim the ERTC for qualified wages.

4. What constitutes fully or partially suspended operations?

A business is suspended if a governmental authority imposes restrictions on the business operations by limiting commerce, travel or group meetings due to COVID-19 so that the business cannot continue all of its typical operations.

Example: A state governor issues an order banning in-person dining at all restaurants in the state in order to reduce the spread of COVID-19. However, the order allows the restaurants to continue food sales to the public on a carry-out, drive-through or delivery basis. Thus, with respect to any restaurant that traditionally offers in-person dining, such businesses are considered to have a partial suspension of operations because they cannot continue all of their typical operations.

Even if a business is not suspended due to a governmental order (e.g., an essential business), such business may still be considered to have a suspension of operations if governmental orders affect the business’s suppliers, such that the business is unable to obtain critical goods or materials to operate its business.

Example: Employer operates an auto parts manufacturing business that is considered an essential business. However, Employer’s supplier of raw materials is required to shut down due to a governmental order. Employer is unable to procure the raw materials from another source and therefore is not able to perform its operations. Under these facts, Employer would be considered an Eligible Employer because its operations have been suspended as a result of a governmental order that suspended the operations of its supplier.

However, a governmental order that causes customers of a business to stay home, but otherwise allows the business to operate under normal conditions, is not considered a suspension of operations for the business.

Example: Employer operates an auto repair business and is not required to suspend any operations. Due to a governmental order that limits travel due to COVID-19, customers are not visiting Employer’s auto repair business. Nevertheless, Employer is not considered to have a suspension of operations (but may be able to qualify for the ERTC as a result of a significant decline in gross receipts).

It is also worth noting that in circumstances where a COVID-19 governmental order requires a business to close its physical location, but work-from-home operations are comparable to operations of the physical location prior to closure, such closure of the physical location will not be considered a suspension of operations.

Example: A software company is required to close its office due to a COVID-19 governmental order. Prior to the governmental order, all employees teleworked once or twice per week and business meetings were held online using a video conferencing service. Following the governmental order, the company required telework for all employees and operations continued in a comparable manner as before the governmental order. Thus, business operations are not considered to be suspended by the governmental order.

When an employer operates a business in multiple jurisdictions and is subject to a governmental order suspending operations in some jurisdictions, it has the option to claim credit for such suspended locations, or it can implement a company-wide policy to operate consistently in all jurisdictions under local, Centers for Disease Control and Prevention (“CDC”) and Department of Homeland Security (“DHS”) guidelines and claim the credit for all locations.

Example: Employer is a national grocery store chain with operations in every state in the United States. In some jurisdictions, Employer is subject to a governmental order to close its stores, but it is permitted to provide customers with curbside service to pick up items ordered online or by phone. In other jurisdictions, Employer is not subject to any governmental order. Employer establishes a company-wide policy, in compliance with the local governmental orders and consistent with the CDC and DHS recommendations and guidance, requiring the closure of all stores and operating with curbside pickup only, even in those jurisdictions where the business was not subject to a governmental order. As a result of the governmental orders requiring closure of Employer’s stores in certain jurisdictions, Employer has a partial suspension of operations of its trade or business. The partial suspension results in Employer being an Eligible Employer nationwide.

5. What is a significant decline in gross receipts?

The determination of a “significant decline in gross receipts” has different meanings based on the date in question.

2020 ERTC:

For the 2020 ERTC, a significant decline in gross receipts means the period beginning with the first calendar quarter in 2020 where gross receipts are less than 50% of gross receipts for the same calendar quarter of 2019, and ending with the calendar quarter following the first calendar quarter where quarterly gross receipts are greater than 80% of gross receipts for the same calendar quarter in the prior year.

Example: Using the table below, Employer had a significant decline in gross receipts commencing on Jan. 1, 2020, (the calendar quarter in which gross receipts were less than 50% of the same quarter in 2019), and ending on July 1, 2020, (the quarter following the quarter for which the gross receipts were more than 80% of the same quarter in 2019). Thus, the Employer is entitled to the ERTC with respect to the first and second calendar quarters of 2020.

