



# ACCOUNTING

## CONTINUING EDUCATION

### COVID Relief Update: American Rescue Plan Act of 2021 and Other Developments

(ARPD2)



# COVID Relief Update: American Rescue Plan Act of 2021 and Other Developments

Manual Updated March 22, 2021

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COVID RELIEF UPDATE: AMERICAN RESCUE PLAN ACT OF 2021 AND  
OTHER DEVELOPMENTS UPDATED MARCH 22, 2021 (ARPD2)

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# Unit

# 1

## American Rescue Plan Act of 2021

### LEARNING OBJECTIVES

*After completing this unit, participants will be able to:*

- Compute the taxable portion of unemployment compensation for taxpayers on their 2020 income tax returns and understand potential after year end planning opportunities.
- Explain to clients the differences between this recovery rebate program and the two that came before this one
- Understand the expanded child tax credit and the advance payment system that is set to start later in 2021
- Apply the extended and modified versions of the various payroll tax credits

On March 11, 2021, President Biden signed into law the American Rescue Plan Act (ARPA) of 2021. The Act, with a \$1.9 trillion price tag, contained a number of provisions enacted under the reconciliation rules that are meant to provide certain types of additional relief related to the COVID-19 pandemic. This is the third major bill passed by Congress in just less than one year dealing with the pandemic.

Most, but not all, of the tax provisions in this bill are short lived, with many impacting only a single year (2021 or 2020).

### EXTEND THE EXCESS BUSINESS LOSS RULE BY ONE YEAR

The Tax Cuts and Jobs Act added IRC §461(l) that limits an individual to deducting no more than an inflation adjusted \$250,000 (\$500,000 for a married couple filing a joint return) in net business losses in a year, with amounts in excess of that limit carried

to the following year as a net operating loss. Originally the provision was scheduled to expire for years beginning on or after January 1, 2026.

ARPA extends this rule for one additional year. So it ceases to apply for years beginning on or after January 1, 2027.<sup>1</sup>

## **TEMPORARY EXCLUSION FROM INCOME OF UNEMPLOYMENT BENEFITS FOR QUALIFIED TAXPAYERS**

The American Rescue Plan Act of 2021 has a special rule that applies to unemployment compensation for taxable years beginning in 2020. The taxpayer may exclude up to \$10,200 of unemployment compensation from income if the adjusted gross income of the taxpayer (as computed under the rules for this provision) is less than \$150,000. If a joint return is filed, then each spouse can exclude up to \$10,200 of their own unemployment compensation—but note that the adjusted gross income cut-off does not go up for the married couple.<sup>2</sup>

For purposes of determining if a taxpayer has adjusted gross income in excess of the \$150,000 limit, adjusted gross income is computed by:

- Not taking into account any exclusion of unemployment compensation under this provision and
- After applying the following sections of the IRC (remembering that we are assuming initially the unemployment compensation is taxable):
  - Calculation of taxable social security benefits under IRC §86;
  - Exclusion from income for certain US Savings Bond interest used to pay educational expenses under IRC §135;
  - Exclusion from income of employer adoption assistance under IRC §137;
  - Deduction for a contribution to a traditional IRA under IRC §219;
  - Deduction for interest on a qualified education loan under IRC §221;
  - Deduction for qualified tuition and related expenses under IRC §222; and
  - Passive loss deductions (in particular the deduction for active rental real estate losses) under §469.<sup>3</sup>

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<sup>1</sup> IRC §461(l)(1) as amended by the American Rescue Plan Act of 2021 §9041

<sup>2</sup> IRC §85(c)(1) as amended by the American Rescue Plan Act of 2021

<sup>3</sup> IRC §85(c)(2) as revised by the American Rescue Plan Act of 2021

The law also makes conforming amendments to those provisions as well as IRC §74(d)(2)(B).<sup>4</sup>

Note that this is a cliff limitation. At \$149,999 of modified adjusted gross income, a full \$20,400 exclusion would be available to a married couple filing a joint return, but if one additional dollar of income is added the full \$20,400 of unemployment compensation becomes taxable.

Revised IRC §85(c) now reads as follows:

(c) Special Rule for 2020.--

(1) In general.--In the case of any taxable year beginning in 2020, if the adjusted gross income of the taxpayer for such taxable year is less than \$150,000, the gross income of such taxpayer shall not include so much of the unemployment compensation received by such taxpayer (or, in the case of a joint return, received by each spouse) as does not exceed \$10,200.

(2) Application.--For purposes of paragraph (1), the adjusted gross income of the taxpayer shall be determined--

(A) after application of sections 86, 135, 137, 219, 221, 222, and 469, and

(B) without regard to this section.<sup>5</sup>

On March 12, 2021, the IRS provided updated instructions on their website for preparing returns that have excludable unemployment compensation.<sup>6</sup> However, on March 23, 2021, the IRS made a significant change in those instructions.<sup>7</sup>

Originally, the IRS instructions had taxpayers *include* the unemployment compensation in determining the modified AGI (reading “without regard to this section” in IRC §85(c)(2)(B) to mean without regard to the exclusion at IRC §85(c)), but now they have decided that means *without regard to any unemployment compensation covered by §85*.

In the interim, many (but not all) tax software providers updated their product to calculate the exclusion, presumably using the original March 12 instructions. Advisers

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<sup>4</sup> American Rescue Plan Act of 2021 §9042(b)

<sup>5</sup> American Rescue Plan Act of 2021 §9042(a)

<sup>6</sup> “New Exclusion of up to \$10,200 of Unemployment Compensation,” IRS website, March 12, 2021, <https://www.irs.gov/faqs/irs-procedures/forms-publications/new-exclusion-of-up-to-10200-of-unemployment-compensation> (retrieved March 13, 2021)

<sup>7</sup> “New Exclusion of up to \$10,200 of Unemployment Compensation,” IRS website, March 23, 2021 version, <https://www.irs.gov/faqs/irs-procedures/forms-publications/new-exclusion-of-up-to-10200-of-unemployment-compensation> (retrieved March 23, 2021)

will need to carefully review returns that used the software that determined the unemployment was taxable to determine if that remains correct under the March 23 worksheet.

The revised IRS notice and March 23 version of the Form 1040 instructions read as follows:

If your modified adjusted gross income (AGI) is less than \$150,000, the American Rescue Plan enacted on March 11, 2021, excludes from income up to \$10,200 of unemployment compensation paid in 2020, which means you don't have to pay tax on unemployment compensation of up to \$10,200. If you are married, each spouse receiving unemployment compensation doesn't have to pay tax on unemployment compensation of up to \$10,200. Amounts over \$10,200 for each individual are still taxable. If your modified AGI is \$150,000 or more, you can't exclude any unemployment compensation. If you file Form 1040-NR, you can't claim the unemployment compensation exclusion for your spouse.

The exclusion should be reported separately from your unemployment compensation. See the updated instructions and the Unemployment Compensation Exclusion Worksheet to figure your exclusion and the amount to enter on Schedule 1, line 8.

Include the full amount of your unemployment compensation from Schedule 1, line 7 when figuring the following deductions or exclusions from income. See the specific form or instructions for more information. If you file Form 1040-NR, you aren't eligible for all of these deductions. See the Instructions for Form 1040-NR for details.

- Taxable social security benefits (Instructions for Form 1040 or 1040-SR, Social Security Benefits Worksheet)
- IRA deduction (Instructions for Form 1040 or 1040-SR, IRA Deduction Worksheet)
- Student loan interest deduction (Instructions for Form 1040 or 1040-SR, Student Loan Interest Deduction Worksheet)
- Nontaxable amount of Olympic or Paralympic medals and USOC prize money (Instructions for Form 1040 or 1040-SR, Schedule 1, line 8)
- The exclusion of interest from Series EE and I U.S. Savings Bonds issued after 1989 (Form 8815)

- The exclusion of employer-provided adoption benefits (Form 8839)
- Tuition and fees deduction (Form 8917)
- The deduction of up to \$25,000 for active participation in a passive rental real estate activity (Form 8582)

If you have already filed your 2020 Form 1040 or 1040-SR, there is no need to file an amended return (Form 1040-X) to figure the amount of unemployment compensation to exclude. The IRS will refigure your taxes using the excluded unemployment compensation amount and adjust your account accordingly. The IRS will send any refund amount directly to you.

The instructions for Schedule 1 (Form 1040), line 7, Unemployment Compensation, are updated to read as follows.

**Line 7**  
**Unemployment Compensation**

You should receive a Form 1099-G showing in box 1 the total unemployment compensation paid to you in 2020. Report this amount on line 7.

**Caution.** *If the amount reported in box 1 of your Form(s) 1099-G is incorrect, report on line 7 only the actual amount of unemployment compensation paid to you in 2020.*

**Caution.** *When figuring any of the following deductions or exclusions, include the full amount of your unemployment benefits reported on Schedule 1, line 7: taxable social security benefits, IRA deduction, student loan interest deduction, nontaxable amount of Olympic or Paralympic medals and USOC prize money, the exclusion of interest from Series EE and I U.S. Savings Bonds issued after 1989, the exclusion of employer-provided adoption benefits, the tuition and fees deduction, and the deduction of up to \$25,000 for active participation in a passive rental real estate activity. See the specific form or instructions for more information. If you file Form 1040-NR, you aren't eligible for all of these deductions. See the Instructions for Form 1040-NR for details.*

**Note.** If your modified adjusted income (AGI) is less than \$150,000, the American Rescue Plan enacted on March 11, 2021 excludes from income up to \$10,200 of unemployment compensation paid to you in 2020. For married taxpayers, you and your spouse can each exclude up to \$10,200 of unemployment compensation. For example, if you were paid \$20,000 of unemployment compensation and your spouse was

paid \$5,000, report \$25,000 on line 7 and report \$15,200 on line 8 as a negative amount (in parentheses). The \$15,200 excluded from income is \$10,200 for you and all of the \$5,000 paid to your spouse. If your modified AGI is \$150,000 or more, you can't exclude any unemployment compensation. Use the Unemployment Compensation Exclusion Worksheet to figure your modified AGI and the amount to exclude. However, if you file Form 1040-NR, you can't claim the unemployment compensation exclusion for your spouse.

If you made contributions to a governmental unemployment compensation program or to a governmental paid family leave program and you aren't itemizing deductions, reduce the amount you report on line 7 by those contributions. If you are itemizing deductions, see the instructions on Form 1099-G.

**Caution.** *Your state may issue separate Forms 1099-G for unemployment compensation received from the state and the additional \$600 a week federal unemployment compensation related to coronavirus relief. Include all unemployment compensation received on line 7.*

If you received an overpayment of unemployment compensation in 2020 and you repaid any of it in 2020, subtract the amount you repaid from the total amount you received. Enter the result on line 7. Also enter "Repaid" and the amount you repaid on the dotted line next to line 7. If, in 2020, you repaid more than \$3,000 of unemployment compensation that you included in gross income in an earlier year, see Repayments in Pub. 525 for details on how to report the payment.

**Tip.** *If you received unemployment compensation in 2020, your state may issue an electronic Form 1099-G instead of it being mailed to you. Check your state's unemployment compensation website for more information.*

### **Unemployment Compensation Exclusion Worksheet – Schedule 1, Line 8**

1. If you are filing Form 1040 or 1040-SR, enter the total of lines 1 through 7 of Form 1040 or 1040-SR. If you are filing Form 1040-NR, enter the total of lines 1a, 1b, and lines 2 through 7.
2. Enter the amount from Schedule 1, lines 1 through 6. Don't include any amount of unemployment compensation from Schedule 1, line 7 on this line.
3. Use the line 8 instructions to determine the amount to include on Schedule 1, line 8, and enter here. Do not reduce this amount by the amount of unemployment compensation you may be able to exclude.

4. Add lines 1, 2, and 3.

5. If you are filing Form 1040 or 1040-SR, enter the amount from line 10c. If you are filing Form 1040-NR, enter the amount from line 10d.

6. Subtract line 5 from line 4. This is your modified adjusted gross income.

7. Is the amount on line 6 \$150,000 or more?

Yes. Stop You can't exclude any of your employment compensation

No. Go to line 8

8. Enter the amount of unemployment compensation paid to you in 2020. Don't enter more than \$10,200.

9. If married filing jointly, enter the amount of unemployment compensation paid to your spouse in 2020. Don't enter more than \$10,200. If you are filing Form 1040-NR, enter -0- .

10. Add lines 8 and 9 and enter the amount here. This is the amount of unemployment compensation excluded from your income.

11. Subtract line 10 from line 3 and enter the amount on Schedule 1, line 8. If the result is less than zero, enter it in parentheses. On the dotted line next to Schedule 1, line 8, enter "UCE" and show the amount of unemployment compensation exclusion in parentheses on the dotted line. Complete the rest of Schedule 1 and Form 1040, 1040-SR, or 1040-NR.<sup>8</sup>

The IRS has also posted temporary guidance suggesting that taxpayers not immediately file an amended return. In a statement posted on the IRS website on March 12, 2021<sup>9</sup> the agency stated that:

The IRS is reviewing implementation plans for the newly enacted American Rescue Plan Act of 2021. Additional information about a new round of Economic Impact Payments, the expanded Child Tax Credit, including advance payments of the Child Tax Credit, and other tax provisions will be made available as soon as possible on IRS.gov. The IRS strongly urges taxpayers to not file amended returns

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<sup>8</sup> "New Exclusion of up to \$10,200 of Unemployment Compensation," IRS website, March 23, 2021 version

<sup>9</sup> "IRS Statement - American Rescue Plan Act of 2021," IRS website, March 12, 2021, <https://www.irs.gov/newsroom/irs-statement-american-rescue-plan-act-of-2021> (retrieved March 14, 2021)

related to the new legislative provisions or take other unnecessary steps at this time.

The IRS will provide taxpayers with additional guidance on those provisions that could affect their 2020 tax return, including the retroactive provision that makes the first \$10,200 of 2020 unemployment benefits nontaxable. For those who haven't filed yet, the IRS will provide a worksheet for paper filers and work with software industry to update current tax software so that taxpayers can determine how to report their unemployment income on their 2020 tax return. For those who received unemployment benefits last year and have already filed their 2020 tax return, the IRS emphasizes they should not file an amended return at this time, until the IRS issues additional guidance.<sup>10</sup>

## **COBRA CONTINUATION COVERAGE ASSISTANCE**

ARPA provides a provision that pays for COBRA coverage for certain individuals using a payroll tax credit given to the employer that normally would receive COBRA premiums from a qualified employee.<sup>11</sup> The program applies to *assistance eligible individuals* who are treated as having paid in full an applicable COBRA premium for the coverage period beginning on the first day of any month:

- Beginning after March 11, 2021 and
- Ending on September 30, 2021.<sup>12</sup>

However, the rule does not apply for months of coverage beginning on or after the earlier of:

- The first date that such individual is eligible for
  - Coverage under any other group health plan (other than coverage consisting of only excepted benefits (as defined in section 9832(c) of the Internal Revenue Code of 1986, section 733(c) of the Employee Retirement Income Security Act of 1974, and section 2791(c) of the Public Health Service Act),
  - Coverage under a flexible spending arrangement (as defined in section 106(c)(2) of the Internal Revenue Code of 1986),
  - Coverage under a qualified small employer health reimbursement arrangement (as defined in section 9831(d)(2) of the Internal Revenue Code of 1986)), or

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<sup>10</sup> “IRS Statement - American Rescue Plan Act of 2021,” IRS website, March 12, 2021

<sup>11</sup> American Rescue Plan Act of 2021 §9501

<sup>12</sup> American Rescue Plan Act of 2021 §9501(a)(1)(A)



- Eligible for benefits under the Medicare program under title XVIII of the Social Security Act; *or*
- The earlier of:
  - The date following the expiration of the maximum period of continuation coverage required under the applicable COBRA continuation coverage provision; *or*
  - The date following the expiration of the period of COBRA continuation coverage if the coverage had been elected as required by the individual or not discontinued.<sup>13</sup>

## **Assistance Eligible Individual**

An *assistance eligible individual* is any individual that is a qualified beneficiary who:

- Is eligible for COBRA continuation coverage by reason of a qualifying event that leads to the loss of coverage under standard COBRA rules, except for the voluntary termination of such individual’s employment by such individual; and
- Who elects such COBRA coverage.<sup>14</sup>

## **Extension of Election Period for COBRA Coverage**

ARPA provides special rules to allow an individual to elect COBRA coverage during the period beginning on the first day of the first month after March 11, 2021 and ending 60 days after the individual receives the required notice regarding this provision.<sup>15</sup>

