

Tax & Wealth Planning

Legal Alert

Key Contacts

Jeffrey B. Tate

Partner, DC
202.857.6185
jeffrey.tate@arentfox.com

Christian M. McBurney

Partner, DC
202.857.6228
christian.mcburney@arentfox.com

Samantha Overly

Associate, DC
202.857.6016
samantha.overly@arentfox.com

Jennifer A. Stecco

Associate, DC
202.715.8516
jennifer.stecco@arentfox.com

Happy Birthday, Employee Retention Tax Credit: Congress's Gift to Cash-Strapped Employers Extended Through December 31

The Employee Retention Tax Credit (“ERTC”) has been expanded and extended further, providing relief to small and large employers affected by COVID-19 business disruptions. As we approach the one-year anniversary of its original enactment, employers should take a fresh look at their eligibility for the expanded ERTC in order to obtain the maximum tax benefits available.

On Thursday, March 11, 2021, President Biden signed the American Rescue Plan Act of 2021 (the “Rescue Act”) into law. The Rescue Act further expanded and extended the ERTC through the end of 2021, following up on changes made in December 2020 as part of the “Taxpayer Certainty and Disaster Tax Relief Act of 2020” (the “Relief Act”). The Relief Act and the Rescue Act extended and substantially expanded the availability of the ERTC for both large and small employers, including recipients of Paycheck Protection Program (PPP) loans (who previously were ineligible to claim the ERTC).

The ERTC was created in March 2020 under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) to assist employers experiencing economic hardship or closure due to COVID-19. It is a refundable tax credit available to “eligible employers” based on the amount of “qualified wages” paid to certain employees.

On March 1, 2021, the Internal Revenue Service (the “IRS”) released guidance ([Notice 2021-20](#)) (the “Notice”) addressing the ERTC as it applies to qualified wages paid after March 12, 2020 and before January 1, 2021 (but not addressing the changes that are effective for 2021). The Notice indicates that the Department of the Treasury and the IRS will address the modifications made by the Relief Act applicable to calendar quarters in 2021 in future guidance.

This client alert provides a comprehensive explanation of the ERTC as it applies to calendar quarters in 2020 and in 2021, with discussion on developments from the newly issued Notice, the Relief Act, and the Rescue Act.

Tax & Wealth Planning

Legal Alert

Key Contacts

Jeffrey B. Tate

Partner, DC
202.857.6185
jeffrey.tate@arentfox.com

Christian M. McBurney

Partner, DC
202.857.6228
christian.mcburney@arentfox.com

Samantha Overly

Associate, DC
202.857.6016
samantha.overly@arentfox.com

Jennifer A. Stecco

Associate, DC
202.715.8516
jennifer.stecco@arentfox.com

General Overview of the ERTC

The ERTC is available as a refundable credit (meaning that it is available even if the amount of the credit exceeds an employer's tax liability) to "eligible employers" based on a specified percentage of "qualified wages" paid in 2020 and 2021. We discuss separately below which employers may qualify as "eligible employers" and which wages constitute "qualified wages." For 2020, the applicable credit percentage is equal to 50 percent of qualified wages (up to \$10,000 for the entire year, or a \$5,000 credit, per employee). For 2021, the applicable credit percentage is equal to 70 percent of qualified wages (up to \$10,000 per *quarter* for the first two quarters, resulting in a potential credit of up to \$14,000 per employee). Thus, the modifications made pursuant to the Relief Act may result in a significant increase in credits available for 2021, as shown in the illustrative example below.

Illustrative Example

An eligible employer pays an employee a base wage of \$50,000 (all of which is considered qualified wages, subject to the overall limitations).

Under the CARES Act, which governs the provisions of the ERTC for 2020, the employer is permitted a credit equal to 50 percent of the first \$10,000 of qualified wages paid, resulting in a \$5,000 tax credit.