	2020 Gross Receipts	2019 Gross Receipts	% of Prior Year
Q1	\$100,000	\$210,000	48%
Q2	\$190,000	\$230,000	83%
Q3	\$230,000	\$250,000	92%

2021 ERTC

For Jan. 1, 2021, through June 30, 2021, for the 2021 ERTC, a significant decline in gross receipts means the period beginning with the first calendar quarter in 2021 where gross receipts are less than 80% of gross receipts for the same calendar quarter of 2019, and ending with the calendar quarter following the first calendar quarter where quarterly gross receipts are greater than 80% of gross receipts for the same calendar quarter in 2019.

Example: Using the table below, Employer had a significant decline in gross receipts commencing on Jan. 1, 2021, (the calendar quarter in which gross receipts were less than 80% of the same quarter in 2019), and ending on July 1, 2020, (the quarter following the quarter for which the gross receipts were more than 80% of the same quarter in 2019). Thus, the Employer is eligible for the 2021 ERTC with respect to Q1 and Q2 2021 qualified wages, even though it only experienced a 24% drop in 2021 Q1 as compared to 2019, and performed better in Q2 2021 as compared to Q2 2019.

	2021 Gross Receipts	2019 Gross Receipts	% of 2019
Q1	\$160,000	\$210,000	76%
Q2	\$240,000	\$230,000	104%

Additionally, for the 2021 ERTC, Eligible Employers may elect to use the immediately preceding quarter as a measuring point for determining whether there is a significant decline in gross receipts.

Example: When determining whether Employer has a significant decline in gross receipts for Q1 2021, Employer can either (1) compare Q1 2021 and Q1 2019 gross receipts to see if there is at least a 20% decline, or (2) make an election to compare Q4 2020 and Q4 2019 gross receipts to see if there is at least a 20% decline.

After the CARES Act was passed, there was confusion about the determination of “gross receipts” with respect to tax-exempt organizations, so the CAA included a clarification (as if originally included in the CARES Act and retroactively applicable to March 12, 2020) that with respect to tax-exempt organizations, “gross receipts” is treated as a reference to gross receipts within the meaning of § 6033 of the Internal Revenue Code of 1986, as amended (“Code”).

Documentation. While an employer does not need to prove a significant decline in gross receipts is related to COVID-19, IRS guidance provides that employers should retain records for the relevant calendar quarters in 2019–2021 to document that a significant decline in gross receipts occurred. Such records should be kept for at least four years for IRS review. We recommend that such documentation be created contemporaneously when the analysis is performed.

6. How are significant declines in gross receipts determined for new or acquired businesses?

For the 2020 CARES Act, guidance updated by the IRS on Nov. 27, 2020, provides specific rules for how businesses started in 2019 or acquired in 2020 should determine whether there is a significant decline in gross receipts for purposes of claiming the 2020 ERTC.

Business:	Gross Receipts to Compare:
Started Q1 2019	Compare 2019 quarters with applicable 2020 quarters
Started Q2 2019	Compare 2019 Q2 with Q1 and Q2 of 2020 Compare 2019 Q3 with Q3 of 2020 Compare 2019 Q4 with Q4 of 2020
Started Q3 2019	Compare 2019 Q3 with Q1, Q2 and Q3 of 2020 Compare 2019 Q4 with Q4 of 2020
Started Q4 2019	Compare 2019 Q4 with Q1, Q2, Q3 and Q4 of 2020
Started middle of any quarter	Estimate gross receipts the business would have had for that entire quarter based on the gross receipts for the portion of the quarter in operation, then apply the above cells in this table.
Acquired in 2020	An employer who acquires a business in 2020 may use a safe harbor method allowing the acquirer to include such business's 2019 gross receipts to determine whether there is a significant decline in gross receipts of the acquirer, but use of the safe harbor requires the acquirer to estimate the gross receipt that the acquirer would have had from the business for the entire calendar quarter in which the business was acquired.

It is anticipated that similar guidance will be released for claiming the 2021 ERTC (modified for the election to compare gross receipts against the immediately preceding quarter).

