

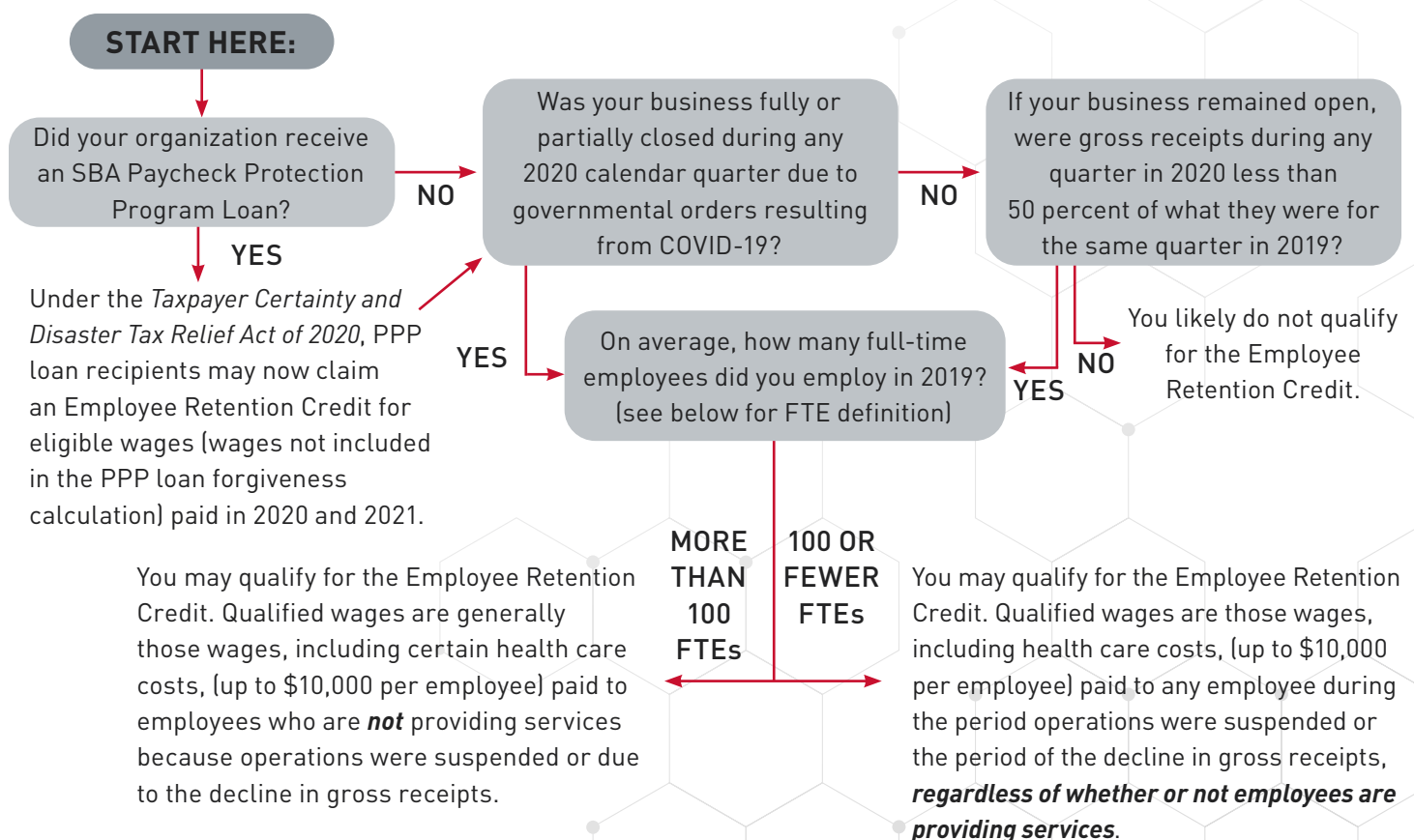
EMPLOYEE RETENTION CREDIT: WHAT BUSINESSES SHOULD KNOW

The *Coronavirus Aid, Relief, and Economic Security Act*, passed on March 27, 2020, provides a refundable tax credit against certain employment taxes equal to 50 percent of up to \$10,000 of qualified wages (including certain health plan costs) that an eligible employer pays to employees after March 12, 2020, and before January 1, 2021. Thus, the maximum credit per year is \$5,000 (50 percent × \$10,000) per employee.

