

THE EMPLOYEE RETENTION TAX CREDIT (ERTC),
as originally enacted by the CARES Act,¹ and as amended by the CAA² and further amended by the ARPA³

ISSUE	ERTC FOR 2020 (as originally enacted by the CARES Act and amended retroactively by the CAA)	ERTC FOR Q1 & Q2 2021 (as extended and amended by the CAA)	ERTC FOR Q3 & Q4 2021 (as further extended and amended by the ARPA)
DURATION OF CREDIT	The ERTC applies with respect to wages paid by eligible employers after March 12, 2020 and before January 1, 2021.	ERTC Extended for 6 Months: The ERTC is extended with respect to wages paid through June 30, 2021.	ERTC Extended for Additional 6 Months: The ERTC is extended with respect to wages paid after June 30, 2021 and before January 1, 2022.
AMOUNT OF CREDIT	<p>Credit Percentage: Eligible employers are generally entitled to a refundable tax credit against OASDI taxes for each calendar quarter equal to 50% of “qualified wages” with respect to each employee for the quarter. [Note: because this is a refundable tax credit, it is provided to the taxpayer even if in excess of OASDI taxes due.</p> <p>Maximum Credit: Maximum total wages considered for any employee for all calendar quarters in 2020 are capped at \$10,000 (i.e., the maximum credit is \$5,000 per employee during 2020).</p>	<p>Credit Percentage Increased: Beginning with respect to wages paid on January 1, 2021 and through June 30, 2021, the ERTC credit rate is increased to 70% of qualified wages.</p> <p>Maximum Credit Increased: For Q1 & Q2 2021, the limit on per-employee qualified wages is increased from \$10,000 for all quarters to \$10,000 for <u>each</u> quarter (i.e., maximum credit is \$7,000 for each of the first two quarters of 2021, for a total maximum credit in the first half of 2021 of \$14,000 per employee).</p>	<p>Credit Percentage: Same as Q1 & Q2 2021, except the ERTC becomes a credit against Hospital Insurance taxes instead of OASDI.</p> <p>Maximum Credit: Same per-employee quarterly maximum credit as Q1 & Q2 2021 (see, however, the new limit for recovery startup businesses, described next).</p> <p>New Aggregate Limit for Recovery Startup Businesses: A “recovery startup business” (defined below in row “ELIGIBLE EMPLOYERS”) is subject to an aggregate ERTC limit of \$50,000 per quarter. [Eligible employers that are not a recovery startup business are <i>not</i> subject to an aggregate ERTC limit.]</p>
QUALIFIED WAGES DEFINED	<p>“Qualified wages” are calculated as follows:</p> <ul style="list-style-type: none"> • Small Employers: For employers with 100 or fewer full-time employees (based on Code section 4980H): all employee wages paid to any employee during (1) any period in the calendar quarter in which the business 	<p>Threshold for Treatment as Small Employer Increased: For Q1 & Q2 2021, the more generous small employer definition of qualified wages (described to the left) applies to employers that have 500 or fewer employees (instead of 100 or fewer employees).</p>	<p>Threshold for Treatment as Small Employer: Same as Q1 & Q2 2021 (subject to a new rule for certain large employers, described next).</p>

¹ The Coronavirus Aid, Relief, and Economic Security (CARES) Act (enacted March 27, 2020). IRS FAQs on the CARES Act ERTC provisions are available [here](#). As of the date of this chart, the IRS FAQs have not been updated to reflect the changes made to the ERTC by the CAA or ARPA.

² The Consolidated Appropriations Act, 2021 (CAA) (enacted December 27, 2020). The CAA includes both retroactive (to the date of the CARES Act) and prospective (for Q1 & Q2 2021 only) amendments to the ERTC. IRS guidance on the ERTC, as amended by the CAA, is provided in [Notice 2021-20](#) (for 2020) and [Notice 2021-23](#) (for Q1 & Q2 2021).

³ The American Rescue Plan Act (ARPA) (enacted March 11, 2021). As of the date of this chart, the IRS has not published guidance on the ARPA amendments to the ERTC.