7. What are qualified wages?

- a. Qualified wages generally are “wages” as defined in IRC § 3121(a) and “compensation” as defined in IRC § 3231(e) paid by an eligible employer after March 12, 2020, and before July 1, 2021. The term also includes qualified health plan expenses. **Note that the definition of qualified wages is also modified based on the date in question and the average number of full-time equivalent employees in 2019. These differences are discussed below:** 2020 ERTC, 101 or More Employees. For businesses with an average of over 100 full-time equivalent employees during 2019, qualified wages means wages paid to an employee for the time the employee is not providing services when (1) the business is suspended for government orders related to COVID-19, or (2) there is a significant decline in gross receipts. Note, if an employee is performing services on a reduced schedule, wages paid to that employee are treated as qualified wages only to the extent that those wages exceed what the employee would have otherwise been paid for the services performed; however, for these businesses, qualified wages for an employee may not exceed the amount such employee would have been paid for working an equivalent duration during the 30 days immediately prior to the period during which the business was suspended or experienced a significant decline in gross receipts, as applicable (“30-day lookback”). The term “qualified wages” does not include required paid sick leave or required paid family leave under the FFCRA, or any wages for paid time off for vacations, holidays, sick days and other days off pursuant to existing leave policies that represent benefits accrued during a prior period.
- b. 2020 ERTC, 100 or Fewer Employees. For businesses with an average of 100 or less full-time equivalent employees during 2019, qualified wages means all wages paid to an employee (whether or not providing services) when (1) the business is suspended under COVID-19 government orders, or (2) there is a significant decline in gross receipts. The term “qualified wages” also includes wages for paid time off for vacations, holidays, sick days and other days off pursuant to existing leave policies, but does not include required paid sick leave or required paid family leave for which the employer is claiming FFCRA credits.
- c. 2021 ERTC, 501 or More Employees. For businesses with an average of over 500 full-time equivalent employees during 2019, qualified wages generally have the same meaning and restrictions applicable to the 2020 ERTC for businesses with over 100 employees, except that the 30-day lookback limitation is removed.
- d. 2021 ERTC, 500 or Fewer Employees. For businesses with an average of 500 or less full-time equivalent employees during 2019, qualified wages have the same meaning and restrictions applicable to the 2020 ERTC for businesses with 100 or less employees.

The term “full-time employee” means an employee who, with respect to any calendar month in 2019, worked an average of at least 30 hours per week or 130 hours in the month, as determined in accordance with IRC § 4980H. For purposes of determining the number of full-time employees, employers are treated as a single employer if they are aggregated as a controlled group of corporations under IRC § 52(a) or are partnerships, trusts or sole proprietorships under common control under IRC § 52(b), or are entities aggregated under the IRC § 414(m) or (o) (related to affiliated service groups).

Example: Employer averaged more than 500 full-time employees in 2019 and is subject to a governmental order limiting store hours. In response, Employer reduces the hours its employees work, but increases the employees’ rate of pay by \$1 an hour.

- 2020 ERTC: Only the amounts paid to employees for time they are not providing services, and at the rate of pay in effect prior to the increase, would be considered qualified wages.
- 2021 ERTC: Only the amounts paid to employees for time they are not providing services would be considered qualified wages, but the pay increase could be considered qualified wages.

Example: Pursuant to a state order, all restaurants in the state are required to close in order to reduce the spread of COVID-19. However, the order allows restaurants to continue food sales to the public on a carry-out, drive-through or delivery basis. To comply with the state order, Employee A typically works inside a restaurant as a manager, but has since been required to work from home remotely. Assuming that there are no sick leave or required paid family leave wages paid, will wages paid to Employee A be qualified wages? If Employee A (who is now required to work from home) receives 100% of his wages, but has his hours cut so that he is only working 75% of the time, does that change anything? Do the answers change if average full-time equivalent employees in 2019 were 75, 150 or 600?