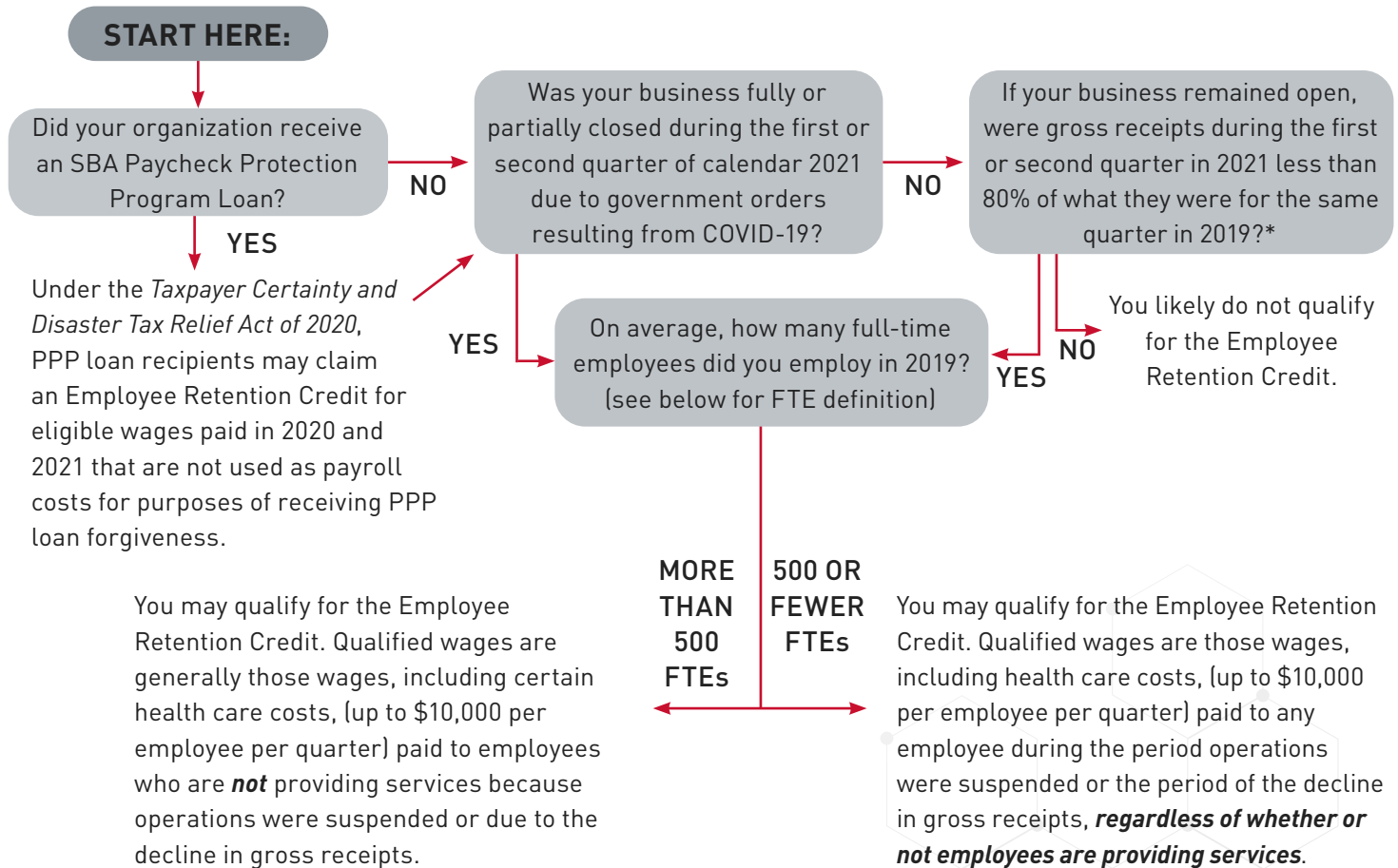
The *Taxpayer Certainty and Disaster Tax Relief Act of 2020*, passed on December 27, 2020, expanded and extended the Employee Retention Credit. For 2021, this refundable tax credit is increased to 70 percent of up to \$10,000 of qualified wages per quarter (including certain health plan costs) that an employer pays to employees between January 1, 2021, and July 1, 2021. Thus, the maximum credit per quarter in 2021 is \$7,000 (70 percent × \$10,000) per employee.

WHO QUALIFIES FOR THIS CREDIT?

2020 (March 13–December 31)



2021 (through June 30)



*An election is available to use the immediately preceding calendar quarter (e.g., for first quarter of 2021, an employer may elect to compare gross receipts of fourth quarter 2020 to the fourth quarter of 2019)

HOW IS THE CREDIT CALCULATED?

Calculate the number of employees. The term “full-time employee” (FTE) means an employee who, with respect to any calendar month in 2019, had an average of at least 30 hours of service per week or 130 hours of service in the month. Employees who don’t meet the 30/130-hour threshold for the month are excluded from that month’s FTE calculation. An employer that operated its business for the entire 2019 calendar year determines the number of FTEs by taking the sum of the number of FTEs in each calendar month in 2019 and dividing that number by 12.