ISSUE	ERTC FOR 2020 (as originally enacted by the CARES Act and amended retroactively by the CAA)	ERTC FOR Q1 & Q2 2021 (as extended and amended by the CAA)	ERTC FOR Q3 & Q4 2021 (as further extended and amended by the ARPA)
	<p>operations are fully or partially suspended due to a governmental order or (2) any calendar quarter in which the business is experiencing a significant decline in gross receipts.</p> <ul style="list-style-type: none"> • Large Employers: For employers with more than 100 full-time employees: wages paid to employees <i>not performing services</i> due to COVID-19-related circumstances (during either the period of suspension of operations or the quarter satisfying the reduction in gross receipts requirement). <p>[For guidance on determining the number of full-time employees employed during 2019, see Notice 2021-20 Q&A 31.⁴]</p> <p>Past Pay Limitation: In certain cases, qualified wages are limited to the amount the employee would have been paid for working the equivalent duration during the 30 days immediately preceding such period.</p> <p>FFCRA Paid Leave Wages: Wages considered under paid sick/family leave (FFCRA) (i.e., those that receive a separate 100% credit) are excluded.</p>	<p>Past Pay Limitation Repealed: The limitation based on the employee’s past pay no longer applies for wages paid in Q1 & Q2 2021.</p>	<p>More Generous “Small Employer” Rule Extended to Large Employers that are “Severely Financially Distressed”: In the case of a severely financially distressed employer, which is defined as an eligible employer that experienced a decline in gross receipts of <i>more than 90%</i> in the quarter (or immediately preceding quarter) as compared to the same calendar quarter in 2019, qualified wages mean wages paid by such employer with respect to an employee during any calendar quarter.</p>
<p>QUALIFIED HEALTH PLAN EXPENSES AS WAGES</p>	<p>The calculation of qualified wages includes the employer’s “properly allocable” qualified health plan expenses with respect to the employee.</p> <p>Retroactive CAA Clarification: Consistent with previous IRS guidance, the CAA clarified that certain group health plan expenses are treated as wages for purposes of the ERTC, even if no other wages are paid to the employee. [See below re: special reporting option for this retroactive provision.]</p>	<p>Same as 2020.</p>	<p>Same as 2020.</p>

⁴ Although this chart highlights certain Q&As from IRS Notice 2021-20 and Notice 2021-23 with respect to select issues, not all available IRS guidance is noted. Taxpayers and others reviewing this chart should consult the notices and any other available IRS guidance, such as tax forms and instructions, for additional information.

ISSUE	ERTC FOR 2020 (as originally enacted by the CARES Act and amended retroactively by the CAA)	ERTC FOR Q1 & Q2 2021 (as extended and amended by the CAA)	ERTC FOR Q3 & Q4 2021 (as further extended and amended by the ARPA)
	[For guidance on allocable qualified health plan expenses, see Q&As 40-48 in IRS Notice 2021-20.]		
ELIGIBLE EMPLOYERS	<p>The ERTC is available to an employer:</p> <ul style="list-style-type: none"> (1) that was carrying on a trade or business during calendar year 2020, and (2) with respect to any calendar quarter: <ul style="list-style-type: none"> o had its operations fully or partially suspended under government orders due to COVID-19, or o had a decline of at least <u>50%</u> in gross receipts as compared to the same calendar quarter in 2019. <p>Gross Receipts Recovery Test: An employer that is an eligible employer for a quarter based on having a decline in gross receipts continues to be an eligible employer until the earlier of (1) the calendar quarter that follows the first calendar quarter in which gross receipts rebounded to greater than 80% for the same calendar quarter in the prior year or (2) January 1, 2021.</p> <p>Special rules apply for employers that were not in operation for all or part of the same calendar quarter in 2019.</p> <p>[For guidance on government orders that result in a suspension of business operations, see Q&As 10-22 in IRS Notice 2021-20. For guidance on determining a decline in gross receipts, see Q&As 23-28.]</p>	<p>Expanded Eligible Employer Definition: Beginning with respect to wages paid on January 1, 2021 and through June 30, 2021, the reduction in gross receipts eligibility requirement applies on a quarter-by-quarter basis to any business that experienced a decline in gross receipts of more than 20% compared to the same calendar quarter in 2019. As a result, the Gross Receipts Recovery Test is no longer relevant.</p> <p>For employers that were not in existence in 2019, the decline in gross receipts test is applied by comparing 2021 gross receipts for the calendar quarter to the same calendar quarter in 2020.</p> <p>Use of Preceding Quarter Allowed: The CAA also gives employers the option of determining ERTC eligibility based on the reduction in gross receipts based on the immediately preceding calendar quarter when compared to the corresponding calendar quarter in 2019.</p> <p>[See Section III.C. of Notice 2021-23 for guidance, including documentation requirements, with respect to the changes to the decline in gross receipts test.]</p>	<p>An employer that was carrying on a trade or business “during the calendar quarter for which the [ERTC] is determined” is an eligible employer under the same rules that apply with respect to Q1 & Q2 2021.</p> <p>Recovery Startup Business as Eligible Employer: For Q3 & Q4 2021, a “recovery startup business” is also an eligible employer, where recovery startup business means any employer:</p> <ol style="list-style-type: none"> 1) which began carrying on any trade or business after February 15, 2020; 2) for which the average annual gross receipts of such employer (as determined under rules similar to the rules under section 448(c)(3)) for the 3-taxable-year period ending with the taxable year which precedes the calendar quarter for which the ERTC is determined do not exceed \$1 million; and 3) which does not otherwise meet the definition of an “eligible employer.”

