COVID-19 Accounting Tutorial
CARES ACT: EMPLOYEE RETENTION CREDIT (An Update)

This tutorial updates a tutorial issued in 2020 that explained both the Employee Retention Credit (ERC) and Employer Tax Deferral Programs. Since that tutorial was issued there have been significant changes to the Employee Retention Credit, and some have wondered if their college can retroactively claim the credit – prompting this update.

BACKGROUND

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) included two programs to help employers retain their employees and improve their cash flows—the Employee Retention Credit (ERC) program and the Deferral of Employer Tax Deposits and Payments program. This tutorial covers the latest information about the Employee Retention Credit.

The ERC was amended three times after it was originally enacted under the CARES Act—by the Taxpayer Certainty and Disaster Relief Act of 2020 (Relief Act), the American Rescue Plan (ARPA) Act of 2021, and the Infrastructure Investment and Jobs Act (IIJA). Information on these changes can be found at https://www.irs.gov/newsroom/employee-retention-credit-2020-vs-2021-comparison-chart.

Originally the ERC was available to not-for-profit (NFP) employers such as private colleges and universities, but not governmental employers such as public institutions. Amendments under the Relief Act of 2021 expanded the eligibility to public colleges or universities and government employers whose principal purpose is to provide medical or hospital care.

Eligibility and Benefits

Eligibility criteria and benefit amounts have changed with each amendment.

Under the original legislation, employers were eligible for the credit if there was either:

1. a full or partial suspension of the operation of their trade or business during any calendar quarter because of governmental orders limiting commerce, travel, or group meetings due to COVID-19, or
2. a significant decline in gross receipts, defined as a decline of 50 percent or more when compared to the same quarter in the prior year.

Qualifying employers could receive a tax credit for 50 percent of qualified wages (up to a maximum of $10,000 in wages per employee, i.e. maximum benefit of $5,000 per employee) that were paid to employees after March 12, 2020 and before January 1, 2021.

The credit applied to qualified wages (including certain health plan expenses) paid during the period in which there was a significant decline in gross receipts, or any calendar quarter in which operations were suspended. Rules for eligible employees and calculations varied depending on whether there were less than or greater than 100 employees.
Modifications to the ERC as a result of updated legislation.
The Relief Act of 2021 modified the decline in gross receipts (criteria #2 above) for a quarter in which gross receipts were less than 80 percent of the same quarter in 2019. The Relief Act included an alternative quarter election rule, employers can look at a prior calendar quarter and compare to the same calendar quarter in 2019 to determine whether there was a decline in gross receipts.

The Relief Act of 2021 increase the maximum benefit to 70 percent of $10,000 in qualified wages and certain health care expenses paid between January 1, 2021 and June 30, 2021, up to a maximum credit of $7,000 per employee. Provisions in ARPA and IIJA resulted in extending the period for qualifying wages to September 30, 2021. Employers with over 500 employers became eligible and it did not matter if the salaries related to the provision of shut down services or any salaries in the organization. The same rule applied to smaller employers.

Originally employers participating in the Paycheck Protection Program (PPP) were not eligible for the ERC. However, Relief Act of 2021 expands eligibility in that only wages claimed for reimbursement under the Paycheck Protection Program (PPP) are not eligible for the ERC. Other wages excluded from the ERC are those for which an employer received a tax credit for paid sick and family leave under the Families First Coronavirus Response Act, and wages included in a credit for paid family and medical leave under section 45S of the Internal Revenue Code.

Calculating and claiming the ERC.
Employers that did not take advantage of the ERC in 2020 and 2021 can go back and retroactively calculate the credit. IRS Form 941X is used to claim the credit as an offset to FICA and Medicare taxes paid in prior years. The deadline for ERC claims for calendar year 2020 is April 15, 2024, for wages paid in calendar year 2021 the deadline is April 15, 2025.

Note – the ARP extended the eligible quarters in 2021 from July 1 – December 31, but the fourth quarter availability is limited to start-up businesses per the Infrastructure Investment and Jobs Act. Consequently, this means that all eligible employers can claim the ERC for the first three quarters of 2021.

Instructions for claiming the credit (based on when qualified wages were paid) can be found at https://www.irs.gov/coronavirus/employee-retention-credit.

Because the declaration of a national emergency remained in effect throughout 2021, colleges and universities whose campuses remained closed through eligible periods in 2021, should document that local laws supported their continued shut down. This is an important component of eligibility documentation.

However, institutions that opened up during 2021 or that remained shut down despite jurisdiction laws to the contrary would have to show revenue reductions of at least 20 percent compared with a pre-pandemic base year of 2019. Institutions would have to follow IRS gross receipts guidelines when comparing 2019 to 2021.

Consult with External Accounting and Audit Firms.
The IRS continues to be concerned about the proliferation of those claiming to be experts in the ERC area and has warned employers and tax preparers to proceed with caution. The IRS has urged taxpayers to fully consider their eligibility for the credit prior to amending payroll tax returns and that incorrect claims may be subject to significant interest and penalties. Institutions are urged to consult with their external accounting and tax experts.