## **Notice Requirement**

The COBRA notices required under §606(a)(4) of ERISA, IRC §4980B(f)(6)(D) or §2206(4) of the Public Health Service Act to individuals who become eligible for this special COBRA continuation coverage must contain an additional written notification to the recipient in clear and understandable language of—

- The availability of premium assistance with respect to such coverage under this subsection; and
- The option to enroll in different coverage if the employer permits assistance eligible individuals to elect enrollment in different coverage.<sup>16</sup>

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<sup>13</sup> American Rescue Plan Act of 2021 §9501(a)(2)(A)

<sup>14</sup> American Rescue Plan Act of 2021 §9501(a)(3)

<sup>15</sup> American Rescue Plan Act of 2021 §9501(a)(4)(A)

<sup>16</sup> American Rescue Plan Act of 2021 §9501(a)(5)(A)(i)

This may be a separate notice or incorporated into the standard COBRA notice provided.<sup>17</sup>

Each special notification shall contain:

- The forms necessary for establishing eligibility for premium assistance under this subsection;
- The name, address, and telephone number necessary to contact the plan administrator and any other person maintaining relevant information in connection with such premium assistance;
- A description of the extended election period;
- A description of the obligation of the qualified beneficiary and the penalty provided under section 6720C of the Internal Revenue Code of 1986 for failure to carry out the obligation;
- A description, displayed in a prominent manner, of the qualified beneficiary's right to a subsidized premium and any conditions on entitlement to the subsidized premium; and
- A description of the option of the qualified beneficiary to enroll in different coverage if the employer permits such beneficiary to elect to enroll in such different coverage.<sup>18</sup>

Failure to provide this information when required is treated as failure to provide the COBRA notice entirely.<sup>19</sup>

Within 30 days after March 11, 2021 the Department of Labor, IRS and Department of Health and Human Services are to publish models for this additional notification.<sup>20</sup>

## **Notice of Upcoming Expiration of Period of Premium Assistance**

Those individuals covered under this provision must also be notified as the end of the subsidy approaches. The written notice is to be provided to the individual in clear and understandable language—

- That the premium assistance for such individual will expire soon and the prominent identification of the date of such expiration; and

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<sup>17</sup> American Rescue Plan Act of 2021 §9501(a)(5)(A)(iii)

<sup>18</sup> American Rescue Plan Act of 2021 §9501(a)(5)(B)

<sup>19</sup> American Rescue Plan Act of 2021 §9501(a)(5)(C)

<sup>20</sup> American Rescue Plan Act of 2021 §9501(a)(5)(D)

- That such individual may be eligible for coverage without any premium assistance through—
  - COBRA continuation coverage; or
  - Coverage under a group health plan.<sup>21</sup>

The notice of upcoming termination of benefits must be given:

- No more than 45 days before the date of expiration and
- No less than 15 days before the date of expiration.<sup>22</sup>

However, this notice of the upcoming end of benefits is not required if the person becomes eligible for other coverage, described earlier (group health plan, FSA, etc.) which terminates this special coverage.<sup>23</sup>

### **Continuation Coverage Premium Assistance Credit**

While the assistance eligible individual is not required to pay the premium, the party that would have received those premiums is eligible to receive a payroll tax credit under new IRC §6432. The credit, while technically only available against payroll taxes imposed under IRC §3221(a) as are attributable to the rate under IRC §3111(b), since the excess is refundable on a payroll by payroll basis the IRS will presumably allow the employer to offset the entire credit against the payroll tax deposit due, then refund the excess only.<sup>24</sup>

## **2021 RECOVERY REBATES TO INDIVIDUALS**

Another round of recovery rebates are being sent out, though this time under somewhat different rules than the 2020 rebates. This tax credit is a refundable credit<sup>25</sup> for the first tax year beginning in 2021.<sup>26</sup>

**Note:** While the earlier advanced payments, including the one paid in January 2021, were reconciled on the 2020 income tax return, in this case the reconciliation will not take place until the 2021 return is filed.

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<sup>21</sup> American Rescue Plan Act of 2021 §9501(a)(6)(A)

<sup>22</sup> American Rescue Plan Act of 2021 §9501(a)(6)(C)

<sup>23</sup> American Rescue Plan Act of 2021 §9501(a)(6)(B)

<sup>24</sup> IRC §6432(a), (c)

<sup>25</sup> IRC §6428B(e)(3)

<sup>26</sup> IRC §6428B(a)

## Base Rebate Amount

The base rebate amount this time is set at:

- \$1,400 (\$2,800 for a joint return) plus
- \$1,400 times the number of dependents claimed by the taxpayer.<sup>27</sup>

This time the dependent rebate is the same amount as that for a taxpayer and it is not limited only to dependents that are qualifying children.

## Excluded Individuals

Again, rebates will not be available to:

- Any nonresident alien individual;
- Any individual who is a dependent of another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins; and
- An estate or trust.<sup>28</sup>

## Phase-Out of Rebates

A major change in this version of the recovery rebate is how quickly the rebate phases out. Previously it phased out in amount equal to 5% of a taxpayer's adjusted gross income over the limit for that type of taxpayer. This time, while the beginning of the phase-out has not changed, the formula for phasing it out has been modified so that it phases out very quickly.

The rebate is phased out beginning at \$75,000 for a single taxpayer or a married individual filing a separate return. It phases out entirely ratably over the next \$5,000 of adjusted gross income, with the rebate reduced to zero when the taxpayer's adjusted gross income exceeds \$80,000. This is true regardless of how many dependents the taxpayer may claim.<sup>29</sup>

For a married couple the phase-out of the rebate begins yet again at \$150,000 (twice the amount of other filing statuses) but again sees a much more rapid phase-out, ratably being reduced for the next \$10,000 of adjusted gross income and phasing out entirely at \$160,000. Again, the number of dependents does not impact how quickly the taxpayers find the rebate eliminated entirely.<sup>30</sup>

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<sup>27</sup> IRC §6428B(b)(1)

<sup>28</sup> IRC §6428B(c)

<sup>29</sup> IRC §6428B(d)(1)

<sup>30</sup> IRC §6428B(d)(2)(A)

For a taxpayer filing head of household status, the phase-out begins at \$112,500 and entirely phases out (regardless of the number of dependents) over the next \$7,500.<sup>31</sup>

## **Identification Number Rules**

Similar rules as were found in the December 2027 Act apply for this recovery rebate with regard to identification numbers.

If a taxpayer does not provide a valid identification number on the return, the recovery rebate for that taxpayer is zero.<sup>32</sup> In the case of a joint return, the \$2,800 is treated as \$1,400 if only one spouse provides a valid identification number and zero if neither spouse provides such a number.<sup>33</sup> Similarly, a dependent must also provide a valid identification number to qualify for the \$1,400 credit,<sup>34</sup> although an adoption taxpayer identification number can qualify as such a number for a dependent.<sup>35</sup>

For a married couple filing a joint return, if one spouse is a member of the armed forces and at least one spouse provides a valid identification number, the reduction of the base rebate does not apply.<sup>36</sup>

## **Advance Refund Coordination**

The credit on the 2021 individual return will be reduced, but not below zero, by the advance refund amount paid to the taxpayer—that is, the payments made early in 2021 based on prior year information.<sup>37</sup>

## **Advance Refunds and Credits**

Each individual who was an eligible individual for that individual's first taxable year beginning in 2019 shall again be treated as having made a payment for that year equal to the advance refund—the amount that would have been allowed as a credit under this provision if the 2021 recovery rebate rules had applied to that year.<sup>38</sup>

All advance payments must be paid on or before December 31, 2021.<sup>39</sup>

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<sup>31</sup> IRC §6428B(d)(2)(B)

<sup>32</sup> IRC §6428B(e)(2)(A)

<sup>33</sup> IRC §6428B(e)(2)(B)

<sup>34</sup> IRC §6428B(e)(2)(C)

<sup>35</sup> IRC §6428B(e)(2)(D)(ii)

<sup>36</sup> IRC §6428B(e)(2)(E)

<sup>37</sup> IRC §6428B(f)

<sup>38</sup> IRC §6428B(g)(1),(2)(A)

<sup>39</sup> IRC §6428B(g)(3)

## ***Deceased Taxpayers and the Advance Refund***

Special rules apply to deceased individuals. Generally, so long as the person was alive on January 1, 2021, he/she will qualify for an advance refund.<sup>40</sup>

Specifically, the law provides that, for purposes of determining the advance refund:

- Any individual who was deceased before January 1, 2021, shall be treated for purposes of computing the advance payment in the same manner as if the valid identification number of such person was not included on the return of tax for such taxable year (ignoring the special armed services rule);
- Notwithstanding the above, in the case of a joint return with respect to which only 1 spouse is deceased before January 1, 2021, such deceased spouse was a member of the Armed Forces of the United States at any time during the taxable year, and the valid identification number of such deceased spouse is included on the return of tax for the taxable year, the valid identification number of 1 (and only 1) spouse shall be treated as included on the return of tax for the taxable year; and
- No amount shall be allowed with respect to any dependent of the taxpayer if the taxpayer (both spouses in the case of a joint return) was deceased before January 1, 2021.<sup>41</sup>

## ***Special Rules for 2020 Income Tax Returns***

Although the advance is initially based on 2019 income tax returns, the law provides two special rules with regard to 2020 returns.

- If, at the time the IRS calculates the advance payment, the taxpayer has already filed a 2020 income tax return for his/her first tax year beginning in 2020, that return, rather than the 2019 return, will be used to compute the advance payment.
- If that 2020 return is filed before the *additional payment determination date*, the IRS will determine if the individual would have qualified for a larger advance payment based on the 2020 return. If so, the taxpayer will receive a payment for the difference.<sup>42</sup>

However, “already filed” doesn’t mean what you probably think it means (or what it means in standard English). Rather IRC §6428B(g)(7) provides “a return of tax shall not be treated as filed until such return has been processed by the Internal Revenue Service.” The wording indicates that this same “processed” rule will apply to those looking to get their 2020 return filed by the additional payment determination date.

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<sup>40</sup> IRC §6428B(g)(2)(B)

<sup>41</sup> IRC §6428B(g)(2)(B)

<sup>42</sup> IRC §6428B(g)(5)(B)(i)

The *additional payment determination date* is the earlier of

- The date that is 90 days after the 2020 calendar year filing deadline *or*
- September 1, 2021.<sup>43</sup>

The *2020 calendar year filing deadline* is determined after taking into account any period disregarded under §7508A if that period applies to substantially all returns for calendar year 2020. Basically, if the IRS again were to extend the filing season deadline to July 15 as the agency did in 2020, that date would become the date that begins the 90-day period rather than April 15.<sup>44</sup>

## **CHILD TAX CREDIT CHANGES FOR 2021**

Revisions are made to the child tax credit for 2021. So long as a taxpayer (or, in the case of a joint return, either spouse) has a place of abode in the United States over half of the year or is a bona fide resident of Puerto Rico, the rules under IRC §24(d) for a partially refundable credit are replaced by new, temporary rules found at IRC §24(i) for 2021 that create a fully refundable credit.

### **17 Year Olds Can Be Qualifying Children**

One long time feature of the Child Tax Credit has been the quirky rule that provided that 17 year olds were not qualifying children for purposes of computing the child tax credit. For 2021 that will no longer be the case—a 17 year old child, if otherwise a qualifying child, will serve to increase the child tax credit.<sup>45</sup>

### **Increase in the Per-Child Credit Amount to \$3,000 (\$3,600 for a Child Under Age 6)**

The amount of the credit is also increased temporarily for 2021, rising from \$1,000 to:

- \$3,600 for any child that has not attained the age of 6 by the end of the calendar year and
- \$3,000 for all other qualifying children.<sup>46</sup>

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<sup>43</sup> IRC §6428B(g)(5)(B)(ii)

<sup>44</sup> IRC §6428B(g)(5)(B)(iii)

<sup>45</sup> IRC §24(i)(2)

<sup>46</sup> IRC §24(i)(3)

## Revised Phase-Out of the Credit

ARPA looks to accelerate the phase-out of the increased credit, but still retain the slower phase-out found in the Tax Cuts and Jobs Act for the pre-ARPA credit amounts. This complicates the phase-out a bit.

In general, the 2021 child tax credit is phased out by \$50 for each \$1,000 (or portion thereof) over the *applicable threshold amount*.<sup>47</sup> The *applicable threshold amount* is:

- \$150,000, in the case of a joint return or surviving spouse;
- \$112,500, in the case of a head of household; and
- \$75,000, in any other case.<sup>48</sup>

But, as noted, this reduction is limited by a separate provision. The amount of the above reduction is limited to the lesser of:

- the *applicable credit increase amount*, or
- 5 percent of the *applicable phaseout threshold range*.<sup>49</sup>

The first limit is the *applicable credit increase amount* which is defined as the excess of

- The amount of the child tax credit allowed at the higher 2021 rate without regard to either the standard reduction (found at IRC §24(b)) or the special 2021 reduction calculation described above *over*
- That amount of such credit so determined without regard to the higher based \$3,600/\$3,000 rate.<sup>50</sup>

### EXAMPLE

Thus, for a single child age 4, the applicable credit increase amount would be \$1,600 (\$3,600 - \$2,000 prior child tax credit). If the child were 8 years old, the applicable credit increase amount would be \$1,000 (\$3,000 - \$2,000 prior child tax credit).

The second limit will be 5% of the *applicable credit phaseout range* which is defined as:

- The higher, post TCJA threshold amount found at IRC §24(b), as modified by IRC §24(h)(3) (\$400,000 for a married couple filing a joint return, \$200,000 in any other case) *over*

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<sup>47</sup> IRC §24(i)(4)(A)

<sup>48</sup> IRC §24(i)(4)(B)

<sup>49</sup> IRC §24(i)(4)(C)(i)

<sup>50</sup> IRC §24(i)(4)(C)(ii)



- The special 2021 applicable threshold amount (the \$150,000, \$117,500 and \$75,000 noted earlier).<sup>51</sup>

At this point the credit is then subjected to the old law reduction computation found at IRC §24(b).

**EXAMPLE**

The table below shows the computation for a taxpayer filing head of household, with 3 children, 1 of whom is under age 6 at December 31, 2021.

## Child Tax Credit Example Under ARPA

<b>Base Amount</b>	
Children	3
Under age 6	1
<b>Base Credit</b>	<b>9,600</b>

<b>ARPA Base 2021 Phase-Out (§24(i)(4)(A))</b>	
Adjusted Gross Income	210,000
Filing Status	Head of Household
Applicable Threshold Amount	112,500
Amount over applicable threshold amount	97,500
\$1,000/partial over threshold amount	98
<b>Initial reduction</b>	<b>4,900</b>

<b>Applicable Credit Increase Amount</b>	
New Base Credit	9,600
Regular Credit	6,000
<b>Applicable Credit Increase Amount</b>	<b>3,600</b>

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<sup>51</sup> IRC §24(i)(4)(C)

<b>Applicable Phaseout Threshold Range</b>	
Old law threshold amount	200,000
ARPA 2021 threshold amount	112,500
Difference	87,500
<b>5% of the difference</b>	<b>4,375</b>

<b>Credit Before §24(b) Reduction</b>	<b>6,000</b>
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<b>Original Phase-Out (§24(b))</b>	
Adjusted Gross Income	210,000
Filing Status	Head of Household
Applicable Threshold Amount	200,000
Amount over applicable threshold amount	10,000
\$1,000/partial over threshold amount	10
<b>Final Reduction</b>	<b>500</b>

<b>Child Tax Credit - 2021</b>	<b>5,500</b>
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### **Advance Payment of Child Tax Credit**

ARPA adds a new advance payment of a portion of a taxpayer's expected 2021 child tax credit over the period from July 1, 2021 to December 31, 2021.<sup>52</sup>

The taxpayer will be paid periodic equal payments (absent a modification to reflect an excess or deficit in prior payments) that will total the annual advance amount.<sup>53</sup>

#### ***Annual Advance Amount***

The amount of the advance payment is an amount estimated by the IRS to be equal to 50% of the amount of the 2021 child tax credit that would be allowed if:

- The status of the taxpayer as a taxpayer meeting the residency requirements is determined with respect to 2020 (the reference taxable year as described in the law);

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<sup>52</sup> IRC §7527A(f)

<sup>53</sup> IRC §7527A(a)

- The taxpayer's modified adjusted gross income for 2021 is equal to the taxpayer's modified adjusted gross income for 2020;
- The only children of such taxpayer for such taxable year are qualifying children properly claimed on the taxpayer's 2020 income tax return, and
- The ages of such children (and the status of such children as qualifying children) are determined for such taxable year by taking into account the passage of time since 2020 (that is, adding one year to those ages).<sup>54</sup>

If a taxpayer has not filed a 2020 income tax return, then 2019 will be used instead.<sup>55</sup>

If the status of the taxpayer as eligible for the refundable credit cannot be established based on the information in the reference year return, the IRS will use information known to the agency to make the determination.<sup>56</sup>

If the IRS is aware of the death of a child as of the beginning of the year for which the estimate is being made (2021), then the child will not be taken into account in determining the advance payment amount.<sup>57</sup>

The use of a 50% calculation would appear to be based on the fact that the payments won't start until July, thus a taxpayer would only get these payments for half of the months during 2021.