Under the Relief Act (as further extended by the Rescue Act) the employer is permitted a credit equal to 70 percent of the first \$10,000 of qualified wages paid in each quarter of 2021, resulting in a maximum \$7,000 credit per quarter (up to \$28,000 total).

The same principles apply to qualified wages paid to the employer's other employees.

"Eligible Employers"

An employer is considered an "eligible employer" if one of two conditions is satisfied: (1) its business is fully or partially suspended during a calendar quarter due to a governmental order or (2) the employer experiences a significant decline in gross receipts (based on parameters described below). These two conditions are subject to aggregation rules, discussed in further detail below, which in particular instances treat certain entities as a single employer for purposes of claiming the ERTC. This means that entities treated as a single employer for purposes of the ERTC would evaluate whether business operations for any of the aggregated entities have suffered a suspension during a calendar quarter due to a governmental order and would also aggregate their gross receipts to determine whether the aggregated entities have experienced a "significant decline" in gross receipts.

Tax & Wealth Planning

Legal Alert

Key Contacts

Jeffrey B. Tate*Partner, DC*

202.857.6185

jeffrey.tate@arentfox.com**Christian M. McBurney***Partner, DC*

202.857.6228

christian.mcburney@arentfox.com**Samantha Overly***Associate, DC*

202.857.6016

samantha.overly@arentfox.com**Jennifer A. Stecco***Associate, DC*

202.715.8516

jennifer.stecco@arentfox.com

Full or Partial Suspension of Business

The first category of eligible employer includes an employer whose business is partially or totally suspended due to a governmental order. The determination of whether an employer has suffered a full or partial suspension of their business is fact-specific but generally requires a reduction or halt to business activity due to “orders from an appropriate governmental authority.” The Notice clarifies that “orders, proclamations, or decrees from the Federal government or any State or local government may be taken into account by an employer as ‘orders from an appropriate governmental authority’ only if they limit ‘commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to the coronavirus disease 2019 (COVID-19)’ and relate to the suspension of an employer’s operation of its trade or business.” The Notice further clarifies that statements from a government official, including comments made during press conferences or in interviews with the media, do not rise to the level of a government order for purposes of the ERTC. Examples of government orders provided by the Notice include the following:

- An order from the city’s mayor stating that all non-essential businesses must close for a specified period;
- A state’s emergency proclamation that residents must shelter in place for a specified period, other than residents who are employed by an essential business and who may travel to and work at the workplace location;
- An order from a local official imposing a curfew on residents that impacts the operating hours of a trade or business for a specified period;
- An order from a local health department mandating a workplace closure for cleaning and disinfecting.

Accordingly, while the ERTC is a federal tax credit, the availability of the credit hinges in many cases on state and local factors, and the availability of the credit to employers may differ from state to state (or from locality to locality within a given state). Employers should be mindful of orders at both the state and local level (e.g., if a particular state discontinues all restrictions on businesses, a locality in which an employer is located may nonetheless continue certain restrictions, in which case the employer might still be eligible for the ERTC).

As the Notice explains, an employer that operates an essential business is not considered to have a full or partial suspension of operations if the governmental order allows all of the employer’s operations to remain open. The IRS takes the position that an employer that operates an essential business may be considered to have a partial suspension of operations if more than a “nominal portion” of its business operations are suspended by a governmental order. More specifically, the Notice states that, solely for purposes of the ERTC, a portion of an employer’s business operations will be deemed to constitute more than a nominal portion of its business operations

Tax & Wealth Planning

Legal Alert

Key Contacts

Jeffrey B. Tate*Partner, DC*

202.857.6185

jeffrey.tate@arentfox.com**Christian M. McBurney***Partner, DC*

202.857.6228

christian.mcburney@arentfox.com**Samantha Overly***Associate, DC*

202.857.6016

samantha.overly@arentfox.com**Jennifer A. Stecco***Associate, DC*

202.715.8516

jennifer.stecco@arentfox.com

if either (i) the gross receipts from that portion of the business operations is not less than 10 percent of the total gross receipts, *or* (ii) the hours of service performed by employees in that portion of the business is not less than 10 percent of the total numbers of hours of service performed by all employee's in the employer's business.

