operations.

How Does the Employee Retention Credit Work?

For 2020, the ERC is **50% of all qualified wages** you paid employees between March 12, 2020, and Dec. 31, 2020. It's limited to $10,000 in wages per employee for all quarters. Therefore, you could claim a maximum credit of $5,000 for each employee.

For 2021, the credit is **70% of all qualified wages** you pay employees from Jan. 1, 2021, through Sept. 30, 2021. It's limited to $10,000 in wages per employee for any quarter. Therefore, you can claim $7,000 for each employee in every quarter. The maximum credit is $21,000 per employee.

If your organization is considered a **recovery startup business**, your total credit is limited to $50,000 per calendar quarter. Wages paid through Dec. 31, 2021, are eligible for the credit. You aren't limited to wages paid by Sept. 30, 2021. Recovery startup businesses are those that began operations after Feb. 15, 2020, with average annual gross receipts under $1 million.

What are Qualified Wages?

Generally, qualified wages are compensation you pay to employees, including qualified health plan expenses. However, the definition also depends on your average number of full-time employees in 2019. If your business wasn't in existence in 2019, you'll use the average number of full-time employees in 2020.

If you continue to provide health care benefits to employees who aren't working, those benefits may be qualified wages. Determining the amount of health care benefits allocable to each employee depends on whether you're fully insured, self-insured or a combination of both. If group health care costs are your only expenses that qualify for this credit, work with a business tax advisor to correctly calculate and maximize your credit amount.

Now, if you're considered a **severely financially distressed employer**, you may treat all wages paid during the third quarter of 2021 as qualified wages. A severely financially distressed employer is an eligible employer that experiences a decline in gross receipts of more than 90% compared to the same 2019 calendar quarter.

2020 Employee Retention Credit

1. If your average was more than 100 full-time employees in 2019, qualified wages are the wages you paid to employees ***who aren't providing services*** because of:

- A full or partial suspension of operations by order of a governmental authority due to the coronavirus, OR

2. If your average was fewer than 100 full-time employees in 2019, qualified wages are the wages you paid to ***any employee*** because of:

- A full or partial suspension of operations by order of a governmental authority due to the coronavirus, OR
- A significant decline in gross receipts

If you fall within this category, qualified wages aren't impacted by whether an employee is or isn't working. Any employee you continue to pay affects your credit amount.

2021 Employee Retention Credit

1. If your average was more than 500 full-time employees in 2019, qualified wages are the wages you paid to employees ***who aren't providing services*** because of:

- A full or partial suspension of operations by order of a governmental authority due to the coronavirus, OR
- A significant decline in gross receipts

2. If your average was fewer than 500 full-time employees in 2019, qualified wages are the wages you paid to ***any employee*** because of:

- A full or partial suspension of operations by order of a governmental authority due to the coronavirus, OR
- A significant decline in gross receipts

If you're a small employer, all wages you pay during an eligible period qualify for the ERC. If you're a large employer and you don't pay any employees for not working during 2020 or 2021, you're not eligible for this credit. But, if you pay employees for working and not working, the wages you pay employees for not working qualify for this credit.

Example: Toys Inc. is a large employer and paid Ted for 40 hours in Feb. 2021. He worked 10 hours and didn't work 30 hours. In this case, you'd exclude any wages you paid Ted for working when calculating the credit. Only the wages you paid him for *not working* (30 hours) are qualified wages and eligible for this credit.

	Large Employer	Small Employer
2020 Credit	More than 100 full-time employees in 2019	Fewer than 100 full-time employees in 2019
2021 Credit	More than 500 full-time employees	Fewer than 500 full-time

A full-time employee is an individual who's employed at least 30 hours per week or 130 hours per month (on average). Full-time status is based on hours worked in 2019.

How Do You Calculate the Credit Amount for Each Employee?

You calculate the credit based on qualified wages you pay your employees each quarter. Here are some examples.

2021 Credit

- You pay Keith $10,000 in the first quarter of 2021. The credit amount available to you is 70% of qualified wages – $7,000. In Q2 of 2021, you pay Keith $10,000. Once again, you can claim a $7,000 credit in Q2.
- You pay Kelly $8,000 in Q2 of 2021. You pay her $12,000 in Q3 of 2021. Your credit is $5,600 in Q2 and $7,000 in Q3. Kelly's wages exceed $10,000 in Q3, so the credit calculation is capped at $10,000. 70% of $10,000 equals a $7,000 credit.

2020 Credit

- You pay Amy $8,000 in Q2 of 2020. You pay her $6,000 in Q3 of 2020. Your credit amount for Amy is $4,000 in Q2 and $1,000 in Q3. Once you hit the $5,000 cap, any additional wages you pay Amy in 2020 won't increase your credit amount.

What's a Significant Decline in Gross Receipts?

In 2020, the significant decline is a **50% decrease in gross receipts** compared to the same calendar quarter in 2019. The significant decline ends with the first 2020 calendar quarter where your gross receipts are greater than 80% of gross receipts for the same calendar quarter in 2019.

In 2021, the significant decline is a **20% decrease in gross receipts** compared to the same quarter in 2019. A safe harbor is available for Q1 2021 that allows you to use the previous quarter's gross receipts compared to the same quarter in 2019. For example, in Q1 2021, you can compare gross receipts for Q1 2021 to Q1 2019 or compare gross receipts for Q4 2020 to Q4 2019.

Gross receipts are your total revenue without subtracting returns or discounts, operating expenses, or unpaid invoices. It's strictly the total amount of revenue your business collects in a tax year. You must calculate your gross receipts using the same basis you use for tax purposes.

Example: You have $250,000 in gross receipts in Q1 2019. In Q1 2021, your gross receipts are $100,000. That's more than a 20% decrease and marks the start of a significant decline. In Q2 2019, your gross receipts were $200,000. In Q2 2021, your gross receipts are $150,000. Your gross receipts have decreased by more

How Do You Claim the Employee Retention Credit?

You'll report your qualified wages and related credits for each calendar quarter that you qualify for the credit on Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, appropriately. If you qualify and claim the credit, you will need to reduce the total wages reported for the tax year on your income tax return for that year. For 2020, this could mean that you will need to file amended income tax returns for the 2020 tax year. For 2021, you will want to apply for the credit before finalizing your 2021 income tax returns.

What Else Do I Need To Know About the Employee Retention Credit?

You can claim both the ERC and the tax credit for providing paid leave because of COVID-19. However, you can't claim both credits for the same wages. And, you can't include the paid leave wages in your calculation of qualified wages for the ERC. Keep them separate.

If you receive a restaurant revitalization fund grant or a shuttered venues operator grant, the wages you pay with the grant funds can't be used to claim the ERC. However, you can use restaurant grant funds until 2023 and pay business expenses beyond payroll costs. It's highly likely that you could claim the ERC and maximize a restaurant grant.

If you received a PPP loan, you can now claim the ERC, too. When the CARES Act first passed, you had to choose between this credit and a PPP loan. If you applied for loan forgiveness and it was approved, you can't claim this credit for wages you paid with your PPP loan. If your forgiveness request isn't granted, you can use wages paid with your PPP loan to claim the ERC.

If you have any questions about this credit or need assistance claiming it, Doeren Mayhew's tax advisors are here to help. Contact us today for assistance.

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