The annual advance amount may be modified during the year to take into account:

- A return of tax filed by such taxpayer during such calendar year (and the taxable year to which such return relates may be taken into account as the reference taxable year), and
- Any other information provided by the taxpayer to the IRS which allows the agency to determine advance payments which, in the aggregate during any taxable year of the taxpayer, more closely total the agency's estimate of the amount treated as the child tax credit for 2021.<sup>58</sup>

In the case of such a modification of the annual advance amount, the IRS may adjust the amount of any periodic payment made after the date of such modification to properly take into account the amount by which any periodic payment made before such date was greater than or less than the amount that such payment would have been on the basis of the annual advance amount as so modified.<sup>59</sup>

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<sup>54</sup> IRC §7527A(b)(1)

<sup>55</sup> IRC §7527A(b)(2)

<sup>56</sup> IRC §7527A(b)(4)

<sup>57</sup> IRC §7527A(b)(5)

<sup>58</sup> IRC §7527A(b)(3)(A)

<sup>59</sup> IRC §7527A(b)(3)(B)

### ***Online Information Portal***

The IRS will be establish an online portal which will allow taxpayers to:

- Elect not to receive these advance payments, and
- Provide information to the IRS which would be relevant to a modification of the annual advance amount, including information regarding—
  - A change in the number of the taxpayer’s qualifying children, including by reason of the birth of a child,
  - A change in the taxpayer’s marital status,
  - A significant change in the taxpayer’s income, and
  - Any other factor which the IRS may provide.<sup>60</sup>

### ***IRS to Send Notice of Amounts Paid by January 31, 2022***

No later than January 31, 2022 the IRS shall provide the taxpayer with a written notice which includes:

- The taxpayer’s identity,
- The aggregate amount of such payments made to such taxpayer during such calendar year, and
- Such other information as the IRS determines appropriate.<sup>61</sup>

### **Reconciliation of the 2021 Child Tax Credit and the Advance Payment**

The 2021 child tax credit will be reduced by the amount of the advance payments received by the taxpayer.<sup>62</sup> If a taxpayer received more in advance payments than the total amount of 2021 child tax credit the taxpayer qualified for, the excess will be treated as increase in tax for the year<sup>63</sup> but subject to relief under a safe harbor for certain taxpayers.

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<sup>60</sup> IRC §7527A(c)

<sup>61</sup> IRC §7527A(d)

<sup>62</sup> IRC §24(j)(1)

<sup>63</sup> IRC §24(j)(2)(A)

## ***Safe Harbor for Reduction in Repayment of Excess Advance Payment***

To qualify for some level of relief under the safe harbor for reducing the repayment required, a taxpayer's modified taxable income must be less than 200% of the applicable income threshold described below.<sup>64</sup>

The *applicable income threshold* amounts are:

- \$60,000 in the case of a joint return or surviving spouse;
- \$50,000 in the case of a head of household, and
- \$40,000 in any other case.<sup>65</sup>

The safe harbor amount is the product of:

- \$2,000 times
- The excess (if any) of the number of qualified children taken into account in determining the annual advance amount with respect to months beginning in such taxable year, over the number of qualified children taken into account in determining the credit allowed under this section for such taxable year.<sup>66</sup>

The safe harbor amount is subject to phaseout for taxpayers with income above the applicable income threshold. The safe harbor is reduced by multiplying the safe harbor by the ratio of:

- The excess of the taxpayer's modified adjusted gross income over the applicable income threshold amount as compared to
- The applicable income threshold amount.<sup>67</sup>

## ***Priority of the Advance Payment of the Recovery Rebate***

While the law provides that the IRS is to establish this program as soon as practicable, the IRS is ordered to first insure that the timing of setting up this program does not interfere with the payment of the advances on the 2021 recovery rebates under IRC §6428B(g).<sup>68</sup>

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<sup>64</sup> IRC §24(j)(2)(B)(i)

<sup>65</sup> IRC §24(j)(2)(B)(iii)

<sup>66</sup> IRC §24(j)(2)(B)(iv)

<sup>67</sup> IRC §24(j)(2)(B)(ii)

<sup>68</sup> American Rescue Plan Act of 2021 §9611(c)(2)

## EARNED INCOME TAX CREDIT CHANGES

ARPA makes a number of changes to the earned income tax credit under IRC §32.

### Expansion of Credit for Taxpayers With No Qualifying Children

Prior to ARPA, a taxpayer who had no qualifying children had to have attained age 25 but not attained age 65 before the end of the taxable year to potentially be an eligible individual for purposes of the earned income tax credit.<sup>69</sup> However, for 2021 the minimum age will be lowered to:

- Age 24 for a *specified student*;
- Age 18 for a *qualified former foster youth* or a *qualified homeless youth*; and
- Age 19 for all other individuals.<sup>70</sup>

A *specified student* for 2021 is an individual who was an eligible student during at least 5 calendar months during the year.<sup>71</sup> An *eligible student* meets the requirements of section 484(a)(1) of the Higher Education Act of 1965 (20 U.S.C. 1091(a)(1)) and is carrying at least 1/2 the normal full-time work load for the course of study the student is pursuing.<sup>72</sup> The IRS is directed to use information provided with Forms 1098-T to check the status of individuals as specified students.<sup>73</sup>

A *qualified former foster youth* is an individual who:

- On or after the date that such individual attained age 14, was in foster care provided under the supervision or administration of an entity administering (or eligible to administer) a plan under part B or part E of title IV of the Social Security Act (without regard to whether Federal assistance was provided with respect to such child under such part E), and
- Provides (in such manner as the IRS may provide) consent for entities which administer a plan under part B or part E of title IV of the Social Security Act to disclose to the IRS information related to the status of such individual as a qualified former foster youth.<sup>74</sup>

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<sup>69</sup> IRC §32(c)(1)(A)(ii)(II)

<sup>70</sup> IRC §32(n)(1)(B)

<sup>71</sup> IRC §32(n)(1)(C)

<sup>72</sup> IRC §25A(b)(3)

<sup>73</sup> American Rescue Plan Act of 2021 §9621(b)

<sup>74</sup> IRC §32(n)(1)(D)

A *qualified homeless youth* means, with respect to 2021, an individual who certifies, in a manner as provided by the IRS, that such individual is either an unaccompanied youth who is a homeless child or youth, or is unaccompanied, at risk of homelessness, and self-supporting.<sup>75</sup>

The maximum age of 65 will also be eliminated for 2021.<sup>76</sup>

The credit percentage and phaseout percentage for a taxpayer with no qualifying children will rise in 2021 from 7.65% to 15.3%.<sup>77</sup>

Similarly, the earned income for an individual with no qualifying children will rise from \$4,220 to \$9,820 for 2021. The phaseout amount for 2021 for an individual with no qualifying children will rise from \$5,280 to \$11,610.<sup>78</sup> These dollar amounts are exempted from the inflation adjustment found at IRC §32(j).<sup>79</sup>

## **Repeal of Complete Bar on Claiming of the EITC by Individuals Who Do Not Include the TIN of Any Qualifying Child**

Under the law prior to ARPA, no EITC was allowed to any individual who had one or more qualifying children if no qualifying child of such individual is taken into account due to a failure to provide an identification number.<sup>80</sup>

The provision is permanently removed from the law effective for years beginning after December 31, 2020.<sup>81</sup>

## **EITC Available to Certain Separated Spouses**

Under the law prior to ARPA, the EITC could only be claimed if a married couple filed a joint return.<sup>82</sup>

ARPA allows a spouse to be treated as unmarried for purposes of claiming the EITC if three conditions are met. Such a qualified individual:

- Is married for federal tax purposes and does not file a joint return for the taxable year,

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<sup>75</sup> IRC §32(n)(1)(E)

<sup>76</sup> IRC §32(n)(2)

<sup>77</sup> IRC §32(n)(3)

<sup>78</sup> IRC §32(n)(4)(A)

<sup>79</sup> IRC §32(n)(4)(B)

<sup>80</sup> IRC §32(c)(1)

<sup>81</sup> American Rescue Plan Act of 2021 §9622

<sup>82</sup> IRC §32(d) prior to amendment by the American Rescue Plan Act of 2021 §9623

- Resides with a qualifying child of the individual for more than one-half of such taxable year, and
- Either
  - During the last 6 months of such taxable year, does not have the same principal place of abode as the individual’s spouse, or
  - Has a decree, instrument, or agreement (other than a decree of divorce) described in section 121(d)(3)(C) with respect to the individual’s spouse and is not a member of the same household with the individual’s spouse by the end of the taxable year.<sup>83</sup>

The change applies to tax years beginning after December 31, 2020.<sup>84</sup>

### **Modification of Disqualified Investment Income Test**

For taxable years beginning after December 31, 2020 the disqualified investment income amount is increased substantially.

Under prior law, a taxpayer with disqualified investment income of more than \$2,200 was barred from claiming the EITC.<sup>85</sup>

ARPA first boosts that number from \$2,200 to \$10,000.<sup>86</sup> The law then modifies the related inflation adjustment provisions to restart the inflation adjustment for this provision using calendar year 2020 as the base.<sup>87</sup>

This change takes effect for tax years beginning after December 31, 2020.<sup>88</sup>

### **Election to Use 2019 Earned Income in Lieu of 2021 Earned Income for Purposes of the EITC**

If the earned income of the taxpayer for the taxpayer’s first taxable year beginning in 2021 is less than the earned income of the taxpayer for the taxpayer’s first taxable year beginning in 2019, at the election of the taxpayer the EITC may be determined by substituting such earned income for the taxpayer’s first taxable year beginning in 2019 for the first taxable year beginning in 2021.<sup>89</sup>

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<sup>83</sup> IRC §32(d)(2)

<sup>84</sup> American Rescue Plan Act of 2021 §9623

<sup>85</sup> IRC §32(i)(1) prior to amendment by the American Rescue Plan Act of 2021 §9624

<sup>86</sup> IRC §32(i)(1)

<sup>87</sup> IRC §32(j)(1)

<sup>88</sup> American Rescue Plan Act of 2021 §9624(c)

<sup>89</sup> American Rescue Plan Act of 2021 §9626(a)



In the case of a married couple filing a joint return, the earned income used shall both come from 2019 if this election is made.<sup>90</sup>

## **DEPENDENT CARE ASSISTANCE**

A pair of changes are made in dependent care benefits under the IRC for 2021.

### **Refundability and Enhancement of the Child and Dependent Care Credit**

The child and dependent care credit is expanded and made refundable for 2021 by the American Rescue Plan Act of 2021.

If a taxpayer (either spouse in the case of a joint return) has a principal place of abode in the United States for more than one-half of the taxable year in 2021, the child and dependent care credit found at IRC §21 will be treated as a refundable credit.<sup>91</sup>

The maximum dollar amount that can be taken into account for computing the credit is raised in 2021 to:

- \$8,000 from \$3,000 for one qualifying individual and
- \$16,000 from \$6,000 for two or more qualifying individuals.<sup>92</sup>

The credit begins at 50% of the creditable dollar amounts, up from 35% in other years.<sup>93</sup> Under the law in other years, the percentage is reduced by 1% (but not below 20%) for each \$2,000 or fraction thereof that a taxpayer's adjusted gross income exceeded \$15,000. For 2021 that phase down of the rate does not begin until a taxpayer's adjusted gross income exceeds \$150,000.<sup>94</sup>

However, a complete phase-out is added that begins to come in at a 1% reduction in rate for each \$2,000 or fraction thereof by which a taxpayer's adjusted gross income exceeds \$400,000.<sup>95</sup> Thus, the credit will phase out entirely when a taxpayer's adjusted gross income exceeds \$438,000.

These rules apply solely to tax years beginning after December 31, 2020 and before January 1, 2022.<sup>96</sup>

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<sup>90</sup> American Rescue Plan Act of 2021 §9626(b)

<sup>91</sup> IRC §21(g)(1)

<sup>92</sup> IRC §21(g)(2)(

<sup>93</sup> IRC §21(g)(3)(A)

<sup>94</sup> IRC §21(g)(3)(B)

<sup>95</sup> IRC §21(g)(4)(

<sup>96</sup> IRC §21(g)

## Exclusion for Employer-Provided Dependent Care

For taxable years beginning after December 31, 2020 and before January 1, 2022 (generally calendar year 2021), the maximum amount that can be excluded from an employee's compensation under IRC §129(a)(2) is:

- \$10,500 except for
- Married individuals filing a separate return where the maximum exclusion is reduced to \$5,250.<sup>97</sup>

Dependent care and affected cafeteria plans are allowed to operate consistent with these rules so long as a retroactive amendment implementing this provision is adopted by no later than the last day of the plan year where the amendment is effective.<sup>98</sup>

## CREDITS FOR SICK AND FAMILY LEAVE

A new subchapter (D – Credits) is added to Chapter 21 of the Internal Revenue Code. This new subchapter is home to the payroll tax credits for paid sick leave and paid family leave.<sup>99</sup>

### Credit for Paid Sick Leave

ARPA has extended the refundable payroll tax credit for paid sick leave that first appeared in the Families First Coronavirus Relief Act, adding IRC §3131 to take over for what had previously existed only as a provision in the various bills.

The credit is equal to 100% of qualified sick leave wages paid to employees, subject to certain maximums.<sup>100</sup>

### *Limit on Qualified Sick Leave Wages*

The amount of qualified sick leave wages plus any increases for *certain collectively bargained agreements*, with respect to any individual shall not exceed:

- \$511 per day for the initial three categories provided below (items that directly affect the employee) and
- \$200 per day for the final three categories (primarily those impacting others)

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<sup>97</sup> IRC §129(a)(2)(D)

<sup>98</sup> American Rescue Plan Act of 2021 §9632(c)

<sup>99</sup> American Rescue Plan Act of 2021 §9641(a)

<sup>100</sup> IRC §3131(a)

for any day (or portion thereof) for which the individual is paid qualified sick leave wages.<sup>101</sup>

The new law will modify the maximum allowed leave limitation under this credit, resetting the limits for the last three quarters of 2021 and for each year afterward.<sup>102</sup> The duration of the paid sick time is

- 80 hours for full-time employees and,
- For part-time employees, equal to the average hours that employee works over a two-week period.<sup>103</sup>

Thus, the law provides that the aggregate number of days taken into account for any calendar quarter shall not exceed the excess (if any) of:

- 10, over
- The aggregate number of days so taken into account during preceding calendar quarters in such calendar year (other than the first quarter of calendar year 2021).<sup>104</sup>

### ***Qualified Sick Leave***

Qualified sick leave wages are wages paid by an employer that meet one of the conditions that would have mandated the provision of paid sick leave in Section 5102(a) of the Emergency Paid Sick Leave Act (as modified by IRC §3131(c)(2)(A)(i)):

- The employee is subject to a Federal, State, or local quarantine or isolation order related to COVID-19.
- The employee has been advised by a health care provider to self-quarantine due to concerns related to COVID-19.
- Any of the following apply to the employee
  - The employee is experiencing symptoms of COVID-19 and seeking a medical diagnosis,<sup>105</sup>
  - The employee is seeking or awaiting the results of a diagnostic test for, or a medical diagnosis of, COVID-19 and such employee has been exposed to COVID-19 or the employee's employer has requested such test or diagnosis, or

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<sup>101</sup> IRC §3131(b)(1)

<sup>102</sup> IRC §3131(c)(2)(A)(ii)

<sup>103</sup> HR 6201, Act Section 5102(b)(1)

<sup>104</sup> IRC §3131(b)(2)

<sup>105</sup> Section 5102(a) of the Emergency Paid Sick Leave Act

- The employee is obtaining immunization related to COVID–19 or recovering from any injury, disability, illness, or condition related to such immunization.<sup>106</sup>

*Note that the last two options for paid leave do not take effect until quarters beginning after March 31, 2021, so employers offering paid leave for those obtaining a vaccine will not be reimbursed for anyone receiving such leave before April.*<sup>107</sup>

- The employee is caring for an individual:
  - Who is subject to Federal, State, or local quarantine or isolation order related to COVID–19 or
  - Who has been advised by a health care provider to self-quarantine due to concerns related to COVID–19
- The employee is caring for a son or daughter of such employee if the school or place of care of the son or daughter has been closed, or the child care provider of such son or daughter is unavailable, due to COVID–19 precautions.
- The employee is experiencing any other substantially similar condition specified by the Secretary of Health and Human Services in consultation with the Secretary of the Treasury and the Secretary of Labor.<sup>108</sup>

### ***Additional Requirements for Sick Leave to Qualify***

To obtain the credit, the sick leave offered by the employer must meet all of the requirements generally found for the paid leave in the Emergency Paid Sick Leave Act. If an employer retaliates against employees for taking such leave, filing a complaint or taking any action related to such leave, then the employer will be treated as failing to meet the requirements and the credit will be disallowed.