Additionally, the IRS clarifies that if an employer's operations are suspended due to a reduction in demand because its customers are subject to a government order requiring them to stay at home or otherwise causing a reduction in demand for its products or services, the employer is not considered to have a full or partial suspension for purposes of the ERTC solely as a result of such reduction in demand.

Examples addressing suspension of business operations provided in the Notice include:

- Employer, a software development company, maintains an office in a city where the mayor has ordered that only essential businesses may operate. Employer's business is not essential, and therefore, Employer is required to close its office. Prior to the governmental order, all employees at the company teleworked once or twice per week, and business meetings were held at various locations. Following the governmental order, the company ordered mandatory telework for all employees and limited client meetings to telephone or video conferences. Employer's business operations are not considered to be fully or partially suspended due to the governmental order because the employer is able to continue its business operations in a comparable manner.
- Employer, an automobile repair service business, is an essential business and is not required to close its locations or suspend its operations. However, due to a governmental order that limits travel and requires members of the community to stay at home except for certain essential travel, Employer's business has declined significantly. Employer suspends its operations due to a lack of demand. Employer is not considered to have a full or partial suspension of operations due to a governmental order, although Employer may qualify for the ERTC if it has experienced a significant decline in gross receipts.
- Employer, a physical therapy facility, maintains its facility in a city where the mayor has ordered that only essential businesses may operate. Employer's business is not considered essential. Employer is required to close its workplace. Prior to the governmental order, none of the employees provided services through telework and all appointments, administration, and other duties were carried out at the Employer's workplace. Following the governmental order, Employer moves to an online format and is able to serve some clients remotely, but employees cannot access specific equipment or tools that they typically use in therapy and not all clients can be served remotely. Employer's business operations are considered to be partially suspended because Employer's workplace, including access to physical therapy equipment, is central

Tax & Wealth Planning

Legal Alert

Key Contacts

Jeffrey B. Tate*Partner, DC*

202.857.6185

jeffrey.tate@arentfox.com**Christian M. McBurney***Partner, DC*

202.857.6228

christian.mcburney@arentfox.com**Samantha Overly***Associate, DC*

202.857.6016

samantha.overly@arentfox.com**Jennifer A. Stecco***Associate, DC*

202.715.8516

jennifer.stecco@arentfox.com

to its operations, and the business operations cannot continue in a comparable manner.

Neither the Relief Act nor the Rescue Act meaningfully changed the “governmental order” standard for being considered an eligible employer, and thus, we expect that the guidance and examples provided above are likely to apply to both 2020 and 2021.

Significant Decline in Gross Receipts

The second category of eligible employer includes an employer that has suffered a significant decline in gross receipts (based on a comparison to the corresponding quarter in 2019).

Under the CARES Act, a significant decline in gross receipts occurs when an employer’s gross receipts for a calendar quarter beginning after December 31, 2019 are less than 50 percent of its gross receipts for the corresponding calendar quarter in the prior year. The employer is considered an “eligible employer” from the quarter in which the significant decline in gross receipts test is first until the end of the calendar quarter in which its gross receipts exceed 80 percent of the gross receipts of the corresponding calendar quarter of the prior year.

For example, Employer, a restaurant, had gross receipts of \$600,000 in the second quarter of 2019. In the second quarter of 2020, its gross receipts declined to \$200,000 (*i.e.*, a reduction of 67 percent). Employer’s gross receipts in the second quarter of 2020 are less than 50 percent of its gross receipts earned in the second quarter of 2019, and Employer is considered an “eligible employer” as a result. In the fourth quarter of 2019, Employer had gross receipts of \$1,000,000. During the fourth quarter of 2020, Employer had gross receipts of \$850,000 (*i.e.*, 85 percent of the prior year’s gross receipts for the corresponding quarter). Employer will be considered an “eligible employer” through the fourth quarter of 2020, but will not be considered an eligible employer thereafter.