ISSUE	ERTC FOR 2020 (as originally enacted by the CARES Act and amended retroactively by the CAA)	ERTC FOR Q1 & Q2 2021 (as extended and amended by the CAA)	ERTC FOR Q3 & Q4 2021 (as further extended and amended by the ARPA)
<p>INTERACTION WITH THE PAYCHECK PROTECTION PROGRAM (PPP) AND CERTAIN OTHER PROGRAMS</p>	<p>Under the original CARES Act, the ERTC was <u>not</u> available if an eligible employer received a covered loan under the PPP.</p> <p>The provision denying the ERTC to employers receiving a PPP loan was repealed retroactively by the CAA.⁵ The CAA also amended the definition of “payroll costs” for purposes of PPP loan forgiveness (section 7A(a)(12) of the Small Business Act) to state that such payroll costs “shall not include qualified wages taken into account in determining the [ERTC].”</p> <p>If an eligible employer elects not to take qualified wages into account for purposes of the ERTC (because, for example, the employer is including such wages as payroll costs for purposes of PPP loan forgiveness), the amended statute requires the creation of mechanisms to allow payroll costs paid during the covered period of a PPP loan to be treated as qualified wages for purposes of the ERTC “to the extent that a covered loan of the eligible employer is <i>not forgiven</i> by reason of a decision” by the lender (emphasis added). [See below re: special reporting option for this retroactive provision.]</p> <p>IRS Notice 2021-20 Q&A 49 provides that an eligible employer that received a PPP loan is deemed to have made an election not to take qualified wages into account for those qualified wages “included in the amount reported as payroll costs on a [PPP Loan Forgiveness Application].” The amount for which the employer is deemed to have made the election is “the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not</p>	<p>Same as 2020.</p>	<p>Generally the same as 2020: The ERTC is not available with respect to any qualified wages that are taken into account as payroll costs in connection with a (1) First Draw or Second Draw PPP loan, (2) Shuttered Venue Operators grant (as enacted by the CAA), or (3) Restaurant Revitalization grant (as enacted by the ARPA).</p> <p>Similar mechanisms with respect to PPP loans that are not forgiven continue to be required (with respect to both First Draw and Second Draw PPP loans).</p>

⁵ The CAA further clarified that employers may deduct expenses (e.g., payroll costs), even if those expenses are paid for with a PPP loan that is forgiven and excluded from income. There is no such similar relief with respect to qualified wages for purposes of the ERTC, that is, an employer must reduce its deduction for qualified wages, including qualified health plan expenses, by the amount of the ERTC. See IRS Notice 2021-20, Q&A 60.

ISSUE	ERTC FOR 2020 (as originally enacted by the CARES Act and amended retroactively by the CAA)	ERTC FOR Q1 & Q2 2021 (as extended and amended by the CAA)	ERTC FOR Q3 & Q4 2021 (as further extended and amended by the ARPA)
	<p>exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on [such application], sufficient to support the amount of the PPP loan that is forgiven.” Notwithstanding the deemed election, if the PPP Loan Forgiveness Application is not approved, any qualified wages reported as payroll costs on such application may subsequently be taken into account for purposes of the ERTC.</p>		
<p>ELIGIBILITY OF CERTAIN TAX-EXEMPT AND GOVERNMENTAL EMPLOYERS</p>	<p>In the case of tax-exempt organizations described in section 501(c) of the Internal Revenue Code (Code) and exempt under section 501(a), certain requirements are determined based on “all operations of such organization.”</p> <p>The ERTC is not available to the U.S. government, the government of any state or political subdivision, thereof, or any agency or instrumentality of any of the above.</p> <p>For eligible tax-exempt employers, the CAA provides retroactive clarification that any reference to gross receipts is to be treated as a reference to gross receipts within the meaning of Code section 6033 (the reporting rules applicable to 501(c)(3) organizations).</p>	<p>In Q1 & Q2 2021, the prohibition on governmental entities does not apply to certain public instrumentalities, including certain federally chartered tax-exempt entities and certain tax-exempt colleges, universities, or hospitals.</p>	<p>Same as Q1 & Q2 2021.</p>
<p>CLAIMING THE ERTC</p>	<p>Credit is taken immediately against certain federal employment taxes of the employer that the IRS specifies and is claimed on IRS Form 941. Special Schedule R reporting rules apply for third-party payors of employment taxes. An eligible employer that fails to claim and report the ERTC on Form 941 with respect to qualified wages paid in a particular calendar quarter must generally file an amended employment tax return (Form 941-X) for that quarter in order to make a retroactive claim. [See the special reporting rule below for a limited exception to the 941-X requirement.]</p>	<p>Advance payments with respect to wages paid in Q1 & Q2 2021 are limited to employers whose average number of “full-time employees” during 2019 was 500 or fewer, based on the definition of Code section 4980H.</p> <p>Moreover, the maximum advance payment for eligible small employers in Q1 & Q2 2021 is capped at 70% of the average quarterly wages paid by the employer in calendar year 2019. [See Section III.F. of Notice 2021-23 for guidance on determining “average quarterly wages.”]</p> <p>Special rules are provided for employers not in existence in 2019 and seasonal employers.</p>	<p>Same as Q1 & Q2 2021 (except that, if advance payments exceed the credit allowed, the employer’s Hospital Insurance tax—instead of FICA taxes more broadly—is increased by the excess).</p>

