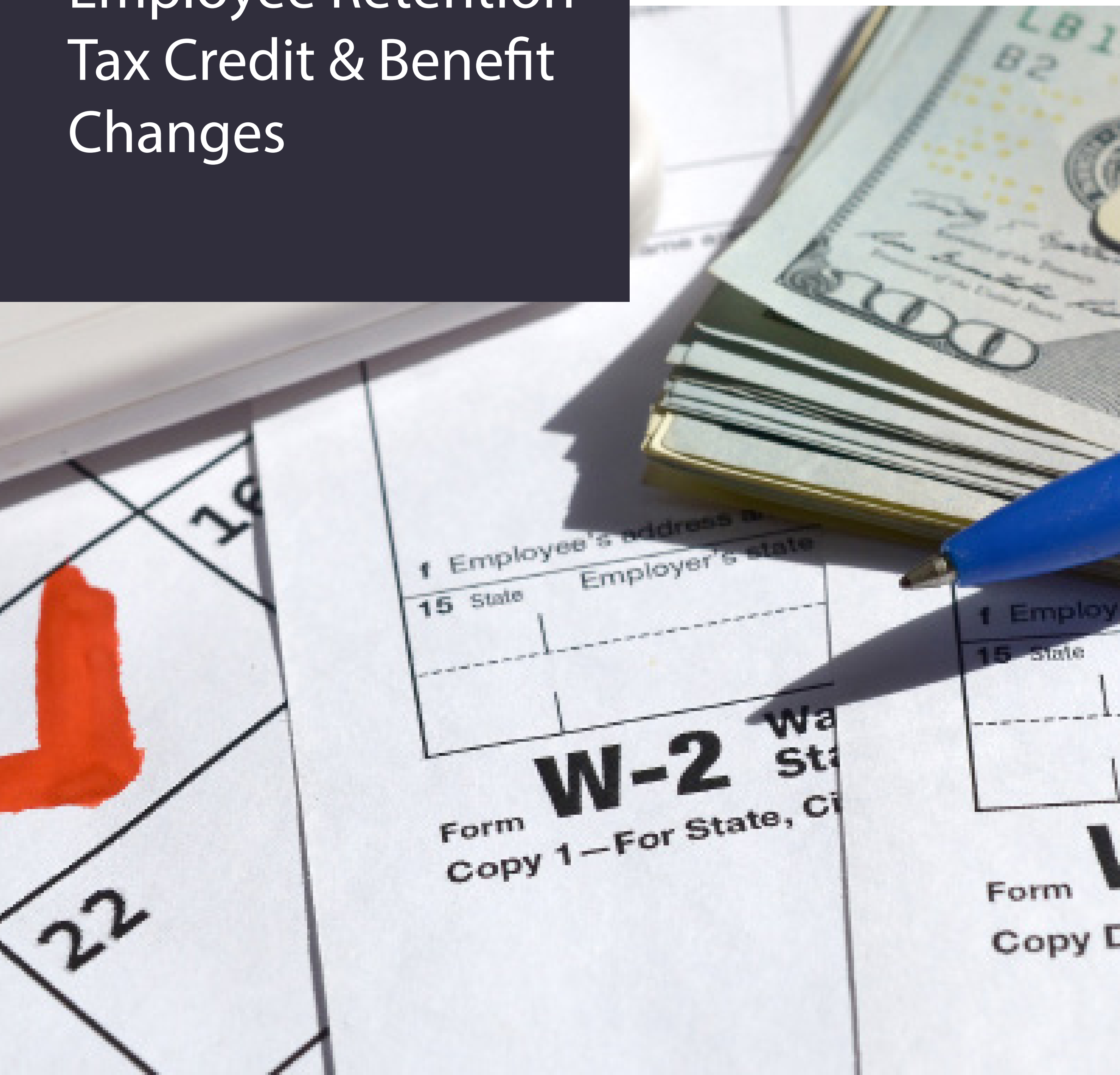
Your Firm LLC

CAA, 2021: Employee Retention Tax Credit & Benefit Changes



The Consolidated Appropriations Act, 2021 was signed into law late last year. This document provides an overview of key changes in regard to employees including the Employee Retention Tax Credit, paid sick and family leave as well as Flexible Spending Accounts or FSAs.