Under the Relief Act, the required percentage to meet the threshold for a significant decline in gross receipts changed so that for quarters in 2021, the gross receipts need only to have declined by more than 20 percent of gross receipts earned in the same quarter in 2019.

Thus, using the same example of the restaurant employer above, suppose that Employer had gross receipts of \$350,000 in the second quarter of 2021. Under the thresholds provided in the Relief Act, Employer would satisfy the “significant decline in gross receipts” test (as gross receipts would be less than 80 percent of the gross receipts in the second quarter of 2019).

Tax & Wealth Planning

Legal Alert

Key Contacts

Jeffrey B. Tate

Partner, DC

202.857.6185

jeffrey.tate@arentfox.com

Christian M. McBurney

Partner, DC

202.857.6228

christian.mcburney@arentfox.com

Samantha Overly

Associate, DC

202.857.6016

samantha.overly@arentfox.com

Jennifer A. Stecco

Associate, DC

202.715.8516

jennifer.stecco@arentfox.com

Interaction with Paycheck Protection Program

Prior to issuance of the Relief Act, the CARES Act provided that an eligible employer that received a Paycheck Protection Program (“PPP”) loan would not be eligible for the ERTC. The Relief Act amended the CARES Act to permit an employer that received a PPP loan to be eligible to claim an ERTC, effective retroactive to the beginning of the ERTC on March 13, 2020. Given the number of employers who obtained PPP loans, this change significantly increases the number of eligible employers for the ERTC, and allows employers to potentially benefit from both the PPP and the ERTC. We note, however, that qualified wages for which the employer claims the ERTC are excluded from payroll costs paid during the covered period that qualify for forgiveness under the PPP.

“Qualified Wages”

As noted above, the ERTC is available as a specified percentage of “qualified wages” paid to employees. For this purpose, different rules apply based on the size of the employer. Large employers under the CARES Act with respect to calendar quarters in 2020 are employers with greater than 100 full-time employees. Under the Relief Act, which applies to calendar quarters in 2021, large employers are employers with greater than 500 employees.

In the case of a small employer, qualified wages include *all wages* paid to employees (up to the overall caps noted above), whether or not the employees provide services to the employer. In contrast, in the case of a large employer, the ERTC is available *only* with respect to “wages paid . . . [when an] employee is *not* providing services” due to either a full or partial suspension of the business or a significant decline in gross receipts (emphasis added).

According to the Notice, a large employer may use “any reasonable method” to determine the hours an employee is not providing services. In determining the number of hours worked by the employee, the Notice states that the number of hours of an employee who continues to work their normal business hours (*i.e.*, whose hours have not changed) are to be included in full, even if the employee is less productive due to COVID-related disruptions of the business. The Notice adopts the approach that it is unreasonable for the employer to treat an employee’s hours as having been reduced based on an assessment of the employee’s productivity levels during the hours the employee is working.

Below are summaries of a few examples provided by the Notice that provide guidance on how an employer can appropriately determine the hours worked by employees:

- Employer, in the business of staging homes for sale, has non-exempt salaried employees who cannot perform their usual services of delivering and installing furniture to be used in staging houses because open houses are prohibited in its service area during the second quarter of

Tax & Wealth Planning

Legal Alert

Key Contacts

Jeffrey B. Tate*Partner, DC*

202.857.6185

jeffrey.tate@arentfox.com**Christian M. McBurney***Partner, DC*

202.857.6228

christian.mcburney@arentfox.com**Samantha Overly***Associate, DC*

202.857.6016

samantha.overly@arentfox.com**Jennifer A. Stecco***Associate, DC*

202.715.8516

jennifer.stecco@arentfox.com

2020. However, the employees are required to provide Employer with periodic status updates about furniture that has been leased out and other administrative matters. Employer continues to pay wages to employees as if they continued to work their typical work hours even though the employees cannot provide their normal services. Using a reasonable method, Employer has determined that its employees are working 20 percent of their typical work hours. Employer may treat 80 percent of the wages paid as qualified wages for purposes of the ERTC.

