

Key takeaways from year-end funding bill's amendments to the employee retention credit

January 4, 2021

In brief

Congress on December 21 approved a \$2.4 trillion [legislative package](#) (the Consolidated Appropriations Act, 2021, or 'the Appropriations Act') to fund the federal government through the end of the fiscal year and provide further COVID-19 economic relief, including expanding and extending the CARES Act employee retention credit (ERC). President Trump signed the package into law on December 27.

The Appropriations Act makes both retroactive and prospective changes to the ERC. Going back to the effective date of the ERC, the Act makes the credit available for certain employers that received Paycheck Protection Program (PPP) loans, clarifies the determination of gross receipts for certain tax-exempt organizations, and clarifies that qualified health expenses can be eligible for the credit even if no qualified wages were paid.

Prospectively, the Appropriations Act extends and expands the ERC for periods between January 1, 2021 through June 30, 2021. Specifically, the Act increases the ERC from 50% to 70% of qualified wages, increases the amount of qualified wages (including qualified health expenses) from \$10,000 for the year to \$10,000 per quarter, changes the definition of large employer to employers with 500 or more employees, increases the maximum credit to \$14,000 per employee, and makes the credit available to employers whose gross receipts decline by 20% and to certain public instrumentalities.

In detail

Background of the ERC

The ERC was enacted in the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to encourage eligible employers financially impacted by the coronavirus to keep employees on their payroll.

Eligible employers qualifying to receive the ERC, per the CARES Act, are employers that carried on a trade or business during calendar year 2020 and that either:

- Fully or partially suspended business operations during any calendar quarter in 2020 due to orders from an appropriate governmental authority imposing restrictions upon the business operations by

- limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19; or
- Experienced a significant decline in gross receipts during the calendar quarter that were below 50% of the comparable quarter in 2019. A significant decline in gross receipts begins with the first quarter in which an employer's gross receipts for a calendar quarter in 2020 are less than 50% of its gross receipts for the same calendar quarter in 2019. The significant decline in gross receipts ends with the first calendar quarter that follows the first calendar quarter for which the employer's 2020 gross receipts for the quarter are greater than 80% of its gross receipts for the same calendar quarter during 2019

Per the CARES Act, the ERC equals 50% of the qualified wages (including qualified health plan expenses) that an eligible employer paid in a calendar quarter in 2020. The maximum amount of qualified wages taken into account with respect to each employee for all calendar quarters in 2020 is \$10,000.

Under the CARES Act, qualified wages are wages and compensation paid by an eligible employer to employees after March 12, 2020 and before January 1, 2021. Qualified wages include cash payments as well as the eligible employer's qualified health plan expenses.

Qualified wages are defined based on the average number of full-time employees employed by the eligible employer during 2019. If the eligible employer averaged more than 100 full-time employees in 2019, qualified wages are the wages paid to an employee for time that the employee is not providing services due to the circumstances that caused the employer to be an eligible employer, relating to mandated suspensions or significant declines in gross receipts. If the eligible employer averaged less than 100 full-time employees in 2019, qualified wages include all wages paid to the employee during an eligible quarter. Qualified wages taken into account for an employee may not exceed what the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period of economic hardship.

Under the CARES Act, tax-exempt organizations were eligible for the credit only if they experience a full or partial suspension of operations. In addition, eligible employers did not include state and local governments and their instrumentalities, self-employed individuals, and businesses that received a PPP loan.

The ERC for 2020 was available to be claimed in advance by reducing deposits by the amount of the credit, by filing Form 7200 to claim an advance payment of the credit, by claiming the credit on Form 941, or by claiming the credit on Form 941-X. The amount of credit that could be claimed in advance was not limited.

Aggregation rules for the ERC

The IRS has explained in its ["COVID-19-Related Employee Retention Credits: Determining Which Entities are Considered a Single Employer Under the Aggregation Rules FAQs"](#) that aggregation rules apply for **all** ERC purposes, including whether an employer has a significant decline in gross receipts and for determining an employer's full-time employee count. The Appropriations Act does not address these aggregation rules. Thus, pursuant to the IRS explanation, employers still are to determine eligibility and qualified wages based on the aggregated group.

Major changes to the ERC provided in the Appropriations Act

The Appropriations Act expands and extends through June 30, 2021, the ERC enacted as part of the CARES Act.