Similarly, a nondiscrimination rule applies for such a leave program to qualify for the credit. No credit is allowed to an employer for any quarter if the employer with respect to the availability of the provision of qualified sick leave wages to which this section otherwise applies for such calendar quarter, discriminates in favor of highly compensated employees (within the meaning of IRC §414(q)), full-time employees, or employees on the basis of employment tenure with such employer.<sup>109</sup>

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<sup>106</sup> IRC §3131(c)(2)(A)(i)

<sup>107</sup> American Rescue Plan Act of 2021 §9641(d)

<sup>108</sup> IRC §3131(c)(2)(A)(i)

<sup>109</sup> IRC §3131(j)

## ***Certain Health Plan Expenses***

Certain health care expenses paid by an employer for an employee on qualified paid leave are treated as eligible for the credit as well.<sup>110</sup>

*Qualified health plan expenses* for this purpose are amounts paid or incurred by the employer to provide and maintain a group health plan (as defined in IRC §5000(b)(1)), but only to the extent that such amounts are excluded from the gross income of employees by reason of IRC §106(a).<sup>111</sup>

The IRS is directed to provide regulations to determine how qualified health care expenses are to be allocated to qualified wages. Unless such regulations provide otherwise, such allocation shall be treated as properly made if made on the basis of being pro rata among covered employees and pro rata on the basis of periods of coverage (relative to the time periods of leave to which such wages relate).<sup>112</sup>

## ***Credit for Amounts Under Certain Collectively Bargained Agreements***

The credit will be increased by the sum of:

- So much of the employer's collectively bargained defined benefit pension plan contributions as are properly allocable to the qualified sick leave wages for which such credit is so allowed, plus
- So much of the employer's collectively bargained apprenticeship program contributions as are properly allocable to the qualified sick leave wages for which such credit is so allowed.<sup>113</sup>

### ***Collectively Bargained Defined Benefit Pension Plan Contribution***

A *collectively bargained defined benefit pension plan contribution* means, with respect to any calendar quarter, contributions which:

- Are paid or incurred by an employer during the calendar quarter on behalf of its employees to a defined benefit plan (as defined in IRC §414(j)), which meets the requirements of IRC §401(a),
- Are made based on a *pension contribution rate*, and

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<sup>110</sup> IRC §3131(d)(1)

<sup>111</sup> IRC §3131(d)(2)

<sup>112</sup> IRC §3131(d)(3)

<sup>113</sup> IRC §3131(e)(1)

- Are required to be made pursuant to the terms of a collective bargaining agreement in effect with respect to such calendar quarter.<sup>114</sup>

A *pension contribution rate* means the contribution rate that the employer is obligated to pay on behalf of its employees under the terms of a collective bargaining agreement for benefits under a defined benefit plan under such agreement, as such rate is applied to contribution base units.<sup>115</sup>

The amount of such contributions allocated to qualified sick leave wages for any calendar quarter is the product of:

- The pension contribution rate (expressed as an hourly rate), and
- The number of hours for which qualified sick leave wages were provided to employees covered under the collective bargaining during the calendar quarter.<sup>116</sup>

### *Collectively Bargained Apprenticeship Program Contributions*

*Collectively bargained apprenticeship program contributions* are, with respect to any calendar quarter, contributions which:

- Are paid or incurred by an employer on behalf of its employees with respect to the calendar quarter to a registered apprenticeship program,
- Are made based on an *apprenticeship program contribution rate*, and
- Are required to be made pursuant to the terms of a collective bargaining agreement that is in effect with respect to such calendar quarter.<sup>117</sup>

A *registered apprenticeship program* is an apprenticeship registered under the National Apprenticeship Act that meets the requirements found in related regulations.<sup>118</sup>

The *apprenticeship program contribution rate* is the contribution rate the employer is obligated to pay on behalf of its employees under the terms of a collective bargaining agreement for benefits under a registered apprenticeship program under such agreement, as such rate is applied to contribution base units<sup>119</sup>

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<sup>114</sup> IRC §3131(e)(2)(A)

<sup>115</sup> IRC §3131(e)(2)(B)

<sup>116</sup> IRC §3121(e)(2)(C)

<sup>117</sup> IRC §3121(e)(3)(A)

<sup>118</sup> IRC §3121(e)(3)(B)

<sup>119</sup> IRC §3121(e)(3)(C)

The amount of such contributions allocated to qualified sick leave wages for any calendar quarter is the product of:

- The apprenticeship program contribution rate (expressed as an hourly rate), and
- The number of hours for which qualified sick leave wages were provided to employees covered under the collective bargaining agreement during the calendar quarter.<sup>120</sup>

### ***Credit Increased to Cover Certain Employer Payroll Taxes***

The credit is increased by the amount of employer FICA and Medicare taxes imposed under IRC §3132 and by similar taxes imposed under the Railroad Retirement Tax Act by IRC §3221(a).<sup>121</sup>

### ***Credit Included in Taxable Income of the Employer***

The amount of any credit allowed under this provision is included in the gross income of the employer, for the taxable year which includes the last day of any calendar quarter with respect to which a credit is allowed.<sup>122</sup>

Any wages taken into account in determining the credit allowed under this section shall not be taken into account for purposes of determining the credit allowed under sections:

- 45A (Indian employment credit),
- 45P (Employer wage credit for employees who are active duty members of the uniformed services),
- 45S (Employer credit for paid family and medical leave),
- 51 (Work opportunity credit),
- 3132 (Payroll tax credit for paid family leave), and
- 3134 (Employee retention credit for employers subject to closure due to COVID-19).<sup>123</sup>

In the case of any credit allowed under section 2301 of the CARES Act (Employee Retention Credit) or section 41 (Credit for increasing research activities) with respect to wages taken into account for this credit, the credit allowed under this section shall be

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<sup>120</sup> IRC §3121(e)(3)(D)

<sup>121</sup> IRC §3133(a)

<sup>122</sup> IRC §3121(f)(3)

<sup>123</sup> IRC §3121(f)(3)

reduced by the portion of the credit allowed under such section 2301(ERC) or section 41 (research credit) which is attributable to such wages.<sup>124</sup>

### ***Option to Elect Not to Take Qualified Wages into Account***

An employer may elect, in a manner the IRS may prescribe, to not take wages that would qualify for this credit into account to compute the credit.<sup>125</sup>

### ***Extended Period to Assess Tax Under This Provision***

The time period for the IRS to assess taxes related to this provision will not expire before five years from the date that is the later of:

- The date on which the original return which includes the calendar quarter with respect to which such credit is determined is filed, or
- The date on which such return is treated as filed under IRC §6501(b)(2) (April 15 of the calendar year following the year in which the wage was paid if the payroll tax return is filed before that date).<sup>126</sup>

### ***Coordination with Other COVID Relief Programs***

The credit does not apply to so much of qualified sick leave wages taken into account as payroll costs in connection with

- A covered loan under section 7(a)(37) (second draw PPP loan) or 7A (first draw PPP loan) of the Small Business Act (the IRS will issue guidance for cases where such forgiveness is denied),<sup>127</sup>
- A grant under the Shuttered Venue Operation Grant (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 American Rescue Plan Act of 2021.<sup>128</sup>

### ***Period Over Which the Provision Applies***

The credit applies only to wages paid with respect to the period from:

- April 1, 2021 to

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<sup>124</sup> IRC §3121(f)(3)

<sup>125</sup> IRC §3121(f)(4)

<sup>126</sup> IRC §3121(f)(6)

<sup>127</sup> IRC §3131(f)(6)(B)

<sup>128</sup> IRC §3131(f)(6)(A)



- September 30, 2021.<sup>129</sup>

A somewhat different version of this credit (COVID-related Tax Relief Act of 2020 §286) that applied to fewer classes of wages applies to wages paid through March 31, 2021. A key difference is that leave paid for the following reasons will not qualify for the credit before April 1:

- An employee's paid time off to get a COVID-19 diagnosis when not displaying symptoms, but after being exposed or when the employer requests such a diagnosis and
- An employee's paid time off to obtain a COVID-19 vaccine or recovering from any injury, disability, illness, or condition related to such immunization.

### **Qualified Family Leave Wages**

ARPA also contains an expansion of the credit for qualified family leave wages. The program works in a very similar fashion to the credit for paid sick leave, except that it goes on for a longer period.

The credit is 100% of *qualified family leave wages* paid by an employer during a calendar quarter.<sup>130</sup> The credit applies first against certain payroll taxes, but any excess credit is refundable.<sup>131</sup>

The credit applies to wages paid with respect to the period:

- Beginning on April 1, 2021 and
- Ending on September 30, 2021.<sup>132</sup>

### ***Maximum Wages Taken Into Account***

The amount of *qualified family leave wages* taken into account in computing the credit for each individual is limited to:

- For any day (or portion thereof) for which the individual is paid *qualified family leave wages*, \$200, and
- In the aggregate with respect to all calendar quarters, \$12,000.<sup>133</sup>

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<sup>129</sup> IRC §3131(h)

<sup>130</sup> IRC §3132(a)

<sup>131</sup> IRC §3132(b)(3)

<sup>132</sup> IRC §3132(h)

<sup>133</sup> IRC §3132(b)(1)

Unlike the original program, for this credit the first 10 days of such leave is no longer unpaid,<sup>134</sup> thus the reason for allowing the maximum amount to grow to \$12,000.

### ***Qualified Family Leave Wages***

*Qualified family leave wages* are wages that would have been required to have been paid by reason of the Emergency Family and Medical Leave Expansion Act if that Act had applied after March 31, 2021. However, the category of what would have been required wages is modified, so that now such wages include up to 12 weeks of leave if the employee is unable to work or telework:

- Due to a need for leave to care for the son or daughter under 18 years of age of such employee if
  - The school or place of care has been closed, or
  - The child care provider of such son or daughter is unavailable, due to a public health emergency, *or*
- The employee is seeking or awaiting the results of a diagnostic test for, or a medical diagnosis of, COVID–19 and such employee has been exposed to COVID–19 or the employee’s employer has requested such test or diagnosis, or
- The employee is obtaining immunization related to COVID–19 or recovering from any injury, disability, illness, or condition related to such immunization.<sup>135</sup>

### ***Credit Increased to Cover Certain Employer Payroll Taxes***

The credit is increased by the amount of employer FICA and Medicare taxes imposed under IRC §3132 and by similar taxes imposed under the Railroad Retirement Tax Act by IRC §3221(a).<sup>136</sup>

### ***Rules Similar to Those For the Paid Family Leave Credit***

Similar rules to those found for the family leave credit apply for:

- The leave must meet all requirements of the Family and Medical Leave Act of 1993 or the Emergency Family and Medical Leave Expansion Act,<sup>137</sup>

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<sup>134</sup> IRC §3132(c)(2)(B)

<sup>135</sup> IRC §3132(c)(2)(A), Section 110(a)(2)(A) of the Family and Medical Leave Act of 1993

<sup>136</sup> IRC §3133(a)

<sup>137</sup> IRC §3132(c)(2)(B)

- The leave program cannot discriminate in favor of highly compensated employees, full time employees or employees on basis of tenure,<sup>138</sup>
- Treatment of certain health care expenses as eligible for the credit,<sup>139</sup>
- Allowance of the credit for certain amounts paid under:
  - The employer’s collectively bargained defined benefit pension plan and
  - The employer’s collectively bargained apprenticeship program,<sup>140</sup>
- Denial of double benefits for certain wage based tax credit programs, the employee retention credit and the research credit,<sup>141</sup>
- An extended five year statute of limitations on assessments of taxes,<sup>142</sup> and
- A bar on using wages that are taken into account as payroll costs under PPP loans, shuttered venue operator grants and restaurant revitalization program grants.<sup>143</sup>

### **Credit for Sick Leave for Certain Self-Employed Persons**

A refundable credit<sup>144</sup> similar to the credit for paid sick leave is available for self-employed. The credit only covers days during the period:

- Beginning on April 1, 2021 and
- Ending on September 30, 2021.<sup>145</sup>

### ***Qualification as a Self-Employed Individual***

In order to claim this credit, the individual must be an individual who:

- Regularly carries on any trade or business within the meaning of IRC §1402 (the definition of income from self-employment) of the Internal Revenue Code of 1986, and

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<sup>138</sup> IRC §3132(j)

<sup>139</sup> IRC §3132(d)

<sup>140</sup> IRC §3132(e)

<sup>141</sup> IRC §3132(f)(3)

<sup>142</sup> IRC §3132(f)(6)

<sup>143</sup> IRC §3132(f)(7)

<sup>144</sup> American Rescue Plan Act of 2021 §9642(d)

<sup>145</sup> American Rescue Plan Act of 2021 §9642(f)

- Would be entitled to receive paid leave during the taxable year pursuant to the Emergency Paid Sick Leave Act if—
  - The individual were an employee of an employer (other than himself or herself), and
  - Such Act applied after March 31, 2021.<sup>146</sup>

The law provides that no credit will be allowed unless the taxpayer maintains such documentation as the IRS may prescribe to establish such individual as an eligible self-employed individual.<sup>147</sup> The mandatory documentation standard bars the taxpayer from trying to argue for qualification based on the argument that even lacking the documentation, the taxpayer has reasonably established qualification (*Cohan v. Commissioner*, CA2 (1930) 39 F. 2d 540).

Thus, advisers need to inquire of taxpayers if they have the documentation that the IRS may require in published guidance when they attempt to claim this credit.

### ***Events Qualifying for the Credit***

The same list of situations that qualify for a credit as appear for the payroll tax credit apply here. To be entitled to the credit, an individual must be unable to work or telework due to one of the following issues:

- The individual is subject to a Federal, State, or local quarantine or isolation order related to COVID-19.
- The individual has been advised by a health care provider to self-quarantine due to concerns related to COVID-19.
- Any of the following apply to the employee:
  - The individual is experiencing symptoms of COVID- 19 and seeking a medical diagnosis,<sup>148</sup>
  - The individual is seeking or awaiting the results of a diagnostic test for, or a medical diagnosis of, COVID-19 and such employee has been exposed to COVID-19 or the employee’s employer has requested such test or diagnosis, or

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<sup>146</sup> American Rescue Plan Act of 2021 §9642(b)(1)

<sup>147</sup> American Rescue Plan Act of 2021 §9642(e)(1)

<sup>148</sup> Section 5102(a) of the Emergency Paid Sick Leave Act

- The individual is obtaining immunization related to COVID–19 or recovering from any injury, disability, illness, or condition related to such immunization.<sup>149</sup>

*Note that the last two options for the credit do not take effect until quarters beginning after March 31, 2021, so self-employed individuals obtaining a vaccine will not be given a credit for any time taken to obtain that vaccination before April.*<sup>150</sup>

- The individual is caring for another individual:
  - Who is subject to a Federal, State, or local quarantine or isolation order related to COVID–19 or
  - Who has been advised by a health care provider to self-quarantine due to concerns related to COVID–19
- The individual is caring for a son or daughter of such individual if the school or place of care of the son or daughter has been closed, or the child care provider of such son or daughter is unavailable, due to COVID–19 precautions.
- The individual is experiencing any other substantially similar condition specified by the Secretary of Health and Human Services in consultation with the Secretary of the Treasury and the Secretary of Labor.<sup>151</sup>

### ***Qualified Sick Leave Equivalent Amount***

The amount of the credit is the *qualified sick leave equivalent amount*. That means, with regard to the self-employed individual, an amount equal to:

- The number of days during the taxable year (but not more than 10) that the individual is unable to perform services in any trade or business referred to in section 1402 of the Internal Revenue Code of 1986 for a reason with respect to which such individual would be entitled to receive sick leave if he/she were an employee, multiplied by
- the lesser of—
  - \$200 (\$511 in the case of any day of paid sick time described in the first three general categories), or

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<sup>149</sup> American Rescue Plan Act of 2021 §9642(b)(2)(A)

<sup>150</sup> American Rescue Plan Act of 2021 §9642(f)

<sup>151</sup> American Rescue Plan Act of 2021 §9642(b)(2)(A)

- 67 percent (100 percent in the case of any day of paid sick time described in the first three categories) of the average daily self-employment income of the individual for the taxable year.<sup>152</sup>

*Average daily self-employment income* is an amount equal to:

- The net earnings from self-employment of the individual for the taxable year, divided by
- 260.<sup>153</sup>

At the taxpayer's election, the net self-employment income of the prior year, rather than the current year, may be used in the above calculation.<sup>154</sup>

The taxpayer may elect, in a manner outlined by the IRS, to not take a qualified day into account for this credit.<sup>155</sup>

## **Credit for Family Leave of Self-Employed Individuals**

As with the credit for employees, a similar credit for family leave exists for self-employed individuals.