- Employer, operating a consulting firm, closed its offices due to various governmental orders and required all employees to telework. Although Employer believes that some of its employees may not be as productive while working remotely, employees are working their normal business hours. Because employees' work hours have not changed, no portion of the wages paid to the employees by Employer are qualified wages.
- Employer, a large eligible employer operating a grocery store chain, is subject to a governmental order limiting store hours. In response, Employer has reduced the hours its employees work, but increases the rate of pay for those employees who continue to provide services by \$2 an hour. 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.

A self-employed individual who employs other individuals and otherwise meets the "eligible employer" requirements may be eligible for the ERTC with respect to qualified wages the self-employed individual pays to the employees. However, the Notice clarifies that a self-employed individual is ineligible for the ERTC with respect to the individual's own self-employment earnings.

Aggregation Rules

The CARES Act provides that all persons treated as a single employer under section 52(a) or (b), or section 414(m) or (o) of the Internal Revenue Code of 1986, as amended (the "Code") will be treated as a single employer for purposes of the ERTC. At a high level, all entities that are members of a controlled group of corporations or trades or businesses under common control under sections 52(a) or (b) of the Code, members of an affiliated service group under section 414(m) of the Code, or otherwise aggregated under section 414(o) of the Code are treated as a single employer for purposes of applying the ERTC.

These aggregation rules can result in aggregation of entities that may not otherwise be grouped together for tax purposes. Thus, commonly-controlled entities or groups of entities that otherwise have no combined tax or other reporting requirements may need to coordinate with each other for purposes of determining eligibility for the ERTC and calculating the number of available credits.

The general impact of the aggregation rule is that employers required to be

Tax & Wealth Planning

Legal Alert

Key Contacts

Jeffrey B. Tate

Partner, DC
202.857.6185
jeffrey.tate@arentfox.com

Christian M. McBurney

Partner, DC
202.857.6228
christian.mcburney@arentfox.com

Samantha Overly

Associate, DC
202.857.6016
samantha.overly@arentfox.com

Jennifer A. Stecco

Associate, DC
202.715.8516
jennifer.stecco@arentfox.com

aggregated are treated as a single employer for the following rules applying to the ERTC:

- Determining whether the employer has a trade or business operation that was fully or partially suspended due to orders related to COVID-19 from an appropriate governmental authority;
- Determining whether the employer experiences a significant decline in gross receipts;
- Determining whether the employer averaged more than 100 or 500 full-time employees; and
- Determining the maximum credit amount per employee (*i.e.*, in the situation where the employee is employed by two or more entities treated as a single employer under the aggregation rules).

Key Changes Under the Rescue Act

In addition to extending the ERTC through December 31, 2021, the Rescue Act also expanded the ERTC by implementing the following changes:

- **Severely Financially Distressed Employers:** In the case of a “severely financially distressed employer” (*i.e.*, an employer that experienced a gross receipts reduction of more than 90 percent as compared to the same quarter in 2019), the employer may treat all wages paid to employees as qualified wages, regardless of the number of full-time employees (similar to the situation for a small employer).
- **Recovery Startup Businesses:** Startup businesses established after February 15, 2020, with annual gross receipts of up to \$1 million and that otherwise do not meet the ERTC eligibility tests are now eligible for the ERTC. The startup ERTC is capped at \$50,000 per quarter, per employer, and the credit is computed under the regular ERTC rules.
- **Extension of Statute of Limitations:** The normal three-year statute of limitations for the IRS to make an assessment of any amount attributable to the ERTC has been extended to five years.