Employee Retention Tax Credit

In March of 2020, the Employee Retention Tax Credit was passed as part of the CARES Act and was intended to help business owners keep their employees during the COVID-19 pandemic. The Consolidated Appropriations Act, 2021 made significant changes to the tax credit by extending relief to a greater number of employers and increasing the overall tax benefit. Let's look at how the changes apply for both the 2020 and 2021 tax years.

ERTC 2020

To qualify for the original Employee Retention Tax Credit, businesses with fewer than 100 employees must have experienced a partial or full shutdown due to government orders or experienced a decline in gross receipts of at least 50% for a quarter as compared to the same quarter in 2019. If a business qualified for the credit in one quarter, then it would continue to qualify in subsequent quarters until a quarter in which gross receipts reached 80% of the same quarter in 2019. The amount of the credit a business could receive was 50% of qualified wages, which includes employee compensation and employer's qualified health plan expenses, paid between March 12th and December 31st, 2020 up to a maximum of $10,000 of wages per employee for the entire year. Thus, the maximum credit was $5,000 per employee for the year.

The Consolidated Appropriations Act, 2021 introduced significant changes to the qualifications and calculations for the tax credit. For one thing, the Act now allows businesses that received a PPP Loan to claim the Employee Retention Tax Credit retroactively to March 27, 2020. Therefore, businesses that had not qualified for the credit, may now qualify for the credit retroactively.

Even though PPP borrowers may now receive the credit retroactively, they can't use the same wages claimed for PPP Loan forgiveness to also claim the Employee Retention Credit. While there are differences in the definition of wages for each purpose, you will want to work closely with your tax advisor to understand when to use wages to apply for full forgiveness of your PPP Loan versus claiming the partial ERC. There is some flexibility in the PPP Loan forgiveness period which can help you maximize both loan forgiveness and the employee retention credit amount.

Once a business has run the calculations to determine eligible wages during a qualified period, they can work with their tax advisors to go back and claim the ERC by filing the Form 941X and an amended return. Since it is a payroll tax credit, it is possible for businesses to amend their 2020 payroll tax filings to receive the credit even if the business had tax losses.

ERTC 2021

The tax credit has been extended to June 30, 2021. However, eligibility rules have been expanded. For 2021, businesses with up to 500 employees that meet the shutdown rule or experience a decrease in gross receipts for a quarter in 2021 of 20% or more as compared to the same quarter in 2019 are eligible. If a business does not meet the gross receipts test for Q1 of 2021, then it can compare the gross receipts in Q4 of 2020 to Q4 of 2019.

Next, the credit has increased from 50% to 70% of qualified wages. Additonally, qualifying wages are now capped at $10,000 per employee per quarter instead of $10,000 per employee for all quarters. For example, if an employee was paid $10,000 in both Q1 & Q2, the resulting credit would be $7,000 for each quarter.

As discussed earlier, wages that were paid with PPP loan funds that were or will be forgiven do not count as qualified wages. Again for 2021, you'll want to work closely with your tax advisor to understand and document which wages are used for PPP Loan forgiveness versus the ERC.

Finally, the CAA added a new component for small employers. Employers with fewer than 500 employees can now take the credit in advance rather than applying it as a deduction on employer payroll tax deposits.

To claim the advance credit, eligible employers can choose any calendar quarter to receive an advance payment of the credit in that quarter as long as they don't exceed 70% of the average quarterly wages they paid in 2019. They would then need to reconcile the advance credit with the actual credit amount at a future date. IRS Form 7200 would be used to request an advance payment of credits that employers would then claim on their Form 941.