- *75 Employees*
 - 2020 ERTC: Wage payments to Employee A will count as qualified wages, regardless of whether he is providing services, as the restaurant’s operations are partially suspended due to COVID-19 orders. Reducing Employee A’s hours does not affect the ability of the restaurant to take the credit.
 - 2021 ERTC: Same as 2020 ERTC.
- *150 Employees*
 - 2020 ERTC: Wage payments to Employee A will not count as qualified wages, as he is still providing services. However, if Employee A’s hours are reduced by 25% while his wages remain the same, 25% of the wages paid to Employee A will be considered qualified wages eligible toward the credit because Employee A is receiving 25% of his wages for not performing services while the restaurant’s operations are partially suspended.
 - 2021 ERTC: Wage payments to Employee A will count as qualified wages, regardless of whether he is providing services, as the restaurant’s operations are partially suspended due to COVID-19 orders. Reducing Employee A’s hours does not affect the ability of the restaurant to take the credit.
- *600 Employees*
 - 2020 ERTC: Wage payments to Employee A will not count as qualified wages, as he is still providing services. However, if Employee A’s hours are reduced by 25% while his wages remain the same, 25% of the wages paid to Employee A will be considered qualified wages eligible toward the credit because Employee A is receiving 25% of his wages for not performing services while the restaurant’s operations are partially suspended.
 - 2021 ERTC: Same as 2020 ERTC.

There are also restrictions for the 2020 ERTC that prohibit (1) employee wages from being eligible for the credit if the employer is allowed a Work Opportunity Tax Credit with respect to the employee, (2) any wages taken into account for the credit being used to determine the Employer Credit for Paid Family and Medical Leave, (3) any severance payments to former employees from being included as qualified wages, (4) any wages paid to related individuals, as defined by Code § 51(i)(1), from being included as qualified wages, and (5) wages exempt from the definition of wages under Code § 3121(a) (wages for FICA tax purposes), other than qualified health plan expenses allocable to qualified wages.

Qualified wages for the 2021 ERTC are generally subject to the same restrictions except that (1) the 2021 ERTC may be taken with respect to an employee for whom the Work Opportunity Tax Credit is claimed—just not for the same wages, and (2) there is also no double benefit for wages taken into account for purposes of Code §§ 41, 45A, 45P and 1396.

Documentation. While the CARES Act and CAA do not prescribe any particular form of documentation, taxpayers should develop a system to gather and maintain records of the following information:

- Documentation to show how the taxpayer figured the amount of the ERTC for an individual employee or group of similarly situated employees;
- Documentation to show how the taxpayer figured the amount of qualified plan expenses that you allocated to wages; and
- Documentation to show the taxpayer’s eligibility for the ERTC based on suspension of operations or a significant decline in gross receipts.

As mentioned above, the IRS has specifically stated that certain documentation must be available for IRS review for at least four years.

8. What are qualified health plan expenses?

Qualified health plan expenses are costs paid by the employee with pre-tax salary reduction contributions and costs paid or incurred by an eligible employer to provide and maintain a group health plan (as defined in Code § 5000(b)(1)), but only to the extent such amounts are excluded from the employee's gross income by Code § 106(a).

The CAA includes language, retroactive as if included in the CARES Act, to clarify that qualified health plan expenses may be treated as qualified wages, even if no other wages are paid.

Since qualified health plan expenses also increase the qualified sick and family leave credits under the FFCRA, such expenses must be properly allocated (so there is no double benefit) between qualified sick leave wages, qualified family leave wages, and qualified wages for purposes of the retention credit. In other words, qualified health plan expenses that are allocable to the FFCRA credits for qualified sick and family leave wages cannot be used for purposes of determining the ERTC.

For purposes of the ERTC, qualified health plan expenses need to be allocated to the time periods to which they relate. The IRS has provided guidance on how to determine the amount of the qualified health plan expenses and how those expenses can be allocated among employees, depending on whether the plan is fully insured, self-insured, or a health reimbursement arrangement (HRA) or a flexible spending arrangement (health FSA) (for example, the average premium for all employees covered by a policy) and pro rata on the basis of period of coverage (relative to the time periods to which such wages relate). Where an employer maintains more than one type of plan, qualified health plan expenses are determined on a plan-by-plan basis. Like traditional wages, for "Large Employers"—those with over 100 full-time equivalent 2019 employees for purposes of the 2020 ERTC and over 500 full-time equivalent 2019 employees for purposes of the 2021 ERTC—qualified health plan expenses must be allocable to time periods where the employees are not providing services.