Beginning on January 1, 2021 and through June 30, 2021, the Appropriations Act:

- Increases the credit rate from 50% to 70% of qualified wages;
- Expands eligibility for the credit by reducing the required year-over-year gross receipts decline from 50% to 20% and provides a safe harbor allowing employers to use prior-quarter gross receipts to determine eligibility;
- Increases the limit on per-employee creditable wages from \$10,000 for the year to \$10,000 for each quarter;
- Increases the 100-employee delineation for determining the relevant qualified wage base to employers with 500 or fewer employees;
- Allows certain public instrumentalities to claim the credit;

- Removes advance payments of the credit except for small employers and limits the amount of advance credit; and
- Provides rules to allow new employers that were not in existence for all or part of 2019 to be able to claim the credit.

Observation: The Appropriations Act's changes make the ERC available to a wider group of employers. Employers that were eligible for the credit in 2020 should determine whether they remain eligible in 2021 under the expanded provisions. Employers that were not eligible for the credit in 2021 should determine whether they are eligible in 2021 under the reduced gross receipts test. Eligibility under the full or partial suspension test also remains available for employers in 2021 to the extent COVID-19 related orders affect an employer's business operations.

Observation: The Appropriations Act significantly increases the amount of credit available. Whereas under the CARES Act employers were entitled to a maximum credit of \$5,000 per employee for 2020, under the Appropriations Act the maximum credit would be \$14,000 per employee in 2021. In addition, the change in definition of what constitutes a large employer means that for employers with less than 500 full-time employees, all wages paid in eligible quarters can be taken into account for purposes of the credit; as a result, tracking qualified wages will be less administratively complicated.

Retroactive to the effective date included in section 2301 of the CARES Act, the Appropriations Act:

- Provides that employers that receive Paycheck Protection Program (PPP) loans still may qualify for the ERC with respect to wages that are not paid for with forgiven PPP proceeds;
- Clarifies the determination of gross receipts for certain tax-exempt organizations; and
- Clarifies that group health plan expenses can be considered qualified wages even when no other wages are paid to the employee, consistent with IRS guidance.

Observation: The Appropriation Act's improved coordination between the PPP and ERC, effective retroactively, allows employers that may not have been eligible for the ERC in 2020 as a result of having received a PPP loan potentially now to qualify for the credit. For employers that were members of an aggregated group (defined under Sections 51(a), 51(b), and 414(m), 414(o)), whether initially or as a result of a transaction in 2020, where a member of the group received a PPP loan, this may mean that the ERC now is available. The ERC can be claimed by filing an amended payroll tax return using Form 941-X, so that employers that determine eligibility based on the Appropriations Act's retroactive changes can claim the credit for 2020.

Claiming the ERC

Under the CARES Act, an eligible employer could claim an advance ERC by reducing its required quarterly payroll tax deposits or by filing Form 7200 to obtain an advanced credit, and then reporting any reduced deposits and advanced credits, along with the total credit on its Form 941.

The Appropriations Act changes the ability to claim advance payments of the credit, except for small employers (defined as those that averaged less than 500 full-time employees in 2019). The Act also limits the amount that can be claimed in advance, providing that a small employer may elect to receive the ERC in an amount not exceeding 70 percent of the average quarterly wages paid by the employer in calendar year 2019.

Observation: For 2021, employers that averaged more than 500 full-time employees in 2019 no longer can claim advance credits and therefore must wait until they file Form 941 to claim the credit. This change will result in reduced liquidity to eligible employers, which now will have to wait until the end of the quarter to avail themselves of the credit, absent further legislative changes.

The takeaway

The Appropriations Act makes significant retroactive and prospective changes to the ERC designed to help employers that have been financially impacted by the pandemic. Based on the changes, more employers now should be eligible for the credit, and the amount of the credit will increase from a maximum of \$5,000 per employee in 2020 to \$14,000 per

employee in 2021. The credit will be available to be claimed against payroll taxes, and employers with fewer than 500 employees will be able to claim an advance of the credit.

For additional information on the ERC, the Appropriations Act, and the CARES Act, see:

- PwC Tax Insight: [Year-end government funding bill includes COVID-19 economic relief and tax extenders](#)
- PwC Tax Insight: [Employee retention credit can help financially impacted business](#)

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Tax Controversy and Regulatory Services

Kevin Brown
(703) 795-9469
kevin.brown@pwc.com

Ligeia Donis
202-809-4072
ligeia.m.donis@pwc.com

Susan Lennon
571-230-3761
susan.m.lennon@pwc.com

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