As with the credit for sick pay, this credit looks to see if the self-employed person, had he/she been employed, would have qualified for the family leave credit that is part of the American Rescue Plan Act of 2021.

The credit only covers days during the period:

- Beginning on April 1, 2021 and
- Ending on September 30, 2021.<sup>156</sup>

### ***Situations Where Family Leave is Available***

To be entitled to the credit, an individual must be unable to work or telework due to one of the following issues:

- Due to a need for leave to care for the son or daughter under 18 years of age of such employee if
  - The school or place of care has been closed, or

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<sup>152</sup> American Rescue Plan Act of 2021 §9643(c)(1)

<sup>153</sup> American Rescue Plan Act of 2021 §9643(c)(1)

<sup>154</sup> American Rescue Plan Act of 2021 §9643(c)(2)

<sup>155</sup> American Rescue Plan Act of 2021 §9643(c)(4)

<sup>156</sup> American Rescue Plan Act of 2021 §9643(f)

- The child care provider of such son or daughter is unavailable, due to a public health emergency, *or*
- The individual is seeking or awaiting the results of a diagnostic test for, or a medical diagnosis of, COVID–19 and such individual has been exposed to COVID–19 or
- The individual is obtaining immunization related to COVID–19 or recovering from any injury, disability, illness, or condition related to such immunization.<sup>157</sup>

The need to have 10 days of “unpaid” family leave days is also removed from the credit.<sup>158</sup>

### ***Qualified Family Leave Equivalent Amount***

The credit is equal to the self-employed person’s *qualified family leave equivalent amount*. That is defined as an amount equal to:

- The number of days (not to exceed 60) during the taxable year that the individual is unable to perform services in any trade or business referred to in section 1402 of the Internal Revenue Code of 1986 for a reason with respect to which such individual would be entitled to receive paid family leave, multiplied by
- The lesser of:
  - 67 percent of the average daily self-employment income of the individual for the taxable year, or
  - \$200.<sup>159</sup>

*Average daily self-employment income* is an amount equal to:

- The net earnings from self-employment of the individual for the taxable year, divided by
- 260.<sup>160</sup>

At the taxpayer’s election, the net self-employment income of the prior year, rather than the current year, may be used in the above calculation.<sup>161</sup>

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<sup>157</sup> American Rescue Plan Act of 2021 §9643(b)(2)(A), Section 110(a)(2)(A) of the Family and Medical Leave Act of 1993

<sup>158</sup> American Rescue Plan Act of 2021 §9643(b)(2)(B)(ii)

<sup>159</sup> American Rescue Plan Act of 2021 §9643(c)(1)

<sup>160</sup> American Rescue Plan Act of 2021 §9643(c)(2)

<sup>161</sup> American Rescue Plan Act of 2021 §9643(c)(3)

A day taken into account as qualified sick leave is not taken into account in determining the qualified family leave equivalent amount.<sup>162</sup>

## **EXTENSION OF THE EMPLOYEE RETENTION CREDIT**

ARPA extends the refundable employee retention credit, adding another set of new provisions for the credit that will take effect on July 1, 2021.<sup>163</sup> The credit is extended from July 1, 2021 to December 31, 2021.<sup>164</sup>

The credit is equal to 70% of qualified wages paid by an employer with respect to each employee of the employer for the calendar quarter.<sup>165</sup> Qualified wages includes amounts paid by the employer to provide and maintain a group health plan, but only to the extent such amounts are excluded from the wages of the employee by IRC §106(a).<sup>166</sup>

Such health care costs shall be treated as paid with respect to any employee (and with respect to any period) to the extent that such amounts are properly allocable to such employee (and to such period) in such manner as the IRS may prescribe. Except as otherwise provided by the IRS, such allocation shall be treated as properly made if made on the basis of being pro rata among periods of coverage.<sup>167</sup>

Generally, the credit is not available to the Government of the United States, the government of any State or political subdivision thereof, or any agency or instrumentality of any of those entities.<sup>168</sup> However, the law contains exceptions if the entity in question:

- Qualifies under IRC §501(c)(1) and is exempt from tax under IRC §501(a) or
- Such a governmental entity is:
  - A college or university or
  - The principal purpose or function of such entity is providing medical or hospital care.<sup>169</sup>

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<sup>162</sup> American Rescue Plan Act of 2021 §9643(c)(4)

<sup>163</sup> American Rescue Plan Act of 2021 §9651(d)

<sup>164</sup> IRC §3131(n)

<sup>165</sup> IRC §3134(a)

<sup>166</sup> IRC §3134(c)(4)(B)(i)

<sup>167</sup> IRC §3134(c)(4)(B)(ii)

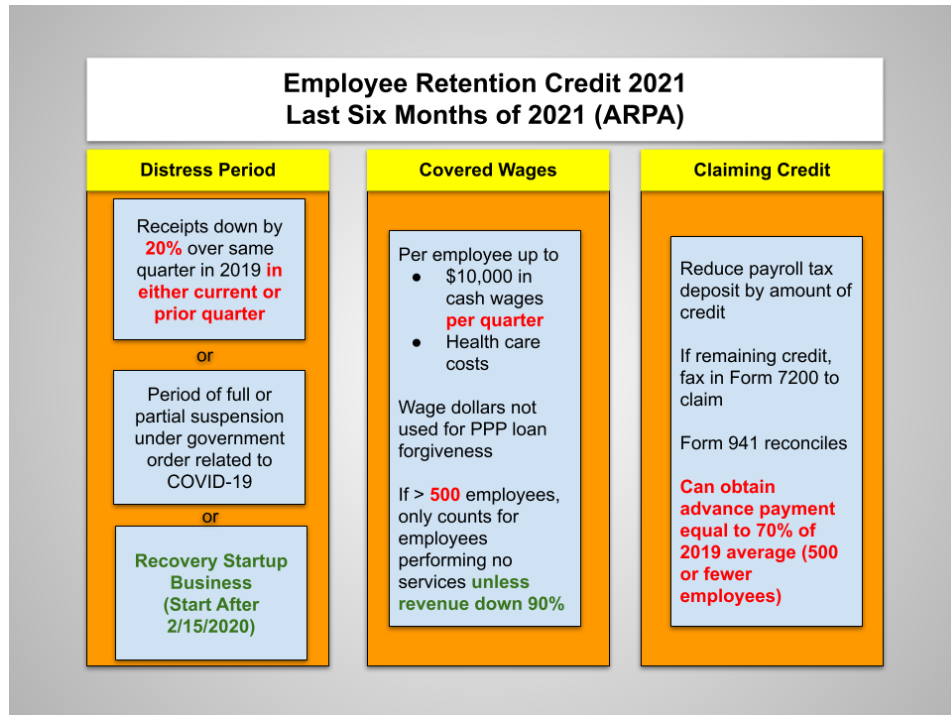
<sup>168</sup> IRC §3134(f)(1)

<sup>169</sup> IRC §3134(f)(2)



## Illustration of Second Half of 2021 Employee Retention Credit

The chart below summarizes the revisions found in the second 2021 version of the employee retention credit that takes effect on July 1, 2021.



### Limit on Wages Taken Into Account

The law provides the following limits on wages taken into account in computing the credit:

- The amount of qualified wages with respect to any employee which may be taken into account for the credit by the eligible employer for any calendar quarter shall not exceed \$10,000, and
- In the case of an eligible employer which is a *recovery startup business*, the amount of the credit allowed (after application of the \$10,000 of wages per employee limit) for any calendar quarter shall not exceed \$50,000.<sup>170</sup>

<sup>170</sup> IRC §3134(b)(1)

## Eligible Employer

An eligible employer is any employer:

- Which was carrying on a trade or business during the calendar quarter for which the credit is determined, and
- With respect to any calendar quarter, for which:
  - The operation of the trade or business is fully or partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to the coronavirus disease 2019 (COVID–19),
  - The gross receipts (within the meaning of section 448(c) (the small business cash basis accounting method eligibility receipts test) of such employer for such calendar quarter are less than 80 percent of the gross receipts of such employer for the same calendar quarter in calendar year 2019 (If an employer was not in existence as of the beginning of the quarter in question in 2019, the quarter in 2020 will be used instead)<sup>171</sup>, or
  - the employer is a recovery startup business.<sup>172</sup>

The employer may also elect to use an alternate quarter by applying the 80% revenue test on the immediately preceding quarter<sup>173</sup> and then comparing that quarter with the corresponding quarter in 2019 (or 2020 if appropriate).<sup>174</sup>

The election is to be made at such time and in such manner as the IRS may prescribe.<sup>175</sup>

## Tax-Exempt Organizations

For a tax-exempt organization the test is changed slightly, being an eligible employer by

- Applying the entire operations of the organization to the trade or business references in the main definition and
- Treating any reference to gross receipts as referring to such gross receipts within the meaning of IRC §6033.<sup>176</sup>

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<sup>171</sup> IRC §3134(c)(2)(A)

<sup>172</sup> IRC §3134(c)(2)(A)

<sup>173</sup> IRC §3134(c)(2)(B)(i)(I)

<sup>174</sup> IRC §3134(c)(2)(B)(i)(II), (ii)

<sup>175</sup> IRC §3134(c)(2)(B)

<sup>176</sup> IRC §3134(c)(2)(C)

## Recovery Start-Up Businesses

A new addition to the ERC found in ARPA is the category of *recovery start-up business*. A *recovery startup business* is any employer:

- Which began carrying on any trade or business after February 15, 2020 (previously such employers could not qualify for the ERC),
- 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 credit is determined does not exceed \$1,000,000, and
- Which, with respect to such calendar quarter, is not described in subclause (I) (full or partial suspension) or (II) (reduction of revenue).<sup>177</sup>

Note that the new ERC found at IRC §3134 no longer requires a business to be in existence on February 15, 2020, so a business started after that date can qualify under one of the two qualification methods that were in the pre-July 1, 2021 ERC. If an otherwise qualified *recovery startup business* meets either of those tests, it is treated under those provisions.

## Qualified Wages

As was true in the 2021 version of the Employee Retention Credit found in the Taxpayer Certainty and Disaster Relief Act of 2020 §207, the ARPA post-June 30, 2021 version of the ERC generally greatly limits the wages that count for an employer who had more than 500 employees in 2019.

In general, the rule reads as follows:

- In the case of an eligible employer for which the average number of full-time employees (within the meaning of IRC §4980H (the ACA shared responsibility payment provision)) employed by such eligible employer during 2019 was greater than 500, wages paid by such eligible employer with respect to which an employee is not providing services due to a qualified decrease in revenue or a full or partial suspension, or
- In the case of an eligible employer for which the average number of full-time employees (within the meaning of section 4980H) employed by such eligible employer during 2019 was not greater than 500—
  - With respect to an employer operating under a full or partial suspension, wages paid by such eligible employer with respect to an employee during any period of full or partial suspension, or

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<sup>177</sup> IRC §3134(c)(5)

- With respect to an eligible employer with a qualified decrease in revenue, wages paid by such eligible employer with respect to an employee during such quarter.<sup>178</sup>

If an employer was not in existence in 2019, the above rules are applied by substituting 2020 for 2019.<sup>179</sup>

In the new ERC, large employers (those who had more than 500 employees in 2019) can qualify to count all employees (not just those not providing services) for the credit if the business qualifies as a *severely financially distressed employer*.<sup>180</sup>

A *severely financially distressed employer* is an employer with a decrease in revenue of more than 90% rather than more than 20% in the applicable quarter.<sup>181</sup>

## **Exclusion for Certain Wages**

Qualified wages for purposes of the ERC does not include wages taken into account under:

- §41 (Research credit),
- §45A (Indian employment credit),
- §45P (Employer wage credit for employees who are active duty members of the uniformed services),
- §45S (Employer credit for paid family and medical leave),
- §51 (Work opportunity credit),
- §1396 (Empowerment zone employment credit)
- §3131 (Payroll tax credit for sick pay), and
- §3132 (Payroll tax credit for paid family leave).<sup>182</sup>

Similar rules to those found at IRC §280C(a) (related to limits on employment credits) apply as well to situations where credits are being claimed under IRC §§45A(a), 45P(a), 45S(a), 51(a), and 1396(a).<sup>183</sup>

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<sup>178</sup> IRC §3134(c)(3)(A)

<sup>179</sup> IRC §3134(c)(3)(B)

<sup>180</sup> IRC §3134(c)(3)(C)(i)

<sup>181</sup> IRC §3134(c)(3)(C)(ii)

<sup>182</sup> IRC §3134(c)(3)(D)

<sup>183</sup> IRC §3134(e)

## Related Party

One area that has created significant confusion with the earlier versions of the credit is found in IRC §3134(e), specifically the clause that states that rules similar to the rules of IRC §51(i)(1) will apply to this credit.

IRC §51(i)(1) reads as follows:

(1) Related individuals

No wages shall be taken into account under subsection (a) with respect to an individual who—

(A) bears any of the relationships described in subparagraphs (A) through (G) of section 152(d)(2) to the taxpayer, or, if the taxpayer is a corporation, *to an individual who owns, directly or indirectly, more than 50 percent* in value of the outstanding stock of the corporation, or, if the taxpayer is an entity other than a corporation, to any *individual who owns, directly or indirectly, more than 50 percent of the capital and profits interests* in the entity (determined with the application of section 267(c)),

(B) if the taxpayer is an estate or trust, is a grantor, beneficiary, or fiduciary of the estate or trust, or is an individual who bears any of the relationships described in subparagraphs (A) through (G) of section 152(d)(2) to a grantor, beneficiary, or fiduciary of the estate or trust, or

(C) is a dependent (described in section 152(d)(2)(H)) of the taxpayer, or, if the taxpayer is a corporation, of an individual described in subparagraph (A), or, if the taxpayer is an estate or trust, of a grantor, beneficiary, or fiduciary of the estate or trust.

In the FAQ on the IRS website related to the ERC,<sup>184</sup> the IRS provides the following guidance on what parties the above restrictions apply to:

Wages paid to related individuals, as defined by section 51(i)(1) of the Internal Revenue Code (the “Code”), are not taken into account for purposes of the Employee Retention Credit. A related individual is any

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<sup>184</sup> “COVID-19-Related Employee Retention Credits: Determining Qualified Wages FAQs,” Question 59, IRS Website, March 1, 2021, <https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-determining-qualified-wages-faqs> (retrieved March 12, 2021)

employee who has any of the following relationships to the employee's employer who is an individual:

- A child or a descendant of a child;
- A brother, sister, stepbrother, or stepsister;
- The father or mother, or an ancestor of either;
- A stepfather or stepmother;
- A niece or nephew;
- An aunt or uncle;
- A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

In addition, if the Eligible Employer is a corporation, then a related individual is any person that bears a relationship described above with an individual owning, directly or indirectly, more than 50 percent in value of the outstanding stock of the corporation.

If the Eligible Employer is an entity other than a corporation, then a related individual is any person that bears a relationship described above with an individual owning, directly or indirectly, more than 50 percent of the capital and profits interests in the entity.

If the Eligible Employer is an estate or trust, then a related individual includes a grantor, beneficiary, or fiduciary of the estate or trust, or any person that bears a relationship described above with an individual who is a grantor, beneficiary, or fiduciary of the estate or trust.<sup>185</sup>

The problem arises with the highlighted *indirect* ownership issue. Section 51 itself does not define "indirectly", nor do the regulations under the provision, and in various other contexts where it is used it often has special definitions applied. But in most contexts, ownership by close family members is deemed to be such indirect ownership of the stock.

