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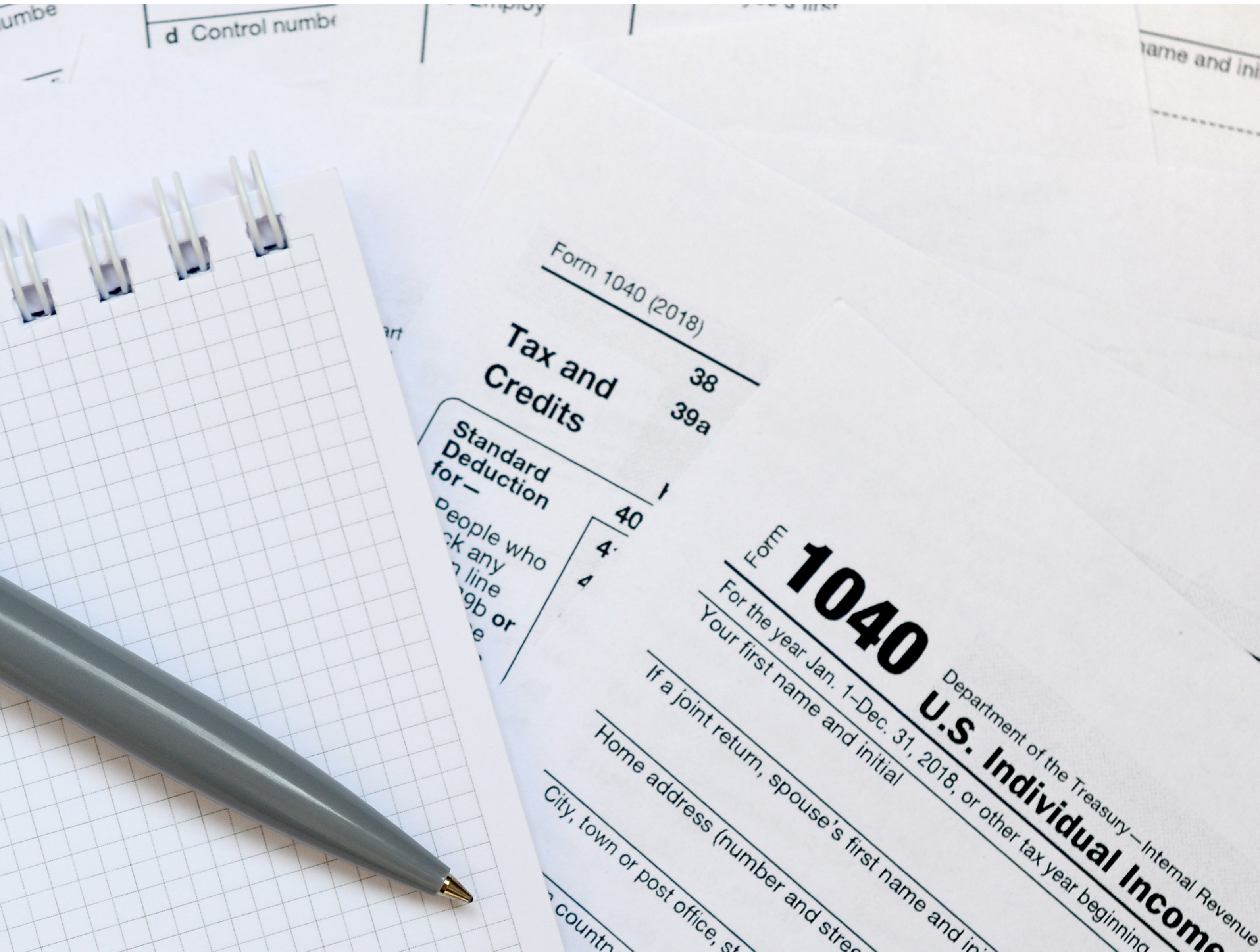

The Expansion of the Employee Retention Tax Credit

The Employee Retention Tax Credit was passed as part of the CARES Act in March of 2020 and was intended to help business owners retain their employees during the COVID-19 pandemic. In December of 2020, the Consolidated Appropriations Act, 2021 made significant changes to the tax credit by extending relief to a greater number of employers and increasing the overall tax benefit. This document provides an overview of the changes and how they apply for the 2020 and 2021 tax years.