ISSUE	ERTC FOR 2020 (as originally enacted by the CARES Act and amended retroactively by the CAA)	ERTC FOR Q1 & Q2 2021 (as extended and amended by the CAA)	ERTC FOR Q3 & Q4 2021 (as further extended and amended by the ARPA)
	<p>If an employer is not able to claim entire credit against applicable employment taxes due, any excess credit is treated as an overpayment to be refunded by the IRS. The IRS has provided that these excess credits may be paid in advance through the use of Form 7200, and that such payments must be reconciled with the Form 941 by third-party payors.</p> <p>[For guidance on substantiation requirements, see Q&As 70-71 in IRS Notice 2021-20.]</p>	<p>In addition, the amount of the advance credit reduces the credit that the taxpayer is allowed to claim, and a failure to do so will be treated as a mathematical or clerical error (and thus not be eligible for certain procedural protections pursuant to Code section 6213(b)(1)). Moreover, the statute states that, if the advance payments exceed the credit allowed, the employer's FICA taxes for the calendar quarter are increased by the excess.</p>	
<p>SPECIAL REPORTING RULES FOR RETROACTIVE CHANGES</p>	<p>In conjunction with the retroactive changes described above, the CAA included a special reporting rule that gave employers that had already filed a tax return with respect to applicable employment taxes before December 27, 2020 the <i>option</i> of treating certain amounts as an amount paid in Q4 2020. This reporting rule was aimed at reducing the need in limited circumstances for employers to file an amended Form 941 for earlier quarters as a result of the retroactive changes to the ERTC.</p> <p>The IRS took the narrow position with this special reporting rule that, with respect to the retroactive PPP-related changes described above, the special reporting rule was only available to employers that, under IRS guidance, were allowed to treat payroll costs as qualified wages for purposes of the ERTC because the employer's PPP loan forgiveness application was denied.</p> <p>The IRS acknowledged on its website that employers may have been challenged to implement the special reporting rule for Q4 2020 due to time constraints and stated the following: "You do not have to use this limited 4th quarter procedure. You can instead choose the regular process of filing an adjusted return or claim for refund for the appropriate quarter to which the additional [ERTC] relates using Form 941-X."</p>	<p>No special reporting rules are available for retroactive ERTC claims. As noted above, IRS guidance states that employers must report any changes or make retroactive claims using Form 941-X for the applicable quarter(s).</p> <p>[NAPEO continues to advocate for an alternative reporting option for retroactive ERTC claims that does not rely on the overburdened Form 941-X system.]</p>	<p>Same as Q1 & Q2 2021.</p>