So let's assume that a 100% shareholder of a corporation has a daughter. The law and the IRS guidance makes it very clear that her wages would not qualify, as she is a child of the person who has control of the corporation—holding more than 50% of the stock.

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<sup>185</sup> 185 "COVID-19-Related Employee Retention Credits: Determining Qualified Wages FAQs," Question 59, IRS Website, March 1, 2021

But it also appears that she indirectly owns 100% of the stock. In which case, her parents would be barred from having their wages count as well. And, in almost all cases, a controlling shareholder is going to have some related party that would cause the problem to splash back onto them, making them ineligible—at least if this view is correct.

But, it may be objected, if this is what Congress meant to happen why didn't they simply say more than 50% owners could not qualify for the work opportunity credit under IRC §51—and, now by reference, the ERC? This seems a rather odd way to accomplish this goal, when Congress could easily have simply said that controlling interest holders and those related to the same cannot claim the credit.

But before you get comfortable with that view, be aware that the *Joint Committee on Taxation Technical Explanation of the Protecting Americans From Tax Hikes Act of 2015*, a law that made some changes to the classes that qualified for the work opportunity credit, states rather matter of factly that “[n]o credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity.”<sup>186</sup> The statement is made in such a matter of fact manner that it seems the author believed that was plainly clear to anyone reading the law.

So where does this leave us? Not in a good position. My own reading is that the most plausible reading is that a controlling owner normally cannot qualify for the credit due to the splash back effect where he/she becomes a disqualified person due to the indirect ownership of a party he/she is related to. That position is consistent with the 2015 Joint Committee on Taxation report. And it certainly seems that if anyone is an indirect owner, the daughter of the controlling shareholder would be such a person—and I can't come up with an obvious way to exclude her.

But I'm also terribly uncomfortable with this rather unnecessarily roundabout way that this answer is arrived at, when it would have been simple for Congress to have just said it in the law the way the Joint Committee report worded it. Ultimately, absent specific IRS guidance, this is a matter of professional judgment.

## **Election Not to Take Certain Wages Into Account**

A taxpayer can elect not to take certain wages that otherwise would qualify into account for the ERC at such time and manner as the IRS may prescribe.<sup>187</sup> Such an election would likely be made to allow the wages to be used for another benefit that cannot be claimed on the same wages as those used for the ERC, such as for forgiveness of a Paycheck Protection Program loan.

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<sup>186</sup> *Joint Committee on Taxation Technical Explanation of the Protecting Americans From Tax Hikes Act of 2015*. JCX-144-15, PL 114-113, December 18, 2015, p. 59, <https://www.jct.gov/CMSPages/GetFile.aspx?guid=3f362419-0dfe-4844-8906-d6e090c5b822> (retrieved March 12, 2021)

<sup>187</sup> IRC §3134(g)

## Coordination with Other COVID Relief Programs

The credit does not apply to so much of qualified sick leave wages as are taken into account as payroll costs in connection with:

- A covered loan under section 7(a)(37) (second draw PPP loan) or 7A (first draw PPP loan) of the Small Business Act (the IRS will issue guidance for cases where such forgiveness is denied),<sup>188</sup>
- A grant under the Shuttered Venue Operator Grant (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 American Rescue Plan Act of 2021.<sup>189</sup>

## Advance Payments

A provision added to the ERC for 2021 allowing small employers to elect to obtain an advance payment of the ERC has been extended in ARPA. For these purposes a small employer is one who did not employ more than 500 employees in 2019—larger employers are barred from receiving such payments.<sup>190</sup>

The advance credit is not to exceed 70% of the average quarterly wages paid by the employer in 2019.<sup>191</sup>

Special rules apply to seasonal employers and those not in existence in 2019. For seasonal employers the special provision provides:

In the case of any employer who employs seasonal workers (as defined in section 45R(d)(5)(B)), the employer may elect to apply subparagraph (A) by substituting ‘the wages for the calendar quarter in 2019 which corresponds to the calendar quarter to which the election relates’ for ‘the average quarterly wages paid by the employer in calendar year 2019’.<sup>192</sup>

For employers not in existence in 2019, the above rules shall be applied by substituting 2020 for 2019 as the base period being evaluated for the advance payment amount.<sup>193</sup>

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<sup>188</sup> IRC §3134(h)(2)

<sup>189</sup> IRC §3134(h)(1)

<sup>190</sup> IRC §3134(j)(2)(A)

<sup>191</sup> IRC §3134(j)(2)(A)

<sup>192</sup> IRC §3134(j)(2)(B)

<sup>193</sup> IRC §3134(j)(2)(C)



At the end of the quarter the credit will be reconciled with the advance payments:

- The amount of credit which would be allowed for the quarter shall be reduced (but not below zero) by the aggregate advance payment allowed to the taxpayer. Any failure to so reduce the credit shall be treated as arising out of a mathematical or clerical error and assessed according to the math error rules.
- If the advance payments to a taxpayer for a calendar quarter exceed the credit allowed for the quarter, the tax imposed under section 3111(b) (Medicare tax on the employer) or so much of the tax imposed under section 3221(a) as is attributable to the rate in effect under section 3111(b) (RRTA Medicare tax equivalent) for the calendar quarter shall be increased by the amount of such excess. In effect, the employer pays back the excess.<sup>194</sup>

### **Extended Period to Assess Tax Under This Provision**

The time period for the IRS to assess taxes related to this provision will not expire before five years from the date that is the later of:

- The date on which the original return which includes the calendar quarter with respect to which such credit is determined is filed, or
- The date on which such return is treated as filed under IRC §6501(b)(2).<sup>195</sup>

## **PREMIUM TAX CREDIT REVISIONS**

A number of revisions are being made to the premium tax credit found at IRC §36B.

### **Expansion of Premium Assistance**

ARPA liberalizes the table for premium tax credit amounts, effectively removing the 400% of the poverty line household income limit. The revised table for the *applicable percentage* of household income (used to set the maximum the taxpayer is expected to pay for the applicable second lowest cost silver plan) is reproduced below.

In the case of household income (expressed as a percent of poverty line) within the following income tier:	The initial premium percentage is—	The final premium percentage is—
Up to 150.0 percent	0.0	0.0
150.0 percent up to 200.0 percent	0.0	2.0
200.0 percent up to 250.0 percent	2.0	4.0
250.0 percent up to 300.0 percent	4.0	6.0
300.0 percent up to 400.0 percent	6.0	8.5
400.0 percent and higher	8.5	8.5

<sup>194</sup> IRC §3134(j)(3)

<sup>195</sup> IRC §3134(l)

## **Removal of the Requirement to Repay Excess Advance Payment for 2020**

For a taxable year beginning in 2020, the requirement to repay the excess advance payment of the premium tax credit found at IRC §36B(f)(2) will not apply.<sup>196</sup>

## **Special Rule for Taxpayers Receiving Unemployment in 2021**

If a taxpayer has received or is approved to receive unemployment compensation for any week beginning during 2021, for the taxable year when the week begins:

- Such taxpayer shall be treated as an applicable taxpayer (that is, eligible to claim the premium tax credit), and
- There shall not be taken into account any household income of the taxpayer in excess of 133 percent of the poverty line for a family of the size involved.<sup>197</sup>

Despite this provision, if the taxpayer is married the taxpayer will still be required to file a joint return to be treated as an applicable taxpayer.<sup>198</sup>

The taxpayer will be required to provide a self-attestation of, and documentation that the IRS may require, that demonstrates such receipt or approval of unemployment compensation in order to make use of this provision.<sup>199</sup>

For purposes of applying the test for employer-sponsored minimum coverage under IRC §36B(c)(2)(C)(i)(II) to see if the employer's required contribution exceed the appropriate percentage of income, the 133% of the poverty line rule above will not be applied. The same will be true for the test for affordable coverage for qualified small employer health reimbursement arrangements under IRC §36B(c)(4)(C)(ii).<sup>200</sup>

## **MISCELLANEOUS PROVISIONS**

The tax provisions in ARPA end with a number of miscellaneous provisions.

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<sup>196</sup> IRC §36B(f)(2)(B)(iii)

<sup>197</sup> IRC §36B(g)(1)

<sup>198</sup> IRC §36B(g)(4), (c)(1)(C)

<sup>199</sup> IRC §36B(g)(3)

<sup>200</sup> IRC §36B(g)(4)(B)

## **Repeal of the Election to Allocate Interest, Etc. on a Worldwide Basis**

The election found at IRC §864(f) to allocate interest, etc. on a worldwide basis is repealed effective for tax years beginning after December 31, 2020.<sup>201</sup>

## **Tax Treatment of Targeted EIDL Advances**

ARPA brings the tax treatment of targeted EIDL advances, added by section 331 of the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act into line with the various other federal assistance programs enacted related to COVID-19.

APRA provides that:

- Amounts received from the Small Business Administration in the form of a targeted EIDL advance shall not be included in the gross income of the person that receives such amounts,
- No deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income of the advance,
- In the case of a partnership or S corporation that receives such amounts—
  - Any amount excluded from income from the advance shall be treated as tax exempt income for purposes of sections 705 and 1366 of the Internal Revenue Code of 1986, and
  - The IRS shall prescribe rules for determining a partner’s distributive share of that tax exempt income for purposes of section 705 of the Internal Revenue Code of 1986.<sup>202</sup>

## **Tax Treatment of Restaurant Revitalization Grants**

A new assistance program added by ARPA involves restaurant revitalization grants, and this program got its own similar tax treatment provision. ARPA provides that:

- Amounts received from the Small Business Administration in the form of a restaurant revitalization grant shall not be included in the gross income of the person that receives such amounts,
- No deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income of the grant, and

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<sup>201</sup> American Rescue Plan Act of 2021 §9671

<sup>202</sup> American Rescue Plan Act of 2021 §9672

- In the case of a partnership or S corporation that receives such amounts—
  - Except as otherwise provided by the IRS, any amount excluded from income shall be treated as tax exempt income for purposes of sections 705 and 1366 of the Internal Revenue Code of 1986, and
  - The IRS shall prescribe rules for determining a partner’s distributive share of any such tax exempt income for purposes of section 705 of the Internal Revenue Code of 1986.

## **Modification of Reporting of Third Party Network Transactions**

ARPA will serve to increase the reporting of third-party network transactions by changing the de minimis exception. Under prior law an information return wasn’t required unless:

- The amount which would otherwise be reported exceeds \$20,000, and
- The aggregate number of such transactions exceeds 200.<sup>203</sup>

ARPA revises the de minimis exception to provide that a third party settlement organization shall not be required to report any information with respect to third party network transactions of any participating payee if the amount which would otherwise be reported with respect to such transactions does not exceed \$600.<sup>204</sup>

However, the law is clarified to provide that reporting is not required on transactions that are not for goods or services.<sup>205</sup>

The new provision applies only to transactions after March 11, 2021 for calendar years beginning after December 31, 2021.<sup>206</sup>

## **Exclusion from Income of Certain Student Debt Forgiveness**

ARPA rewrites IRC §108(f)(5), removing the provision that dealt solely with discharges on account of death or disability of such loans and replacing the section with a much broader exclusion. The new rule offers a broad exclusion from income for certain discharges of student debt in 2021 through 2025.

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<sup>203</sup> IRC §6050W(e) prior to amendment by the American Rescue Plan Act of 2021 §9674

<sup>204</sup> IRC §6050W(e) after amendment by the American Rescue Plan Act of 2021 §9674

<sup>205</sup> IRC §6050W(c)(3)

<sup>206</sup> American Rescue Plan Act of 2021 §9674(c)

Under the new provision, gross income does not include income from the discharge (in whole or in part) after December 31, 2020 and before January 1, 2026 of:

- Any loan provided expressly for postsecondary educational expenses, regardless of whether the loan was provided through the educational institution or directly to the borrower, if such loan was made, insured, or guaranteed by—
  - the United States, or an instrumentality or agency thereof,
  - A State, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof, or
  - An eligible educational institution,
- Any private education loan (as defined in section 140(a)(7) of the Truth in Lending Act),
- Any loan made by any educational organization described in section 170(b)(1)(A)(ii) (an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on) if such loan is made—
  - Pursuant to an agreement with the education institution or any private education lender (as defined in section 140(a) of the Truth in Lending Act) under which the funds from which the loan was made were provided to such educational organization,
  - Pursuant to a program of such educational organization which is designed to encourage its students to serve in occupations with unmet needs or in areas with unmet needs and under which the services provided by the students (or former students) are for or under the direction of a governmental unit or an organization described in section 501(c)(3) and exempt from tax under section 501(a), or
- Any loan made by an educational organization described in section 170(b)(1)(A)(ii) (an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on) or by an organization exempt from tax under section 501(a) to refinance a loan to an individual to assist the individual in attending any such educational organization but only if the refinancing loan is pursuant to a program of the refinancing organization which is designed as described in the sub-bullet item immediately above.<sup>207</sup>

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<sup>207</sup> IRC §108(f)(5)

The exclusion will not apply to the discharge of a loan made by an educational institution or made by a private education lender if the discharge is on account of services performed for either such organization or for such private education lender.<sup>208</sup>

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<sup>208</sup> IRC §108(f)(5)

# Unit 2

## The First Two COVID-19 Employee Retention Credits

### LEARNING OBJECTIVES

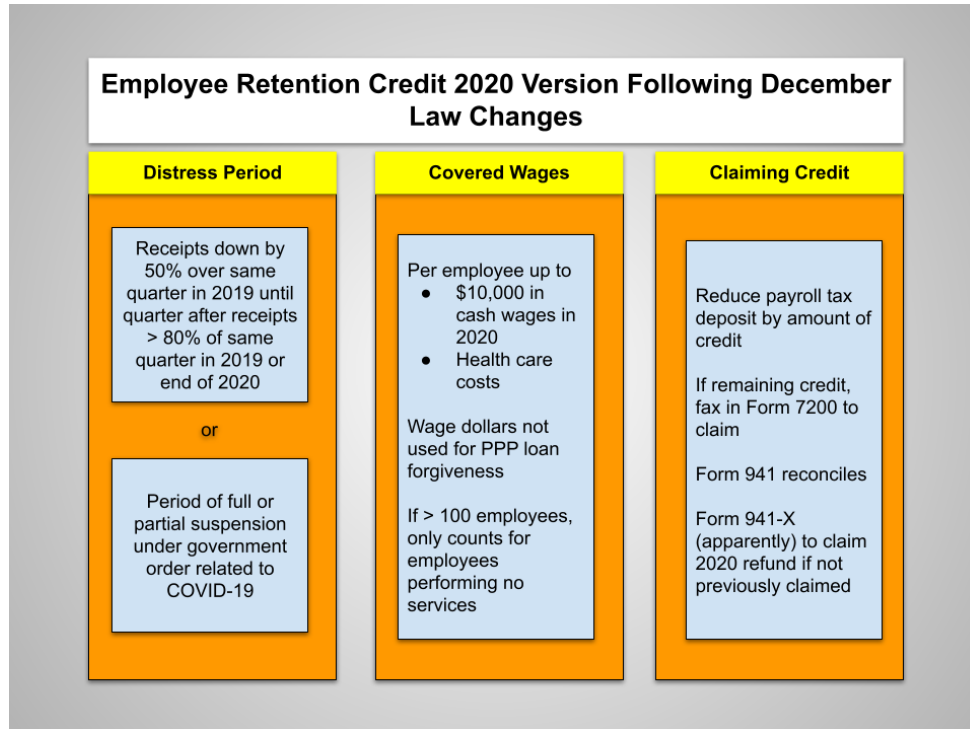
*After completing this unit, participants will be able to:*

- Understand the retroactive revisions made to the employee retention credit for 2020 and identify clients with payroll tax refund opportunities
- Apply guidance given by the IRS in Notice 2021-20 on the interaction of the 2020 employee retention credit and the PPP loan forgiveness process, including helping client maximize their tax credits
- Understand the differences between the 2020 and the early 2021 versions of the employee retention credits and advise clients on dealing with early 2021 version

The employee retention credit (ERC) has been modified since it first appeared as part of 2020's CARES Act. This unit looks at the two COVID-19 pandemic related versions of the ERC that were passed in 2020. A separate ERC for other disasters occurring in 2020 was also added in the Comprehensive Appropriations Act, 2021 which we are not going to discuss and another revision to the COVID-19 pandemic version of the ERC was added in the American Rescue Program Act of 2021 which will discuss in the unit on that bill.

## 2020 VERSION OF THE EMPLOYEE RETENTION CREDIT

The original version of the credit was modified significantly in December. The chart below summarizes the key items in this credit.