Example: Employer has a partial suspension of operations due to a governmental order. Employer sponsors a group health plan that covers its employees. Each employee is expected to work 250 days per year (five days a week for 50 weeks). The employer and pre-tax employee contribution amounts average out to \$10,000 annually per employee. For each employee expected to work 250 days a year, this results in a daily rate equal to \$40. Assume that an employee has his hours cut and only works 100 of the expected 125 days for (i) Q2 and Q3 2020, or (ii) Q1 and Q2 2021.

- Small Employer, Q2 and Q3 2020: If Employer had 100 or less full-time equivalent employees in 2019, then \$5,000 of qualified health plan expenses will be considered qualified retention wages (125 days x \$40 per day), for a \$2,500 credit ($\$5,000 \times 0.5$).
- Large Employer, Q2 and Q3 2020: If Employer had over 100 full-time equivalent employees in 2019, then \$1,000 of qualified health plan expenses will be considered qualified retention wages (25 days x \$40 per day), for a \$500 credit ($\$1,000 \times 0.5$).
- Small Employer Q1 and Q2 2021: If Employer had 500 or less full-time equivalent employees in 2019, then \$5,000 of qualified health plan expenses will be considered qualified retention wages (125 days x \$40 per day), for a \$3,500 credit ($\$5,000 \times 0.7$).
- Large Employer Q1 and Q2 2021: If Employer had over 500 full-time equivalent employees in 2019, then \$1,000 of qualified health plan expenses will be considered qualified retention wages (25 days x \$40 per day), for a \$700 credit ($\$1,000 \times 0.7$).

9. Which employers are aggregated and treated as a single employer for purposes of the credits?

All entities treated as a single employer under Code § 52(a) or (b), or Code § 414(m) or (o) (related to affiliated service groups), are treated as a single employer for purposes of:

- Determining whether the employer has a trade or business operation that was fully or partially suspended due to COVID-19 orders from an appropriate governmental entity;
- Determining whether the employer has a significant decline in gross receipts; and
- Determining whether the employer is a Large Employer.

Example: Assume that Employer A and Employer B are members of the same controlled group of corporations under Code § 52(a).

Employer A	2020 Gross Receipts	2019 Gross Receipts	% of Prior Year
Q2	\$400,000	\$1,000,000	40%

Employer B	2020 Gross Receipts	2019 Gross Receipts	% of Prior Year
Q2	\$750,000	\$1,000,000	75%

Combined	2020 Gross Receipts	2019 Gross Receipts	% of Prior Year
Q2	\$1,150,000	\$2,000,000	57.5%

2020 ERTC Analysis: Since the combined gross receipts did not drop 50%, Employers A and B are not considered to have a significant decline in gross receipts for the 2020 ERTC.

2021 ERTC Analysis: If the 2020 gross receipt numbers were the same in 2021, Employers A and B would be permitted to take the 2021 ERTC, as only a 20% decline in gross receipts is required.

II. Administration of the ERTC

1. How is the ERTC refundable?

The statutory text provides that the credit is allowed against the employer’s share of (1) old-age, survivors, and disability insurance (“OASDI”) taxes, and (2) Social Security and hospital insurance (“Medicare”) portions under the Railroad Retirement Tax Act (after taking into account any credits allowed for the employment of qualified veterans and for research expenditures of a qualified small business as well as the credits allowed for required paid sick or family leave under the FFCRA, and further reduced by the credits for (i) employment of qualified veterans, (ii) research expenditures of a qualified small business, and (iii) qualified sick and family leave under the FFCRA). To the extent that the retention credit for a calendar quarter exceeds the employer’s share of the OASDI taxes for that quarter (or Social Security and Medicare portions under the Railroad Retirement Tax Act), the excess is refundable to the employer.

