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The Employee Retention and Employee Retention and Rehiring Tax Credits

The March 2020 Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) included an employee retention tax credit designed to help businesses retain employees during the Coronavirus Disease 2019 (COVID-19) public health emergency. The credit was modified and expanded in December 2020, becoming the employee retention and rehiring tax credit, in the COVID-related Tax Relief Act of 2020 (enacted as Subtitle B to Title II of Division N of the Consolidated Appropriations Act, 2021; P.L. 116-260). **Table 1** summarizes the employee retention credits available in 2020 and 2021.

The Employee Retention Tax Credit

Employee retention credits have historically been deployed as a policy tool to provide disaster tax relief. The goal has been to reduce the cost to employers of keeping employees on their payrolls during the disaster recovery period. An employee retention tax credit (ERTC) was enacted as a policy response to the COVID-19 pandemic, which has caused prolonged labor market disruptions.

ERTC in the CARES Act

Under the CARES Act, the ERTC could be taken for wages paid after March 12, 2020, and before January 1, 2021. Employers could claim a *payroll* tax credit of up to $5,000 per employee for qualified wages paid while closed or having reduced operations due to COVID-19. For 2020, the credit is computed as 50% of up to $10,000 in qualified wages paid to an eligible employee. (Eligible employees are generally those who have been employed by the employer for at least 30 days.) Health plan expenses can be treated as qualified wages when computing the credit.

Eligible employers are those who (1) are required to fully or partially suspend operations due to a COVID-19-related order (including nonprofit employers); or (2) have gross receipts 50% less than gross receipts in the same quarter in the prior calendar year (with the credit no longer being available once gross receipts are 80% of prior year calendar quarter gross receipts).

Qualified wages for the purposes of the credit depend on the number of employees the employer had during 2019. If the employer had more than 100 full-time employees, qualified wages are wages paid when employee services are not provided. (Qualified wages are limited to the amount the employee would have been paid for working an equivalent duration during the 30 days preceding the nonservice period.) If the employer had 100 or fewer full-time employees, all employee wages paid by eligible employers are credit-eligible. Wages taken into account for this credit cannot be taken into account for the tax credit for employer-provided paid family and medical leave.

The structure as a payroll tax credit allows businesses to receive the benefit more quickly than typically would be the case for an income tax credit. The credit is refundable, meaning it can be received if credit amounts exceed payroll tax liability. Additionally, advance payment of the credit is allowed.

When the ERTC was enacted in the CARES Act, employers receiving Paycheck Protection Program (PPP) loans could not also claim the ERTC. The COVID-related Tax Relief Act of 2020 provided that employers receiving PPP loans could claim the ERTC with respect to wages not used to support PPP loan forgiveness.

This credit does not apply to government employers. A provision provides for transfers to the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund, so that the Social Security trust funds would not be affected.

ERTC in the COVID-related Tax Relief Act of 2020

The COVID-related Tax Relief Act of 2020 extends the employee retention tax credit to apply to wages paid after December 31, 2020, and before July 1, 2021. The credit is renamed, now the "employee retention and rehiring credit." The credit rate is increased to 70% of qualified wages. The credit can be computed on up to $10,000 in qualified wages paid to an eligible employee per calendar quarter. Thus, the maximum credit amount for 2021 is $14,000 (70% of up to $20,000 in qualified wages paid over the first two quarters).

For 2021, the definition of eligible employer is modified so that employers with gross receipts 20% less than gross receipts in the same calendar quarter in 2019 can qualify for the tax credit. Employers can also use the previous calendar quarter (as opposed to the same calendar quarter in the previous calendar year) to establish eligibility for the credit.

For 2021, qualified wages continue to depend on the employer's number of employees. The threshold below which employers can claim the credit for all wages paid, as opposed to claiming it for wages paid only when services are not provided, is increased to 500 full-time employees.

Additional changes to the credit create special rules for employers not in existence for 2019, potentially allowing such employers to be credit-eligible. Limits are also placed on advance payments. Certain governmental employers, including college and university and medical or hospital employers, may also be credit-eligible in 2021.

