

Guidance for Claiming Employee Retention Credit in Third and Fourth Quarters of 2021

The IRS has issued guidance for employers claiming the employee retention credit under Code Sec. 3134, enacted by section 9651 of the American Rescue Plan Act of 2021 (ARP), P.L. 117-2, which provides a credit for wages paid after June 30, 2021, and before January 1, 2022. The guidance amplifies previous notices which addressed the employee retention credit under section 2301 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), P.L. 116-136, as amended by sections 206 and 207 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, P.L. 116-260.

In general, eligible employers can claim a refundable employee retention credit against the employer share of Social Security tax equal to 70 percent of the qualified wages they pay to employees after December 31, 2020, through June 30, 2021. Qualified wages are limited to \$10,000 per employee per calendar quarter in 2021. Thus, the maximum employee retention credit available is \$7,000 per employee per calendar quarter, for a total of \$14,000 for the first two calendar quarters of 2021. Under Code Secs. 3134(a) and (b)(1)(A), these limits continue to apply in the third and fourth calendar quarters in 2021.

The guidance explains changes made to the employee retention credit for the third and fourth calendar quarters of 2021, including:

- making the credit available to eligible employers that pay qualified wages after June 30, 2021, and before January 1, 2022;
- expanding the definition of eligible employer to include "recovery startup businesses";
- modifying the definition of qualified wages for "severely financially distressed employers"; and
- providing that the credit does not apply to qualified wages taken into account as payroll costs in connection with a shuttered venue grant under section 324 of the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act, or a restaurant revitalization grant under section 5003 of the ARP.

The guidance also provides guidance on several miscellaneous issues with respect to the employee retention credit for both 2020 and 2021, including:

- the definition of full-time employee and whether that definition includes full-time equivalents;
- the treatment of tips as qualified wages and the interaction with the Code Sec. 45B credit;
- the timing of the qualified wages deduction disallowance and whether taxpayers that already filed an income tax return must amend that return after claiming the credit on an adjusted employment tax return; and
- whether wages paid to majority owners and their spouses may be treated as qualified wages.

Highlights of some of the items addressed in the guidance are summarized below.

Recovery Startup Businesses

A separate credit limit under Code Sec. 3134(b)(1)(B) applies to "recovery startup businesses." A "recovery startup business" is an employer (i) that began carrying on any trade or business after February 15, 2020; (ii) for which the average annual gross receipts of the employer for the three-tax-year period ending with the tax year that precedes the calendar quarter for which the credit is

determined does not exceed \$1,000,000; and (iii) that is not otherwise an eligible employer due to a full or partial suspension of operations or a decline in gross receipts. For an eligible employer that is a recovery startup business, the amount of the credit allowed under Code Sec. 3134(a) (after application of the limit under Code Sec. 3134(b)(1)(A)) for each of the third and fourth calendar quarters of 2021 cannot exceed \$50,000.

The determination of when a recovery startup business "began carrying on a trade or business" is made in the same manner as for purposes of Code Sec. 162. It is appropriate for the term "qualified wages" to include wages paid by a recovery startup business. In the third and fourth calendar quarters of 2021, a recovery startup business that is a small eligible employer may treat all wages paid with respect to an employee during the quarter as qualified wages. Whether an employer is a recovery startup business is determined separately for each calendar quarter.

Qualified Wages

The rules in Notice 2021-20 for determining the average number of full-time employees continue to apply in the third and fourth calendar quarters of 2021. However, Code Sec. 3134(c)(3)(C) provides a different rule for qualified wages paid by "severely financially distressed employers." For the third and fourth calendar quarters of 2021, an eligible employer with gross receipts that are less than 10 percent of the gross receipts for the same calendar quarter in calendar year 2019 (or 2020, if the employer was not in existence in 2019) is a severely financially distressed employer.

Further, the rules for determining whether an employer is an eligible employer based on a decline in gross receipts also apply, in the third and fourth calendar quarters of 2021, for determining whether an eligible employer is a severely financially distressed employer based on the 10 percent threshold. For the third and fourth calendar quarters of 2021, a severely financially distressed employer that is a large eligible employer may treat all wages paid to its employees during the quarter in which the employer is considered severely financially distressed as qualified wages.

Claiming the Credit

Notice 2021-20 and Notice 2021-23 set forth the rules for claiming the employee retention credit in 2020 and the first and second calendar quarters in 2021, respectively. These rules, including the rules pertaining to claiming an advance and relevant limitations, continue to apply for the third and fourth quarters in 2021.

Reporting

Eligible employers will report their total qualified wages and the related health insurance costs for each quarter on their employment tax returns (Form 941) for the applicable period. If a reduction in the employer's employment tax deposits is not sufficient to cover the credit, certain employers may receive an advance payment from the IRS by submitting Form 7200, Advance Payment of Employer Credits Due to COVID-19.

Effect on Other Documents

Notice 2021-20, I.R.B. 2021-11, 922 and Notice 2021-23, I.R.B. 2021-16, 1113, are amplified.