Determine qualified wages. The determination of which wages are “qualified wages” depends on the average number of FTEs employed by the eligible employer in 2019:

- **Larger employers (for 2020 credit, more than 100 FTEs; for 2021 credit, more than 500 FTEs):** Qualified wages are generally wages, including certain allocable health plan expenses, (up to \$10,000 per employee) paid to employees who aren’t providing services because operations were suspended or due to the decline in gross receipts. Note: Only count wages up to the amount the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period of economic hardship. The 30-day wage limitation is removed for 2021, allowing employers, for example, to claim the credit for bonuses paid to essential workers.
- **Smaller employers (for 2020 credit, 100 or fewer FTEs; for 2021 credit, 500 or fewer FTEs):** Qualified wages are wages, including allocable health plan expenses, (up to \$10,000 per employee) paid to any employee during the period that operations were suspended or the period of the decline in gross receipts, regardless of whether employees are providing services.

For more information on determining the amount of allocable qualified health plan expenses, see [IRS FAQs #62-71](#).

Example (2020): Employer pays employee \$8,000 between April and June 2020 and \$8,000 between July and September 2020. The maximum credit with respect to those wages should be \$4,000 for Q2 and \$1,000 for Q3 (for a total of \$5,000).

Example (2021): Employer pays employee \$8,000 between January and March 2021 and \$8,000 between April and June 2021. The maximum credit with respect to those wages should be \$5,600 for Q1 and \$5,600 for Q2.

HOW DOES AN EMPLOYER CLAIM THE CREDIT?

If your business is eligible for the Employee Retention Credit, you can receive the credit in one of three ways:

1. **Quarterly payroll filings.** Claim the Employee Retention Credit on your quarterly employment tax return (Form 941) beginning with the second quarter of 2020.
2. **Amended payroll returns.** Employers that may now qualify for the ERC in 2020, e.g., PPP borrowers with qualified wages not used to receive loan forgiveness, can amend the prior Forms 941 to claim the credit. Alternatively, an employer may elect to treat qualified wages paid in prior quarters as paid in fourth quarter of 2020 and claim the credit on the 2020 fourth quarter Form 941. The IRS has not yet issued guidance on how to make this election.
3. **Advance Refund.** For 2021, employers with 500 or fewer FTEs in 2019 may elect to receive an advance payment of the credit for the quarter in an amount not to exceed 70 percent of the average quarterly wages paid by the employer in calendar year 2019. The IRS has not yet issued guidance on how to claim the advance payment.

An employer should reconcile any reductions to employment tax deposits or advance refunds received on its Form 941 for the applicable quarter.

WHAT DOCUMENTATION SHOULD BE RETAINED?

Employers should retain the following documentation to support their eligibility for the Employee Retention Credit:

- **Qualifying reason.** If your organization qualifies due to closures related to a governmental order, make sure to retain a copy of the relevant order(s). For more information on which governmental orders may be considered for purposes of the Employee Retention Credit, [see IRS FAQs #28–29](#).

If your organization qualifies under the gross receipts test, document the support to show the decline in gross receipts for the qualifying period. For 2020, an employer is considered to have a significant decline in gross receipts for the period beginning with the first calendar quarter in 2020 for which its gross receipts are less than 50 percent of gross receipts from the same calendar quarter in 2019 and ending with the earlier of January 1, 2021, or the first calendar quarter after the quarter for which gross receipts are greater than 80 percent of gross receipts for the same calendar quarter in 2019.

For 2021, the required year-over-year gross receipts decline is reduced from 50 percent to 20 percent and the *Taxpayer Certainty and Disaster Tax Relief Act of 2020* provides a safe harbor allowing employers to use prior quarter gross receipts to determine eligibility.

- **Employee count calculations.** Since the amount of eligible qualified wages depends on FTE count, maintain records of FTEs, including how you arrive at the average number of FTEs for 2019 for purposes of the Employee Retention Credit computations.
- **Calculations to support the amount of the Employee Retention Credit.** Note, all records of employment taxes should be retained for at least four years and be available for IRS review. These records should include documentation to show how you figured the amount of qualified health plan expenses allocated to wages.
- **Credit reimbursement method.** Since there are multiple ways to receive the Employee Retention Credit, you should maintain records of the method(s) your business uses to receive the credit, which ultimately will be reported on your quarterly payroll tax filings.
- **For PPP borrowers.** Retain documentation to support requirement that qualified wages used to claim an employee retention credit were not also treated as payroll costs used to receive PPP loan forgiveness.

Need assistance determining if your organization is eligible for the Employee Retention Credit? Need help calculating the amount of your eligible credit or evaluating the benefit of the Employee Retention Credit compared to a PPP 2 loan? Reach out to a BKD Trusted Advisor™ for help today!