The 2020 Tax Credit

The original Employee Retention Tax Credit enabled businesses that had fewer than 100 employees and experienced a partial or full shut down due to government orders or experienced a decline in gross receipts of at least 50% for a quarter as compared to the same quarter in 2019 to qualify for the tax credit. If a business qualified for the credit in one quarter, then it would continue to qualify in the following quarters until gross receipts reached 80% of the same quarter in 2019. The amount of the credit a business could receive was 50% of qualified wages, which include employee compensation and employer's qualified health plan expenses, paid between March 12 and December 31, 2020, up to a maximum of $10,000 of wages per employee for the entire year. Thus, the maximum credit a business could receive was $5,000 per employee for the year.

Retroactive Tax Credit Changes for 2020

There was one big caveat to the Employee Retention Tax Credit. Businesses that received PPP loans were not eligible for the tax credit. However, the Consolidated Appropriations Act, 2021 significantly changed the qualifications and calculations for the tax credit. For starters, the Act now allows businesses that received a PPP Loan to claim the Employee Retention Tax Credit retroactively to March 27, 2020. This is a reversal of the original law, which opens the tax credit to many more businesses.

Even though PPP borrowers may now receive the credit retroactively, they can't use the same wages claimed for PPP Loan forgiveness to also claim the Employee Retention Tax Credit. This prevents businesses from "double-dipping."

While there are differences in the definition of wages for each purpose, you will want to work closely with your tax advisor to understand when to use wages to apply for full forgiveness of your PPP Loan versus claiming the partial tax credit. This is especially important considering that there is some flexibility in the PPP Loan forgiveness period. For example, you may want to prioritize the Employee Retention Tax Credit for quarters in which you experienced a shutdown or 50% decline in your gross receipts as long as sufficient wages and non-payroll expenses still remain in the PPP covered period to maximize your full PPP loan forgiveness. If there is an overlap in timing, it's possible to have enough wages for both the Employee Retention Tax Credit and PPP Loan forgiveness. Careful calculations and supporting documentation will be needed to verify that you aren't "double-dipping" by using the same wages.

Once a business has run the calculations to determine eligible wages during a qualifying period, they can work with their tax advisors to go back and claim the Employee Retention Tax Credit by filing the Form 941X and an amended return. Since it is a payroll tax credit, it is possible for businesses to amend their 2020 payroll tax filings to receive the credit even if the business had tax losses.

Tax Credit Changes for 2021

First, the tax credit has been extended to June 30, 2021.

Second, eligibility rules have been expanded. For 2021, businesses with up to 500 employees that meet the shutdown rule or experience a decrease in gross receipts for a quarter in 2021 of 20% or more as compared to the same quarter in 2019. If a business does not meet the gross receipts test for Q1 of 2021, then it can compare the gross receipts in Q4 of 2020 to Q4 of 2019 will qualify. In regard to the shutdown rule, a business must have experienced a full or partial suspension of operations due to orders from a government authority limiting commerce, travel, or group meetings for commercial, social, religious, or other purposes due to COVID-19.

Next, the tax credit has been increased from 50% to 70% of qualified wages. Also, qualifying wages are now capped at $10,000 per employee per quarter instead of $10,000 per employee for all quarters. For example, if an employee were paid $10,000 in both Q1 & Q2 of 2021, the resulting credit would be $7,000 for each quarter. The result is a total of $14,000 for that employee instead of the $5,000 total credit in 2020.

As discussed earlier, wages that were paid with PPP loan funds that were or will be forgiven do not count as qualified wages. Again for 2021, you'll want to work closely with your tax advisor to understand and document which wages are used for PPP Loan forgiveness versus the Employee Retention Tax Credit.

Finally, the CAA added a new component for small employers. Employers with fewer than 500 employees can now take the credit in advance rather than applying it as a deduction on employer payroll tax deposits. To claim the advance credit, eligible employers can choose any calendar quarter to receive an advance payment of the credit in that quarter as long as they don't exceed 70% of the average quarterly wages they paid in 2019. They would then need to reconcile the advance credit with the actual credit amount at a future date. IRS Form 7200 would be used to request an advance payment of credits that employers would then claim on their Form 941.

Final Thoughts

For qualified businesses, the Employee Retention Tax Credit can provide significant financial benefits. This document is intended to provide a general overview of the tax credit and is not intended to be a substitute for discussing the credit with one of our advisors. Please contact our office to discuss if and how your business may benefit from the tax credit.

About The Dolins Group

Our Mission is to provide excellent tax and accounting services to our clients, enabling them to receive the most current tax saving benefits available by law.

We strive towards providing additional quality services such as incorporating new companies, tax planning, relocation tax expertise, and providing accounting software and training. We believe in networking with other businesses and actively refer quality businesses to our clients when the need arises.

We are the small to mid size company's accounting firm and gear many of our services towards those businesses. We pride ourselves in providing high quality, personalized service in a relaxed and friendly environment.

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