Paid Sick and Family Leave

The CAA also makes some provision for paid sick and family leave as the mandatory requirement in the Families First Coronavirus Response Act expired at the end of 2020. The FFCRA required many employers to provide paid sick and family leave to employees who were affected by COVID-19. To help cover these costs, the FFCRA offered tax credits to employers to cover 100 percent of the paid sick or family leave wages paid to employees, up to certain limits. Although the FFCRA expired on December 31, 2020, the CAA extends the tax credit until March 31, 2021. This means that even though paid sick and family leave is no longer mandatory after December 31, 2020, an employer who voluntarily offers paid sick or family leave between January 1, 2021 and March 31, 2021 may still claim the payroll tax credit.

It's important to note that the CAA did not create a new allotment of FFCRA tax credits for employees in 2021. Employers can't claim the tax credit for employees who have previously exhausted their 80-hour Emergency Paid Sick Leave or for those who have maxed out their $10,000 Emergency Family Medical Leave in 2020.

For employers with traditional FMLA plans that run on a calendar year, employees may have qualified for a new block of unpaid, job-protected FMLA on January 1st. If the employer chooses to pay their employees in that case, they will not be able to claim the FFCRA tax credit.

The CAA did offer some additional tax relief for employers by extending a provision from the Tax Cuts and Jobs Act that was passed in 2017. Originally, the TCJA allowed a general business tax credit for employers who paid their employees at least 50% of their normal wages for at least two weeks per year. That tax credit was previously only available for the 2018 and 2019 tax years. The CAA has extended the credit now for five years through December 31, 2025.

CAA Changes for Flexible Spending Accounts

The CAA also provides four important changes for Health and Dependent Care Flexible Spending Accounts with regard to carryovers, grace periods, plan election changes, and payouts post participation.

Carryovers

Most employees who have health or dependent care FSAs know that they typically can't carry over their balances from one year to the next. The CAA changed that by allowing employees to carry their unused funds forward into subsequent years for plans with year-ends in 2020 and 2021. In other words, unused FSA balances from 2020 may carry over into 2021, and unused funds from 2021 can carry forward into 2022.

Grace Periods

Health and dependent care FSAs that have a grace period allow participants additional time to submit claims. Typically, plans that end on December 31st would give participants until March 15th to submit their claims. The CAA changed this to allow health or dependent care FSAs to extend that grace period for plans with year-ends in 2020 or 2021 to 12 months after the end of that plan year. For example, plans with a December 31, 2020 year-end may extend the grace period to December 31, 2021. There may be some eligibility restrictions for participants who were not in a high deductible health plan for the prior year but are for the affected years.

Plan Election Changes

The CAA also makes it possible for employers to allow participants in their health or dependent care FSAs to make prospective election changes without a change in status for plan years ending in 2021. As a reminder, health care FSA participants can claim amounts they've elected for the year, even if those funds have not been contributed, so prospective changes can be a cost risk for employers who choose to allow them.

Post-participation Payouts

For health care FSAs only, the CAA allows participants to submit claims for reimbursement from the plan through the end of the plan year, including any grace period, even if the employee stopped participating in the plan during either 2020 or 2021. In other words, for a calendar year plan with an extended grace period, someone who left the company on July 1, 2020, would be able to receive reimbursements from their account until December 31, 2021.

For dependent care FSAs only, there is a provision that allows participants to claim reimbursements for children who are under the age of 14 if certain conditions are met. The provision is intended to provide benefits for dependents who "aged out" by turning 13 during the pandemic.

Next Steps

This document provides a general overview of key employee tax credit and benefits provisions of the Consolidated Appropriations Act and is not intended to be a substitute for discussing the changes with one of our advisors. Please contact our office to discuss how these changes may impact you and your business.

About Your Firm LLC

We have hand-picked a team with tax, auditing, accounting, business and management advisory expertise in a multitude of fields, including healthcare, professional-services firms, commercial contractors, home builders, real estate companies, manufacturing and distribution companies, dealerships, non-profit organizations and pension funds.

We have the expertise and the resources to provide not only the critical services you need during these evolving economic times, but also, importantly, to build for the future. Our strategic alliances with professional organizations across the country allow us to bring our clients the talent and expertise of national firms with the high-touch service of a local firm. While we remain focused on the core services of tax, accounting and audit, we expand and offer you the business consulting needed to remain competitive. We believe the success of our clients is the greatest measure of our own.

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