### Clarifications and Technical Improvements to CARES Act Employee Retention Credit Effective Retroactive to Enactment of CARES Act (the 2020 ERC Changes)

The *Taxpayer Certainty and Disaster Relief Act of 2020* contains a number of significant changes to the employee retention credit (ERC) found at §2301 of the CARES Act which have retroactive effect, along with a second set that apply for wages paid in 2021. The revisions below, found in §206 of the Act, will apply to 2020 wages (and will continue on along with other changes for 2021 wages).

#### ***Gross Receipts for a Tax Exempt Organization***

The revision clarifies that gross receipts for a tax-exempt organization for the credit will be determined by reference to gross receipts within the meaning of IRC §6033, which is the IRC provision governing returns filed by such exempt organizations.<sup>209</sup>

<sup>209</sup> Taxpayer Certainty and Disaster Relief Act of 2020 §206(a)



## ***Health Care Costs***

The new law rearranges the definitions, treating health care costs as wages, making it clear that such payments by themselves would represent wages even if an employee was not otherwise currently employed by the employer.<sup>210</sup>

## ***Availability for Employers That Obtained PPP and/or PPP2 Loan***

The major change found in the “clarifications and technical improvements” section of the law relates to the interaction of the Paycheck Protection Program (PPP) loans and the ERC. Under the CARES Act, employers who received a Paycheck Protection Program loan were barred from claiming the ERC. Congress has decided to simply block the ability for an employer to both claim the ERC on a payment to the employee and use that same payment as part of the wages used to claim forgiveness of the PPP2 loan.

Congress has removed the provision in the CARES Act that barred an employer who received a Paycheck Protection Program loan from claiming the employee retention credit.<sup>211</sup>

The law provides that any amounts used to claim an ERC cannot be used as payroll costs when claiming forgiveness for either the PPP or PPP2 loan.<sup>212</sup>

In order to enable a business to coordinate between the PPP loan forgiveness and the ERC, the law provides that an employer will be able to elect not to take into account a portion of the wages paid that otherwise would qualify for ERC credit in computing the credit. The law provides that the IRS can prescribe how and when this election is to be made.<sup>213</sup>

As well, the provision provides:

The Secretary, in consultation with the Administrator of the Small Business Administration, shall issue guidance providing that payroll costs paid during the covered period shall not fail to be treated as qualified wages under this section by reason of an election under paragraph (1) to the extent that a covered loan of the eligible employer is not forgiven by reason of a decision under section 7A(g) of the Small Business Act. Terms used in the preceding sentence which are also

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<sup>210</sup> Taxpayer Certainty and Disaster Relief Act of 2020 §206(b)

<sup>211</sup> Removal of CARES Act §2301(j) by Taxpayer Certainty and Disaster Relief Act of 2020 §206(c)(2)

<sup>212</sup> Taxpayer Certainty and Disaster Relief Act of 2020 §206(c)(1) revising SBA §7A(a)(12)

<sup>213</sup> CARES Act §2301(g)(1) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §206(c)(2)(A)

used in section 7A of the Small Business Act shall have the same meaning as when used in such section.<sup>214</sup>

The *Taxpayer Certainty and Disaster Relief Act of 2020* authorizes the IRS to write regulations “to prevent the avoidance of the purposes of the limitations under this section, including through the leaseback of employees.”<sup>215</sup>

### ***IRS Explanation of the Interaction with PPP Loans***

The IRS issued updated guidance for the 2020 version of the employee retention credit in Notice 2021-20,<sup>216</sup> taking into account modifications made to the program by the Taxpayer Certainty and Disaster Tax Relief Act of 2020 signed into law on December 27, 2020.

This guidance is limited to the 2020 version of the ERC, and does not take into account changes that took effect on January 1, 2021. The Notice provides:

The guidance provided in this notice addresses the employee retention credit as it applies to qualified wages paid after March 12, 2020, and before January 1, 2021. This notice does not address the changes made by section 207 of the Relief Act that apply to the employee retention credit for qualified wages paid after December 31, 2020. The Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) will address the modifications made by section 207 of the Relief Act applicable to calendar quarters in 2021 in future guidance.<sup>217</sup>

In a footnote the IRS summarizes these 2021 changes that will be dealt with in future guidance:

Section 207 of the Relief Act makes substantial changes to the employee retention credit that apply to qualified wages paid during the first and second quarter of 2021. Among other changes, section 207 of the Relief Act (1) makes the employee retention credit available for eligible employers paying qualified wages that are paid after December 31, 2020, and before July 1, 2021; (2) increases the maximum credit amount that may be claimed per employee (making it equal to 70 percent of \$10,000 of qualified wages paid to an employee per calendar quarter); (3) expands the category of employers that may be

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<sup>214</sup> CARES Act §2301(g)(2) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §206(c)(2)(A)

<sup>215</sup> Taxpayer Certainty and Disaster Relief Act of 2020 §206(d)

<sup>216</sup> Notice 2021-20, March 1, 2021, <https://www.irs.gov/pub/irs-drop/n-21-20.pdf> (retrieved March 1, 2021)

<sup>217</sup> Notice 2021-20, Section I

entitled to claim the credit; (4) modifies the gross receipts test; (5) modifies the definition of qualified wages; (6) broadens the denial of double benefit rule and applies it to sections 41, 45A, 45P, 51, and 1396 of the Code; and (7) changes the eligibility to receive advance payments and limits the amount of the advances.<sup>218</sup>

### *Update of Original FAQ*

The Notice updates the IRS's FAQ originally published on the ERC, incorporating the information in that FAQ into this Notice.

Following the enactment of the CARES Act, the IRS posted Frequently Asked Questions (FAQs) on IRS.gov to aid taxpayers in calculating and claiming the employee retention credit. As of the publication date of this notice, the FAQs have not been updated to reflect the changes made by the Relief Act. This notice incorporates the information provided in the FAQs and addresses additional issues, including the amendments to section 2301 of the CARES Act made by section 206 of the Relief Act. This notice also identifies instances in which section 206 of the Relief Act made changes to section 2301 of the CARES Act that resulted in rules that are substantially similar to the interpretation provided in the FAQs.<sup>219</sup>

The IRS Notice, continuing the format of the original online FAQ, uses a question and answer format for the guidance. The topics covered and subsections where the specific topic's discussion is found in Section III are:

- A. Eligible Employers
- B. Aggregation Rules
- C. Governmental Orders
- D. Full or Partial Suspension of Trade or Business Operations
- E. Significant Decline in Gross Receipts
- F. Maximum Amount of Employer's Employee Retention Credit
- G. Qualified Wages
- H. Allocable Qualified Health Plan Expenses
- I. Interaction with Paycheck Protection Program (PPP) Loans

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<sup>218</sup> Notice 2021-20, Section I, Footnote 2

<sup>219</sup> Notice 2021-20, Section I

- J. Claiming the Employee Retention Credit
- K. Special Issues for Employees: Income and Deduction
- L. Special Issues for Employers: Income and Deduction
- M. Special Issues for Employers: Use of Third-Party Payers
- N. Substantiation Requirements

In this article we'll look at the most anticipated part of the guidance—how to deal with PPP loans taken out in 2020.

### *Interaction with Paycheck Protection Program (PPP) Loans*

The key change made by the Taxpayer Certainty and Disaster Tax Relief Act of 2020 to the ERC program for 2020 was removing the prohibition on taxpayers claiming the ERC if the taxpayer had obtained a PPP loan, even if none of that loan was forgiven.

Under the modifications found in Section 206 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, taxpayers could claim the ERC even if they took out a PPP loan, but the same wages could not be used to obtain PPP loan forgiveness and claim the ERC credit. A key unanswered question was how borrowers that had already obtained forgiveness would be able to determine wages that were used for forgiveness.

Under the law a taxpayer frees up wages to be used for forgiveness by electing not to use such wages on its employment tax return to obtain the ERC:

Section 2301(g)(1) of the CARES Act, as amended by the Relief Act, permits an eligible employer to elect not to take into account certain qualified wages for purposes of the employee retention credit. An eligible employer generally makes the election by not claiming the employee retention credit for those qualified wages on its federal employment tax return.<sup>220</sup>

However, since employers in 2020 were initially not allowed to claim the credit at all if they obtained a PPP loan, such employers did not claim the credit on any wages. So the IRS, recognizing that fact, has modified the election so it was made when wages were reported as payroll costs on a PPP forgiveness application:

However, an eligible employer that received a PPP loan is deemed to have made the election under section 2301(g)(1) of the CARES Act for those qualified wages included in the amount reported as payroll costs on a Paycheck Protection Program Loan Forgiveness Application (PPP Loan Forgiveness Application).<sup>221</sup>

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<sup>220</sup> Notice 2021-20, Section III.I, Question 49

<sup>221</sup> Notice 2021-20, Section III.I, Question 49

The IRS does recognize that borrowers may very well have listed wages on the application beyond the minimum needed to gain forgiveness of the entire loan, so the agency allows the taxpayer to limit the amount of wages for which the ERC “opt-out” election is made to the minimum necessary to obtain forgiveness based on the *expenses listed on the application filed*:

Specifically, the amount for which the eligible 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 exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. The employee retention credit does not apply to the qualified wages for which the election or deemed election is made.<sup>222</sup>

Similarly, any wages not listed on the PPP forgiveness application are treated as if no election was made to exclude those wages. This would include wages paid outside the covered period for the PPP loan, as well as wages paid in the covered period that are intentionally left off the application.

An eligible employer is not deemed to have made an election for any qualified wages paid by the eligible employer that are not included in the payroll costs reported on the PPP Loan Forgiveness Application.<sup>223</sup>

As well, the Notice provides that if the borrower is only granted partial forgiveness of the PPP loan, the wages for which the deemed election is made is limited to the minimum amount of wages listed on the application necessary to obtain the requested forgiveness:

Notwithstanding a deemed election, if an eligible employer reports any qualified wages as payroll costs on a PPP Loan Forgiveness Application to obtain forgiveness of the PPP loan amount, but the loan amount is not forgiven by reason of a decision under section 7A(g) of the Small Business Act, those qualified wages may subsequently be treated as subject to section 2301 of the CARES Act and may be taken into account for purposes of the employee retention credit. If an eligible employer obtains forgiveness of only a portion of the PPP loan amount, then the employer is deemed to have made an election for the minimum amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application necessary to obtain the forgiveness of that amount of the PPP loan.<sup>224</sup>

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<sup>222</sup> Notice 2021-20, Section III.I, Question 49

<sup>223</sup> Notice 2021-20, Section III.I, Question 49

<sup>224</sup> Notice 2021-20, Section III.I, Question 49

A number of borrowers who applied for forgiveness in 2020 may have opted to only provide payroll costs on the application form when applying for forgiveness. They may (and likely did) incur non-payroll costs that would have also counted towards forgiveness, but decided there was no reason to provide those costs when the borrower incurred more than enough payroll costs to obtain full forgiveness. The time and effort to determine and document those expenses for the forgiveness application appeared to offer no benefit, so many borrowers made the reasonable decision to not do the work to provide that additional information with the application.

While an understandable conclusion given the then existing law, that decision now may not work out well as the Notice looks only to what was provided on the application to determine the amount of ERC eligible wages that were used to obtain forgiveness—not what *could* have been provided in lieu of such expenses to allow a larger ERC to be claimed. Generally, a borrower only needed to spend 60% of the loan proceeds on payroll costs, a category which is made up of certain costs not eligible for the ERC (such as employer contributions to retirement plans), as well as including wages that, themselves, may not have been ERC eligible.

Thus, a borrower with enough non-payroll costs paid during the covered period could, at worst, limit the deemed election wages to 60% of the loan proceeds and, quite often, lower the amount even more by selecting payroll costs that simply aren't ERC eligible at all (retirement plan contributions) and wages that aren't ERC qualified wages to make up as much of that 60% as possible.

But if such costs were not listed on the application, the taxpayer cannot now go back and demonstrate they had incurred such expenses that could have been listed. The IRS looks only to what was listed on the actual application.

**EXAMPLE 1, QUESTION 49, NOTICE 2021-20**

Employer A received a PPP loan of \$100,000. Employer A is an eligible employer and paid \$100,000 in qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. In order to receive forgiveness of the PPP loan in its entirety, Employer A was required, under the Small Business Administration (SBA) rules, to report a total of \$100,000 of payroll costs and other eligible expenses (and a minimum of \$60,000 of payroll costs). Employer A submitted a PPP Loan Forgiveness Application and reported the \$100,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan. Employer A received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$100,000.

Employer A is deemed to have made an election not to take into account \$100,000 of the qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to

support the amount of the PPP loan that is forgiven. It may not treat that amount as qualified wages for purposes of the employee retention credit.

But the IRS does allow that if the borrower listed more in wages on the form than were necessary to obtain forgiveness that the borrower can reduce the deemed election to that minimum necessary. In Example 2 the IRS gives an example of an employer that only listed qualified wages as items to justify forgiveness, but listed all wages paid in the covered period, not just the minimum necessary to obtain forgiveness.

**EXAMPLE 2, QUESTION 49, NOTICE 2021-20**

Employer B received a PPP loan of \$200,000. Employer B is an eligible employer and paid \$250,000 of qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. In order to receive forgiveness of the PPP loan in its entirety, Employer B was required, under the SBA rules, to report a total of \$200,000 of payroll costs and other eligible expenses (and a minimum of \$120,000 of payroll costs). Employer B submitted a PPP Loan Forgiveness Application and reported the \$250,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan. Employer B received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000.

Employer B is deemed to have made an election not to take into account \$200,000 of the qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. It may not treat that amount as qualified wages for purposes of the employee retention credit. Employer B is not treated as making a deemed election with respect to \$50,000 of the qualified wages (\$250,000 reported on the PPP Loan Forgiveness Application, minus \$200,000 reported on the PPP Loan Forgiveness Application up to the amount of the loan that is forgiven), and it may treat that amount as qualified wages for purposes of the employee retention credit.

The third example specifically rejects allowing the borrower who had incurred other expenses qualifying for forgiveness but did not list them on the application from being able to use those expenses *not on the PPP loan forgiveness application* from being used to reduce the deemed election to exclude wages from the ERC credit:

**EXAMPLE 3, QUESTION 49, NOTICE 2021-20**

Employer C received a PPP loan of \$200,000. Employer C is an eligible employer and paid \$200,000 of qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. Employer C also paid other eligible expenses of \$70,000. In order to receive forgiveness of the PPP loan in its entirety, Employer C was required, under the SBA rules, to report a total of \$200,000 of payroll costs and other eligible expenses (and a minimum of \$120,000 of payroll costs). Employer C submitted a PPP Loan Forgiveness Application and reported the \$200,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan, but did not report the other eligible expenses of \$70,000. Employer C received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000.

Employer C is deemed to have made an election not to take into account \$200,000 of qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. Although Employer C could have reported \$70,000 of eligible expenses (other than payroll costs) and \$130,000 of payroll costs, Employer C reported \$200,000 of qualified wages as payroll costs on the PPP Loan Forgiveness Application. As a result, no portion of those qualified wages reported as payroll costs may be treated as qualified wages for purposes of the employee retention credit. Employer C cannot reduce the deemed election by the amount of the other eligible expenses that it could have reported on its PPP Loan Forgiveness Application.

But Example 4 provides that if those non-payroll expenses were listed on the application, even though not required to obtain the full forgiveness, the taxpayer now is able to get credit for those expenses to maximize the ERC eligible wages:

**EXAMPLE 4, QUESTION 49, NOTICE 2021-20**

Same facts as Example 3, except Employer C submitted a PPP Loan Forgiveness Application and reported the \$200,000 of qualified wages as payroll costs, as well as the \$70,000 of other eligible expenses, in support of forgiveness of the PPP loan. Employer C received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000. In this case, Employer C is deemed to have made an election not to take into account \$130,000 of qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with the \$70,000 of other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that was forgiven. As a result, \$70,000 of the qualified wages reported as payroll costs may be treated as qualified wages for purposes of the employee retention credit.

Example 5 illustrates that you cannot use those other non-payroll costs to reduce necessary payroll costs below the 60% of the loan usage requirement for payroll costs—in this case, despite having paid \$90,000 of such costs, the benefit is limited to \$80,000 of freed payroll costs since the borrower must have used 60% of the \$200,000 loan (\$120,000) for payroll costs.

**EXAMPLE 5, QUESTION 49, NOTICE 2021-20**

Same facts as Example 4, except Employer C paid \$90,000 of other eligible expenses, and reported the \$200,000 of qualified wages as payroll costs, as well as the \$90,000 of other eligible expenses, in support of forgiveness of the entire PPP loan. In this case, Employer C is deemed to have made an election not to take into account \$120,000 of qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with the \$90,000 of other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that was forgiven. As a result, \$80,000 of the qualified wages reported as payroll costs may be treated as qualified wages for purposes of the employee retention credit.