With respect to the 2020 ERTC, Notice 2020-22, FAQs and the instructions to Form 7200 (Advance Payment of Employer Credits Due to COVID-19), provide that amounts withheld by an employer from employees' wages for (1) the employees' share of OASDI taxes, (2) the employees' share of Medicare, and (3) federal income taxes as well as the employer's share of hospital insurance (Medicare) taxes that are required to be deposited can be retained by the employee as an advance payment of the refundable portion of the 2020 ERTC, provided that, to the extent such amounts exceed the refundable portion of the retention credit, the excess amount must be timely deposited by the employer in order to avoid any late deposit penalties.

The 2020 ERTC will be applied to offset any remaining tax liability on the employment tax return payable by the employer and the amount of any remaining excess retention credit will be reflected as an overpayment on the return. The overpayment will be subject to offset under Code § 6402(a) prior to being refunded to the employer. An employer can file for an advance payment of any remaining refundable portion of the 2020 ERTC by filing IRS Form 7200 (Advance Payment of Employer Credits Due to COVID-19).

Example: Employer pays \$10,000 in qualified wages to Employee A in Q2 2020, with the resulting tax obligations set forth in the below table:

ER Share OASDI	\$620
EE Share OASDI	\$620
ER Share HI	\$145
EE Share HI	\$145
EE Fed Income Tax WH	\$1,470
Total	\$3,000

In this case, if Employee A was the only employee, Employer would not send in any of these taxes. The ERTC available to Employer for the qualified wages paid to Employee A is \$5,000. This amount may be applied against the employer share of Social Security taxes that Employer is liable for with respect to all employee wages paid in Q2 2020 (the \$620), leaving a refundable 2020 ERTC of \$4,380. The employer can retain the employer's share of FICA taxes and the FICA and federal income taxes withheld from the employee's wages that otherwise would be required to be deposited as an advance payment of the refundable 2020 ERTC ($\$2,280 = 620 + 145 + 145 + 1,470$), leaving a refundable 2020 ERTC of \$2,000, for which the employer can request advance payment by filing the IRS Form 7200.

2021 ERTC. It is anticipated that similar guidance will be provided with respect to the 2021 ERTC (except the advance payment guidance is expected to differ from Form 7200, as relatively few taxpayers requested advance payments of the 2020 ERTC).

2. How does an employer claim the credit?

Employers will report their total qualified wages and the related credits for each calendar quarter on their federal employment tax returns, usually quarterly on Form 941 (though Code § 6302 generally requires deposits of employment taxes to be made on a monthly or biweekly basis).

Form 941 is used to report income and Social Security and Medicare taxes withheld by the employer from employee wages, as well as the employer's portion of Social Security and Medicare tax.

In anticipation of receiving the 2020 ERTC, employers can fund the 2020 ERTC in advance with federal employment taxes, including taxes withheld from employees' wages that are required to be deposited with the IRS or by requesting an advance of the credit from the IRS on Form 7200.

Practical Note: Employers can stop depositing employment taxes to the extent they can claim a retention credit that exceeds the amount of the payroll and federal income taxes required to be deposited.

The CAA added a provision to allow Small Employers (but not Large Employers) the ability to elect an advance payment of the 2021 ERTC in an amount not to exceed 70% of the average quarterly wages paid by the employer in calendar year 2019. If such Small Employer is a seasonal business, it can elect to use 70% of the average quarterly wages that correspond to the calendar quarter to which the election relates. The Secretary is directed to provide rules on the procedures for this Small Employer election for the 2021 ERTC.

The CAA also responded to the concerns of certified professional employer organizations ("CPEO") and third-party payors by making clear that the customer is responsible for the accounting of the ERTC and liability for improperly claimed credits, so long as the CPEO accurately reports the credits based on its customer-provided information.

3. How do I receive my credit?

Employers can be immediately reimbursed for the credit by reducing their required deposits of employment taxes that are required to be deposited, including employment and federal income taxes withheld from the employees' wages up to the amount of the retention credit.

Eligible employers will report their total qualified wages and the related health insurance costs for each quarter on their (quarterly) employment tax returns beginning in the second quarter of 2020.

For the 2020 ERTC, if the employer's employment tax deposits are not sufficient to cover the credit, the employer may receive an advance payment from the IRS by submitting Form 7200, Advance Payment of Employer Credits Due to COVID-19.