Table 1. Key Features of the Employee Retention and Employee Retention and Rehiring Tax Credits

Credit Feature	ERTC in the CARES Act	ERTC in the COVID-related Tax Relief Act
Effective Dates	March 13, 2020-December 31, 2020	January 1, 2021-June 30, 2021
Credit Rate	50%	70%
Maximum Credit Amount	$5,000 in 2020 (50% of $10,000 in qualifying wages)	$14,000 in 2021 (70% of $20,000 in qualifying wages)
Eligibility	Employers who (1) are required to fully or partially suspend operations due to a COVID-19-related order (including nonprofit employers); or (2) have gross receipts 50% less than gross receipts in the same quarter in the prior calendar year (with the credit no longer being available once gross receipts are 80% of prior year calendar quarter gross receipts). Eligible employers include tax-exempt organizations. Employers receiving Paycheck Protection Program (PPP) loans are eligible.[a]	Employers who (1) are required to fully or partially suspend operations due to a COVID-19-related order (including nonprofit employers); or (2) have gross receipts 20% less than gross receipts in the same quarter in the prior calendar year or prior calendar quarter. Eligible employers include tax-exempt organizations. Employers receiving PPP loans are eligible.
Qualified Wage Base	Employers with more than 100 full-time employees: wages paid when employee services are not provided. Qualified wages limited to the amount an employee would have been paid for working an equivalent duration during the 30 days preceding the nonservice period. Employers with 100 or fewer full-time employees: wages paid by eligible employers are credit-eligible.	Employers with more than 500 full-time employees: wages paid when employee services are not provided. Employers with 500 or fewer full-time employees: wages paid by eligible employers are credit-eligible.
Public Entities	Government entities generally ineligible.	College and university and medical or hospital government entities are credit-eligible.

Source: CRS analysis of P.L. 116-136 and P.L. 116-260.

Notes:

a. Employers receiving PPP loans initially were not eligible to claim the ERTC. Retroactive changes in P.L. 116-260 provide that employers receiving PPP loans qualify for the ERTC with respect to wages not used to support PPP loan forgiveness.

Economic and Policy Considerations

Structuring the tax credit as a *payroll* tax credit, as opposed to an income tax credit, addresses policy concerns associated with past employee retention and hiring credits. Payroll tax credits can be delivered relatively quickly, addressing concerns about timing associated with past ERTCs. The benefits of payroll tax credits extend to all employers and are not limited to taxpayers with income tax liability. Further, payroll tax credits can be claimed by nonprofit employers.

Evidence suggests that take-up of the 2020 ERTC was lower than some had anticipated. One factor possibly contributing to low take-up was that employers receiving a PPP loan were generally ineligible for the ERTC. Removing this restriction, alongside other changes such as relaxing the reduction in receipts threshold and increasing the credit amount, could lead employers who had not previously claimed the ERTC to claim the credit in 2021.

One metric for evaluating the effectiveness of ERTCs relates to the *economic efficiency*, or "bang for the buck," of these incentives. To the extent that this credit is claimed for employees that would have been retained absent this credit, it is less economically efficient than payments directly targeted at those who are laid off.

There are also questions about the credit's potential for economic relief. If employers have laid off employees due to lack of consumer demand, employers may be slow to hire, even with employment subsidies. Economic theory tends to indicate that demand-side stimulus, rather than supply-side (like employer tax relief), is the most effective tool for boosting employment during periods of economic weakness.

Reductions in Federal Revenues

The Joint Committee on Taxation (JCT) estimated that the ERTC, as enacted in the CARES Act, would reduce federal revenue by $54.6 billion (the combined total for FY2020 and FY2021). Data on actual credit claims for 2020 are not available.

The retroactive modifications to the ERTC enacted in P.L. 116-260 are estimated to reduce federal revenue by an additional $5.2 billion in FY2021. Modifying the credit and extending it through the first half of 2021 is estimated to reduce federal revenues by $15.5 billion (the combined total for FY2021 and FY2022).

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