American Rescue Plan Act Extends Employee Retention Credit Through 2021

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The American Rescue Plan Act of 2021 (ARPA), signed into law by President Biden on March 11, 2021, extends the employee retention credit, originally enacted as part of the 2020 CARES Act, through the end of 2021.

Under the original CARES Act, businesses and non-profit organizations received a refundable credit against Social Security taxes equal to 50% of "qualified wages" paid to their employees during the COVID-19 crisis. The credit was available to employers whose (1) operations were fully or partially suspended, due to a COVID-19-related shut-down order, or (2) gross receipts declined by more than 50 percent when compared to the same quarter in the prior year. For employers with more than 100 employees, the credit was for wages paid to employees not providing services because of the COVID-19 state of emergency. For employers with 100 or fewer employees, the credit was for wages of all employees. The maximum credit for 2020 was $5,000 per employee. Employers that participated in the CARES Act Payroll Protection Loan Program could not also receive the refundable employee retention tax credit.

The 2020 Consolidated Appropriations Act and ARPA expanded the employee retention credit for 2021 to up to $7,000 per employee per calendar quarter and relaxed the restrictions on its availability for 2021. The credit is available in 2021 to employers whose (1) operations are fully or partially suspended due to a COVID-19-related shut-down order, or (2) the gross receipts of such employer for the calendar quarter are less than 80 percent of the gross receipts of such employer for the same calendar quarter in 2019.

The ARPA also allows a retention credit for the 3rd and 4th quarter of 2021 for an employer that is a "recovery start up business." A recovery startup business is any business that began operations after February 15, 2020, whose average annual gross receipts do not exceed $1,000,000, and the business does not otherwise qualify for the retention credit. Under the new legislation, the maximum employee retention credit for 2021 is $28,000 per employee. For a recovery start up business, however, the maximum credit is $50,000 per quarter for all employees. For the 3rd and 4th quarter of 2021, the retention credit is a credit against Medicare taxes rather than Social Security taxes.

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For qualifying employers with 500 or fewer employees, the employee retention credit is available for all employees. For qualifying employers with more than 500 employees, the credit is available only for furloughed employees. The ARPA provides that for the 3rd and 4th quarter of 2021 certain severely financially distressed large employers (with more than 500 employees) may receive the retention credit for all employees. A severely distressed large employer has gross receipts for a 2021 calendar quarter of less than 10% of the gross receipts it had for the same calendar quarter in 2019.

Under the new legislation, an employer who receives a PPP loan, and the loan is not forgiven, may take the employee retention credit in 2020 or 2021. The employee retention credit is generally not available to federal, state, or local government employers. Effective January 1 to December 31, 2021, the credit is available to some government employers, for example, colleges and universities and those whose principal purpose or function is providing medical or hospital care.

COMPARISON TO PAYROLL PROTECTION LOAN PROGRAM

If a business has 50 employees and each employee earns annual compensation of $60,000 (including benefits), under the Payroll Protection Loan Program, the business could borrow $625,000 (or 2.5 times a monthly payroll of $250,000) in 2021. If the business spends this $625,000 loan on 8 weeks of payroll, rent and utilities, the entire amount of the loan may be forgiven under the terms of the loan program.

If the business qualifies for the employee retention tax credit for the first two quarters of 2021, it could instead receive a refundable credit of $700,000 ($14,000 per employee). Thus, under the new legislation, the employee retention tax credit may be a better option than a forgiven PPP loan. Talk with your tax advisor about this complex but significant tax credit.

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