How to Claim the ERTC

Eligible employers report their total qualified wages for purposes of the ERTC and claim the ERTC (including any refund in excess of an employer portion of social security tax) on their federal employment tax returns. For most employers, this is the quarterly Form 941, *Employer's Quarterly Federal Tax Return*.

In anticipation of receiving the ERTC, eligible employers can (1) reduce their deposits of federal employment taxes, including withheld taxes, that would otherwise be required, up to the amount of the anticipated credit, and (2) request an advance of the amount of the anticipated credit that exceeds the

Tax & Wealth Planning

Legal Alert

Key Contacts

Jeffrey B. Tate*Partner, DC*

202.857.6185

jeffrey.tate@arentfox.com**Christian M. McBurney***Partner, DC*

202.857.6228

christian.mcburney@arentfox.com**Samantha Overly***Associate, DC*

202.857.6016

samantha.overly@arentfox.com**Jennifer A. Stecco***Associate, DC*

202.715.8516

jennifer.stecco@arentfox.com

reduced federal employment tax deposits by filing IRS Form 7200, *Advance Payment of Employer Credits Due to COVID-19*.

For employers who received a PPP loan and thus were unable to claim the ERTC in 2020 but are now eligible, there are two options for claiming the ERTC. The first option is to utilize the regular process of filing an adjusted return or claim for refund for the appropriate quarter to which the ERTC relates using Form 941-X or the equivalent amended form for which the employer filed a federal employment tax return. The second option is available only to employers who have not filed their fourth quarter Form 941. Those employers have the option to report on their fourth quarter Form 941 any ERTC attributable to those qualified wages paid in the second and third quarter of 2020.

According to the Notice, an eligible employer will adequately substantiate eligibility for the ERTC by creating and maintaining records that include the following information:

- Documentation of any governmental order to suspend the employer's business operations;
- Records relied upon to determine whether more than a nominal portion of its operations were suspended due to a governmental order;
- Records the employer used to determine it had experienced a significant decline in gross receipts;
- Records of which employees received qualified wages and in what amounts;
- Documentation related to the determination of whether the employer is a member of an aggregated group;
- Copies of any completed Forms 7200 and completed federal employment tax returns the employer submitted to the IRS.

This is not an exhaustive list and the specific facts and circumstances of the employer will dictate what additional documentation should be created and maintained (for example, large employers should maintain documentation showing that wages were paid for time an employee was not providing services).

Tax & Wealth Planning

Legal Alert

Key Contacts

Jeffrey B. Tate

Partner, DC
 202.857.6185
jeffrey.tate@arentfox.com

Christian M. McBurney

Partner, DC
 202.857.6228
christian.mcburney@arentfox.com

Samantha Overly

Associate, DC
 202.857.6016
samantha.overly@arentfox.com

Jennifer A. Stecco

Associate, DC
 202.715.8516
jennifer.stecco@arentfox.com

Summary Comparison of CARES Act, Relief Act, and Rescue Act ERTC Provisions

The chart below summarizes the key differences between the ERTC as it applies to 2020 and 2021.

	CARES Act	Relief Act	Rescue Act
EFFECTIVE DATE	March 13 - December 31, 2020	January 1 - June 30, 2021	July 1 - December 31, 2021
MAXIMUM WAGES TAKEN INTO ACCOUNT IN CALCULATING CREDIT	\$10,000 for the year	\$10,000 per calendar quarter	
CREDIT PERCENTAGE	50 percent	70 percent	
GROSS RECEIPTS REDUCTION FOR ELIGIBLE EMPLOYERS	50 percent	20 percent	
SMALL EMPLOYER THRESHOLD	100 employees	500 employees	
INTERACTION WITH PPP	No credit available for PPP loan recipients	Credit available for PPP loan recipients, subject to limitations	

Next Steps

Given the changes in the law and the expansion of ERTC to a wide range of employers, employers should take a fresh look at the ERTC and consider how to maximize their available credit. Should you have any questions regarding your eligibility for the ERTC, please contact the tax professionals at Arent Fox, LLP.