For the 2021 ERTC, if the employer's employment tax deposits are not sufficient to cover the credit, the employer may request an advance payment not to exceed 70% of the average quarterly wages paid by the employer in calendar year 2019—guidance forthcoming.

4. May an employer reduce its federal employment tax deposit by the qualified wages that it has paid without incurring a failure to deposit penalty?

Yes, an eligible employer will not be subject to a penalty under Code § 6656 for failing to deposit federal employment taxes relating to qualified wages in a calendar quarter if:

- the employer paid qualified wages to its employees in the calendar quarter before the required deposit;
- the amount of federal employment taxes that the employer does not timely deposit, reduced by any amount of federal employment taxes not deposited in anticipation of the paid sick or family leave credits claimed under the FFCRA, is less than or equal to the amount of the employer’s anticipated ERTC for the qualified wages for the calendar quarter as of the time of the required deposit; and
- the employer did not seek payment of an advance credit with respect to any portion of the anticipated credits it relied upon to reduce its deposits.

The point of these rules is that an employer cannot both retain taxes that it would otherwise be required to deposit (as an advance payment of the refundable portion of the retention credit) and request an advance payment for the same refundable portion of the credit.

5. Can an employer paying qualified wages fund its payment of qualified wages before receiving the credits by reducing its federal employment tax deposits?

Pursuant to Notice 2020-22, an eligible employer may fund qualified wages by accessing federal employment tax deposits. An eligible employer that pays qualified wages to its employees in a calendar quarter before it is required to deposit federal employment taxes with the IRS for that quarter may reduce the amount of federal employment taxes it deposits for that quarter by half of the amount of the qualified wages paid in that calendar quarter (up to the retention credit amount). The eligible employer must account for the reduction in deposits on the Form 941, Employer’s Quarterly Federal Tax Return, for the quarter.

Example: Employer paid \$10,000 in qualified wages (including qualified health plan expenses) and is therefore entitled to a \$5,000 retention credit, and is otherwise required to deposit \$8,000 in federal employment taxes for wage payments made during the same quarter as the \$10,000 in qualified wages. Employer has no paid sick or family leave credits under the FFCRA. Employer may keep up to \$5,000 of the \$8,000 of taxes Employer was going to deposit, and it will not owe a penalty for keeping the \$5,000. Employer is required to deposit only the remaining \$3,000 on its required deposit date. Employer will later account for the \$5,000 it retained when it files Form 941, Employer’s Quarterly Federal Tax Return, for the quarter.

III. Interaction of the ERTC with Other Provisions

1. May an employer receive both the tax credits for the qualified leave wages under the FFCRA and the ERTC under the CARES Act?

Yes, but not for the same wages. The amount of qualified wages for which an eligible employer may claim the ERTC does not include the amount of qualified sick and family leave wages for which the employer received tax credits under the FFCRA. This is because the FFCRA credits are refundable against employment taxes as well, and a double benefit is not permitted.

Example: Employer reports its employment tax liability quarterly on Form 941, Employer's Quarterly Federal Tax Return. Employer is not required to make any deposits or payments with respect to its employment tax liability except at the end of each quarter when it files Form 941.

Employer sponsors a group health plan that covers 200 employees. Each employee is expected to work 250 days per year (five days a week for 50 weeks). The Employer and pre-tax employee amounts paid for the 200 employees are \$1 million. The average for all employees covered by the plan is \$1 million divided by 200, or \$5,000. For each employee expected to work 250 days a year, this results in a daily rate equal to \$20. This is the amount of qualified health plan expenses that can be allocated to each day of paid sick leave, paid family leave and qualified retention wages.

In Q2 2020, Employer pays \$10,000 of wages to Employee, of which, \$2,000 are for 30 days of qualified wages for purposes of the employee retention credit, \$1,000 are for three days of paid sick leave, and \$200 are for one day of paid family leave. The three days of paid sick leave and one day of paid family leave overlapped with four of the 30 days where qualified retention wages were paid.