Example 6 raises the issue that not all payroll costs are ERC eligible even if not used for PPP loan forgiveness. In a footnote, the IRS provides the following discussion of such expenses:

Employer D may have payroll costs that are not qualified wages for various reasons. For example, Employer D may be a large eligible employer that paid wages to employees who continued to provide services during the period of a partial suspension of business operations.<sup>225</sup>

The example illustrates how these ineligible expenses can be deemed to be used to obtain forgiveness, again increasing wages eligible for use in computing the employee retention credit:

**EXAMPLE 6, QUESTION 49, NOTICE 2021-20**

Employer D received a PPP loan of \$200,000. Employer D is an eligible employer and paid \$150,000 of qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. In addition to the qualified wages, Employer D had \$100,000 of other payroll costs that are not qualified wages and \$70,000 of other eligible expenses. In order to receive forgiveness of the PPP loan in its entirety, Employer D was required, under the SBA rules, to report \$200,000 of payroll costs and other eligible expenses (and a minimum of \$120,000 of payroll costs).

Employer D submitted a PPP Loan Forgiveness Application and reported \$130,000 of payroll costs and \$70,000 of other eligible expenses, in support of forgiveness of the entire PPP loan. Employer D can demonstrate that the payroll costs reported on the PPP Loan Forgiveness Application consist of \$100,000 of payroll costs that are not qualified wages and \$30,000 of payroll costs that are qualified wages. Employer D received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000.

Employer D is deemed to have made an election not to take into account \$30,000 of qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. It may not treat that amount as qualified wages for purposes of the employee retention credit. Employer D is not deemed to have made an election with respect to the \$120,000 of qualified wages that are not included in the payroll costs reported on the PPP Loan Forgiveness Application. Accordingly, Employer D may take into account the \$120,000 of qualified wages (\$150,000 of qualified wages paid minus \$30,000 of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application) for purposes of the employee retention credit.

Example 7 deals with a case where the borrower is denied forgiveness of the loan. In such a case, no deemed election to exclude wages from the ERC is made even though the wages were listed on the application form.

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<sup>225</sup> Notice 2021-20, SECTION III, Footnote 17

### **EXAMPLE 7, QUESTION 49, NOTICE 2021-20**

Same facts as Example 6 except Employer D's PPP loan is not forgiven by reason of a decision under section 7A(g) of the Small Business Act. Employer D may treat the full \$150,000 as qualified wages (the \$30,000 of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application, plus the additional \$120,000 of qualified wages not included in the payroll costs) as qualified wages for purposes of the employee retention credit.

#### *Steps to Be Taken Now*

The guidance provides information both for borrowers who have already applied for and received forgiveness as well as those who have yet to apply. In both cases advisers must carefully consider how to maximize the ERC credit available to the employer.

Borrowers who have already applied for and received forgiveness have less flexibility, but that doesn't mean that care shouldn't be taken to maximize the credit based on what was listed on the forgiveness application.

- A borrower should first determine the minimum wage amount necessary to support the forgiveness obtained. The 60% calculation is a starting point here, since forgiveness can be no more than payroll costs divided by 0.60. Looked at from the other direction, payroll costs used in forgiveness will have to be at least 60% of the forgiveness obtained.
- Consider how many payroll costs listed on the forgiveness application would not be qualified wages for ERC purposes and use those first to meet the required minimum. That includes, among other things:
  - Wages paid by a large employer to employees performing services
  - Wages paid to employees not eligible to be used for ERC purposes due to the related party rules found at IRC §51(i)(1)
  - Payroll costs such as retirement plan costs and payroll taxes paid to state and local governments
  - Wages paid to an employee in excess of the \$10,000 cap on ERC qualified wages for 2020
- After minimizing the ERC qualified wages used to meet the 60% test, determine if the borrower reported sufficient non-payroll costs to have obtained forgiveness if only this minimum amount of ERC qualified wages listed on the PPP application are included as leading to forgiveness
- If the non-payroll expenses are not sufficient, determine the minimum amount of qualified wage costs that need to be treated as expenses leading to forgiveness to obtain the forgiveness granted.

For borrowers who have not yet applied for forgiveness, care should be taken in filling out the PPP forgiveness application to be certain enough in non-ERC costs are included on the application so that only the very minimum amount of ERC wages are deemed used to obtain forgiveness. Thus, borrowers will want to make sure they maximize the use of non-payroll costs in obtaining forgiveness, as well as maximizing the use of non-ERC qualified payroll costs for the minimum payroll costs that must be included in the forgiveness application.

### ***Provisions in This Section Retroactive to Enactment of CARES Act***

These changes are effective as if they had been part of the original CARES Act.<sup>226</sup> This means that many taxpayers who received a PPP loan now will be able to claim an ERC credit for wages paid in 2020. Although the law provided an option to claim the 2020 credit on the fourth quarter 941, IRS guidance on the matter that came out late in January limited this option so that it was not available to most taxpayers

It appears, unless the IRS develops a more streamlined process, that affected taxpayers will need to file Forms 941-X. And, to date, there's been no sign whatsoever that the IRS is working on such a streamlined system.

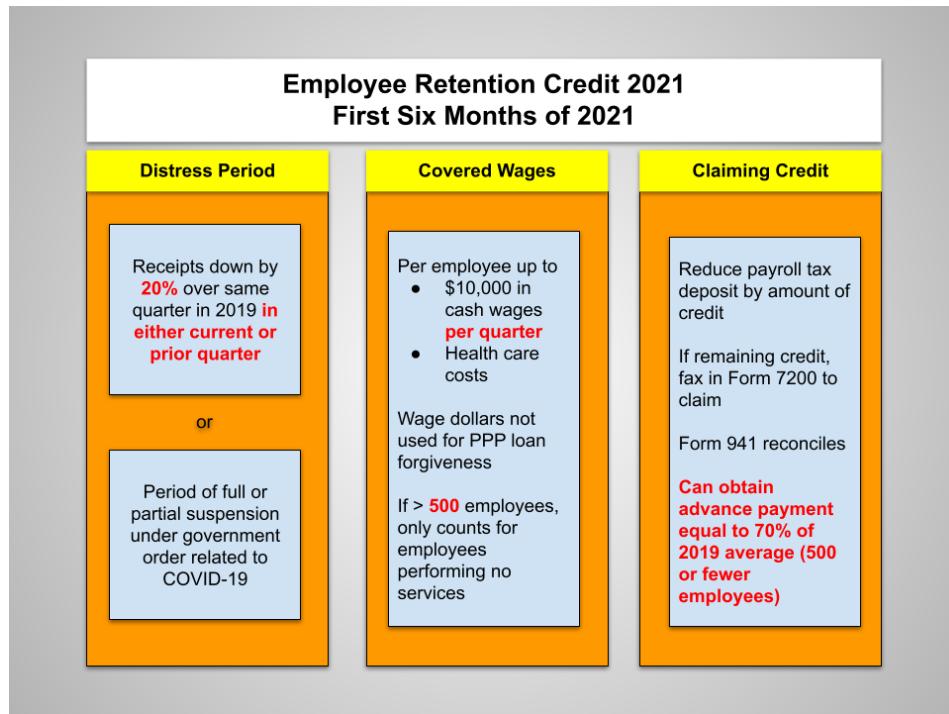
## **2021 VERSION (1<sup>ST</sup> TWO QUARTERS) OF THE EMPLOYEE RETENTION CREDIT**

In 2021 a new version of the credit was added, one that expires after June 30. On that date, more revisions found in the American Rescue Program Act of 2021 described in the unit covering that bill, will take effect.

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<sup>226</sup> Taxpayer Certainty and Disaster Relief Act of 2020 §206(e)(1)

The first half of 2021 employee retention credit is outlined in the following chart.



The first half 2021 changes found in the Consolidated Appropriations Act, 2021 are summarized in the following pages.

## **Extension and Modifications of Employee Retention and Rehiring Tax Credit First Effective in 2021**

The second set of revisions to the original ERC do not take effect until 2021. Note that these apply *in addition* to the modifications that took effect in 2020 that were part of §206 of this Act.

### ***Extension of ERC Program into First Half of 2021***

First, the ending date for the ERC is pushed forward from the fourth quarter of 2020 to the second quarter of 2021.<sup>227</sup>

### ***Increase in the Credit Percentage***

The amount of the credit is also increased from 50% of qualified wages paid to 70% of qualified wages paid beginning with the first quarter of 2021.<sup>228</sup>

<sup>227</sup> CARES Act §2301(m) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(a)(1)

<sup>228</sup> CARES Act §2301(a) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(b)

### ***\$10,000 per Employee Test Applied on a Per Quarter Basis***

In 2021 the per employee wage limit also is modified, no longer limiting the qualified wages per employee to \$10,000 over the lifetime of the ERC to \$10,000 per quarter that the ERC is claimed.<sup>229</sup>

### ***80% Test for Substantial Reduction in Gross Receipts***

The revisions effective in 2021 also make it easier for a taxpayer to qualify for the credit based on a reduction in revenue for a quarter. Under the 2020 version of the ERC, a taxpayer had to show a decrease below 50% of revenue for the same quarter in 2019. In the new version, a quarter where revenue is less than 80% of the revenue for the same quarter in 2019 will begin to qualify a taxpayer for the credit.

However, now each quarter is tested on its own. The prior rule provided that the credit applied until the first quarter *after* the taxpayer's revenues (computed under the rules for §448(c)) were more than 80% of the same period in 2019.<sup>230</sup>

### ***Employers Not in Existence in 2019***

If an employer was not in existence in 2019, the following special rule applies:

With respect to any employer for any calendar quarter, if such employer was not in existence as of the beginning of the same calendar quarter in calendar year 2019, clause (ii)(II) shall be applied by substituting '2020' for '2019'.<sup>231</sup>

Essentially, such taxpayers will begin comparing the quarter in 2021 vs. the quarter in 2020.

### ***Election to Use Prior Quarter for Revenue Testing***

The revised ERC also contains the option to allow an employer to elect to test the decrease in revenue based upon the preceding rather than current calendar quarter.<sup>232</sup> Nothing in the section forces a taxpayer to use this election for both quarters, so it seems to allow the taxpayer the "extra" quarter that resulted from the 2020 ERC rule that allowed a taxpayer to keep using the credit until the quarter after the taxpayer exceeded 80% of revenues in the same quarter in 2019.

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<sup>229</sup> CARES Act §2301(b)(1) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(c)

<sup>230</sup> CARES Act §2301(c)(2)(A)(ii)(II) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(d)(1)(A)

<sup>231</sup> CARES Act §2301(c)(2)(A) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(d)(1)(B)

<sup>232</sup> CARES Act §2301(c)(2)(B) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(d)(2)(A)

The effect of this, though, would be to limit the ability of a taxpayer that had exceeded 80% of 2019's revenue for the fourth quarter in the fourth quarter of 2020 to continue to use the credit unless that taxpayer's first quarter 2021 revenue was less than 80% of the first quarter of 2019.

### ***Certain Governmental Entities Qualify for ERC***

While CARES Act §2301(f) still generally bars governmental entities from receiving the ERC, the new law provides a list of certain governmental entities that will be allowed to receive the ERC in 2021 if they otherwise qualify.

These governmental entities include:

- Any §501(c)(3) organization exempt from tax under IRC §501(a);
- A college or university; and
- An entity where the principal purpose or function of the entity is providing medical or hospital care.<sup>233</sup>

### ***Changes to Computation of Qualified Wages (Increase in Small Business Employee Limit)***

The Act revises the definition of a large employer by raising the number of employees from 100 to 500.<sup>234</sup> Thus, more employers will be able to claim the ERC for wages paid to employees who are performing services for the employer during the periods the employer qualifies for the credit, rather than, as a large employer, only being able to claim the credit for amounts paid to employees performing no services for the employer.

The Act also removes the original limitation that provided that qualified wages for an employee could not exceed the amount the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period.<sup>235</sup>

### ***Double Benefit Rule Simplified***

The Act removes two provisions that 1) denied any credit for any quarter in which the employer claimed the work opportunity credit under IRC §51 and 2) prohibited taking a credit under §45S (credit for paid family or medical leave) for any wages on which the ERC was claimed. They are replaced with a single, broader bar on claiming a double benefit.

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<sup>233</sup> CARES Act §2301(f)(2) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(d)(3)

<sup>234</sup> CARES Act §2301(c)(3)(A) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(e)(1)

<sup>235</sup> Repeal of CARES Act §2301(c)(3)(B)

Any wages taken into account in determining the ERC may not be taken into account in computing a credit under:

- IRC §41 (Credit for increasing research activities);
- IRC §45A (Indian employment credit);
- IRC §45P (Employer wage credit for employees who are active duty members of the uniformed services);
- IRC §45S (Employer credit for paid family and medical leave);
- IRC §51 (Work opportunity credit); and
- IRC §1396 (Empowerment zone employment credit).<sup>236</sup>

### ***Advance Payment of Employee Retention Credit***

A new provision has been added to the ERC by the Act allowing small employers to elect to obtain an advance payment of the ERC. For these purposes a small employer is one who did not employ more than 500 employees in 2019—larger employers are barred from receiving such payments.<sup>237</sup>

The advance credit is not to exceed 70% of the average wages paid by the employer in 2019.<sup>238</sup>

Special rules apply to seasonal employers and those not in existence in 2019. For seasonal employers the special provision provides:

In the case of any employer who employs seasonal workers (as defined in section 45R(d)(5)(B) of the Internal Revenue Code of 1986), the employer may elect to substitute ‘the wages for the calendar quarter in 2019 which corresponds to the calendar quarter to which the election relates’ for ‘the average quarterly wages paid by the employer in calendar year 2019’<sup>239</sup>

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<sup>236</sup> CARES Act §2301(h)(1) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(f)

<sup>237</sup> CARES Act §2301(j)(2)(A) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(g)(1)

<sup>238</sup> CARES Act §2301(j)(2)(A) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(g)(1)

<sup>239</sup> CARES Act §2301(j)(2)(B) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(g)(1)

For employers not in existence in 2019, the above rules shall be applied by substituting 2020 for 2019 as the base period being evaluated for the advance payment amount.<sup>240</sup>

The ERC for the quarter shall be reduced (but not below zero) by the amount of the advance credit. A failure to reduce the credit by the advance payment shall be treated as a mathematical or clerical error under IRC §6213(b)(1).<sup>241</sup>

If an excess advance payment exists for a quarter, the FICA or Railroad Retirement Tax Act tax imposed on the employer shall be increased by the amount of the excess.<sup>242</sup>

### ***Third Party Payors***

The Act provides the following provision related to third party payors (such as certified professional employer organizations):

Any forms, instructions, regulations, or guidance described in paragraph (2) shall require the customer to be responsible for the accounting of the credit and for any liability for 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.<sup>243</sup>

### ***Public Awareness Campaign***

The law requires the IRS to conduct a public awareness campaign in coordination with the Small Business Administration to provide information regarding the availability of the ERC.<sup>244</sup> As part of that campaign the IRS shall

- Provide to all employers which reported not more than 500 employees on the most recently filed return of applicable employment taxes a notice about the credit allowed under this section and the requirements for eligibility to claim the credit,<sup>245</sup> and

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<sup>240</sup> CARES Act §2301(j)(2)(C) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(g)(1)

<sup>241</sup> CARES Act §2301(j)(3)(A) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(g)(1)

<sup>242</sup> CARES Act §2301(j)(3)(B) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(g)(1)

<sup>243</sup> CARES Act §2301(l) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(h)

<sup>244</sup> CARES Act §2301(n)(1) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(i)

<sup>245</sup> CARES Act §2301(n)(2)(A) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(i)



- Not later than 30 days after the date of the enactment of this subsection, provide to all employers educational materials relating to the credit allowed under this section, including specific materials for businesses with not more than 500 employees.<sup>246</sup>

### ***Effective Date - Quarters Beginning in 2021***

A key issue to remember about all changes described in this second ERC section is they only become effective for calendar quarters beginning in 2021.<sup>247</sup> Thus, unlike the first set of changes, none of these changes apply retroactively to quarters back to the enactment of the CARES Act.

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<sup>246</sup> CARES Act §2301(n)(2)(B) as amended by Taxpayer Certainty and Disaster Relief Act of 2020 §207(i)

<sup>247</sup> Taxpayer Certainty and Disaster Relief Act of 2020 §207(k)

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