ISSUE	ERTC FOR 2020 (as originally enacted by the CARES Act and amended retroactively by the CAA)	ERTC FOR Q1 & Q2 2021 (as extended and amended by the CAA)	ERTC FOR Q3 & Q4 2021 (as further extended and amended by the ARPA)
RESTRICTIONS ON OTHER TAX CREDITS	<p>Employers may not double count:</p> <ul style="list-style-type: none"> the same employee for purposes of the ERTC if the employer was “allowed” a work opportunity tax credit (Code section 51) for that employee any wages taken into account in determining the ERTC for purposes of the employer credit for voluntary paid family and medical leave added in 2017 tax reform legislation (Code section 45S) qualified leave wages under the FFCRA 	<p>The anti-double dip rules are prospectively extended in Q1 & Q2 2021 to also apply to tax credits under Code sections 41 (R&D), 45A (Indian employment), 45P (active duty military), and 1396 (empowerment zone employment).</p> <p>[Note, it will be important for taxpayers to carefully review the interaction of these credits. For example, under the original CARES Act, an employee can’t be included for purposes of the ERTC if the employer is allowed a WOTC for that employee. Under the prospective CAA modifications, a different rule applies to Q1 & Q2 2021. Under that rule, any wages taken into account for determining the ERTC cannot also be taken into account as wages for WOTC. So, in 2020, the WOTC precludes the employee completely from the ERTC, but in Q1 & Q2 2021 there is just no double counting of wages.]</p>	<p>Generally the same as Q1 & Q2 2021: Qualified wages for purposes of the ERTC may not include any wages taken into account under Code sections 41 (R&D), 45A (Indian employment), 45P (active duty military), 45S (paid family and medical leave under 2017 tax reform); 51 (WOTC), 1396 (empowerment zone employment), 3131 (FFCRA credit for paid sick leave in Q2/Q3 2021), and 3132 (FFCRA credit for paid family leave in Q2/Q3 2021).</p>
LIMITATION ON ASSESSMENT			<p>The limitation on the time period for the assessment under Code section 6501 of any amount attributable to a claimed ERTC is extended from 3 years to 5 years.</p>
TREASURY/IRS REGULATIONS AND GUIDANCE	<p>The Treasury Department and IRS are directed to issue forms, instructions, regulations, and guidance, as are necessary, including:</p> <ol style="list-style-type: none"> to allow advance payment of the credit; to provide reconciliation of such advance payment with the amount advanced at the time of filing the return for the applicable calendar quarter or taxable year; with respect to the application of the credit to “third party payors” (including specifically PEOs, CPEOs or agents under section 3504 of the Code), including guidance allowing such payors to submit documentation necessary to substantiate the eligible employer status of employers that use such payors; for application of certain eligibility rules for employers that were not carrying on a trade or business for all or part of 2019; and 	<p>The Treasury/IRS direction to provide guidance to allow advance payment of the ERTC (#1, as described to the left) is limited in accordance with the restrictions on advance payments in Q1 & Q2 2021. [See discussion of changes regarding advance payments under CLAIMING THE ERTC above.]</p> <p>The Treasury/IRS direction to provide guidance re: #2 and #4, as described to the left, is eliminated with respect to Q1 & Q2 2021. [See discussion of changes regarding advance payments under CLAIMING THE ERTC above.]</p> <p>The Treasury/IRS direction to provide ERTC guidance is modified by adding the following flush language:</p> <p>“Any forms, instructions, regulations, or guidance shall require the customer to be responsible for the accounting of the credit and for any liability for</p>	<p>Generally the same as Q1 & Q2 2021.</p>

ISSUE	ERTC FOR 2020 (as originally enacted by the CARES Act and amended retroactively by the CAA)	ERTC FOR Q1 & Q2 2021 (as extended and amended by the CAA)	ERTC FOR Q3 & Q4 2021 (as further extended and amended by the ARPA)
	<p>5. “to prevent the avoidance of the purposes of the limitations under this section, including through the leaseback of employees.” [Note, this #5 was added retroactively by the CAA.]</p>	<p>improperly claimed credits and shall require the certified professional employer organization or other third party payor to accurately report such tax credits based on the information provided by the customer.”</p> <p>[Note, the IRS Instructions for Form 7200 (Rev. Jan. 2021) state the following: “The common-law employer is responsible for the accounting of the employee retention credit and for any liability for improperly claimed credits. CPEOs and other third-party payers must accurately report the employee retention credits based on the information provided by the common-law employer. The CPEO or other third-party payer will be liable for employment taxes, in accord with its normal liability, that are due as a result of any improperly claimed credits.”]</p>	
<p>CPEOS AND THEIR CLIENTS</p>	<p>The statute provides that the ERTC is treated as a credit described in Code section 3511(d)(2) (i.e., the list of tax credits that clarifies that, for CPEOs, credit eligibility is determined at the client level).</p>	<p>Same as 2020.</p>	<p>Same as 2020.</p>

This document is for informational purposes only and is not intended to constitute legal advice or a recommended course of action in any given situation. This document does not create an attorney-client relationship between Davis & Harman LLP and the reader and should not be relied upon by the reader in making decisions of a legal nature. Taxpayers are encouraged to consult independent counsel before making any decisions or taking any action concerning the matters addressed herein.