Qualified health plan expenses can be allocated among the employee retention credit, paid sick leave credit and paid family leave credit:

- $\$2,000 + \600 qualified health plan expenses = $\$2,600$ qualified retention wages
- $\$1,000 + \60 qualified health plan expenses = $\$1,060$ paid sick leave wages
- $\$200 + \20 qualified health plan expenses = $\$220$ paid family leave wages

While Employer can receive tax credits for qualified leave wages and qualified retention wages, it cannot be for the same wages. Thus, the \$2,600 qualified retention wages are reduced by the \$1,060 paid sick leave wages and \$220 paid family leave wages.

Employer will then have an anticipated \$1,060 paid sick leave credit, \$220 paid family leave credit and \$660 retention tax credit ($\$1,320$ qualified retention wages divided by two).

Generally, the \$10,000 of wages paid to Employee in Q2 2020 would result in the following tax obligations for Employer:

ER Share OASDI	\$620
EE Share OASDI	\$620
ER Share HI	\$145
EE Share HI	\$145
EE Fed Income Tax WH	\$1,470
Total	\$3,000

However, paid sick leave wages and paid family leave wages (plus allocable qualified health plan expenses) are not subject to the employer share of OASDI on such wages, so the tax obligations for Employer would actually be:

ER Share OASDI	\$620 \$540.64 ($\$8,720 \times 0.062$)
EE Share OASDI	\$620
ER Share HI	\$145
EE Share HI	\$145
EE Fed Income Tax WH	\$1,470
Total	\$3,000 \$2,920.64

Pursuant to § 2302 of the CARES Act, Employer is not required to deposit its share of OASDI at the end of Q2 when it files Form 941. Instead, Employer is permitted to defer paying 50% of the \$540.64 until Dec. 31, 2021, and the remaining 50% until Dec. 31, 2022.

With respect to the remaining \$2,380 of employment tax liability, Notice 2020-22 allows Employer to reduce such liability by the \$1,060 paid sick leave wages and \$220 paid family leave wages. Employer would then reduce the remaining \$1,100 employment tax liability by the \$660 employee retention credit leaving a \$440 liability, due and to be paid when Employer files its Q2 Form 941.

In the example above, Employer still has to pay an amount when filing its Form 941. However, if Employer instead had enough paid sick leave wages, paid family leave wages and qualified retention wages to cover the Q2 employment tax liabilities, it could retain the entire \$2,920.64 of employment taxes as a portion of the refundable credit to which it is entitled, and file a request for an advance payment for the remaining amounts of the 2020 ERTC using Form 7200, Advance Payment of Employer Credits Due to COVID-19.

2. How does the ERTC interact with Paycheck Protection Program (“PPP”) loans?

Originally, a taxpayer who received a PPP loan was not eligible for the ERTC. As a welcome provision to businesses, the CAA struck this CARES Act provision retroactively, allowing employers to both receive a PPP loan and be eligible for the 2020 ERTC and 2021 ERTC.

Forgivable payroll costs under PPP loans do not include amounts taken into account for purposes of the ERTC. However, CAA retroactively amends the CARES Act to provide that employers who receive PPP loans can elect to treat the payroll costs paid during the loan’s covered period as qualified retention wages to the extent the wages are not paid for with forgiven PPP loan proceeds. The Administrator of the SBA and the Secretary of the Treasury are required to issue guidance on this process.

3. Will there be additional guidance forthcoming?

Additional guidance is expected in a few areas, many of which are discussed above. The Secretary of the Treasury is directed to conduct a public awareness campaign to provide information about the ERTC and its availability, including (1) by providing notice to all employers reporting 500 or less employees of the information and requirements for eligibility, and (2) before the end of January 2021, by providing all employers educational materials on the ERTC. Guidance is also required (1) to prevent the avoidance of the ERTC limitations through leaseback of employees or otherwise, and (2) for the interaction of the PPP loans and the ERTC.

Russell W. Sullivan

Shareholder

Charlie A. Iovino

Senior Policy Advisor and Counsel

Harold Hancock

Shareholder

Radha Mohan

Senior Policy Advisor and Counsel

Gregory M. Janssen

Associate

Information is changing daily and some of the content included in this alert may have changed or been updated since publication. Last updated Jan. 11, 2021.

This document is intended to provide you with general information regarding the employee retention tax credit. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact the attorneys listed or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.