In Brief: In 2020, many employers, including child care small businesses, were impacted by the COVID-19 pandemic. Congress responded by passing several bills designed to help individuals, families, employers, and communities. Among new business relief options is the Employee Retention Tax Credit. The basic design is to provide a tax credit against employer payroll taxes as an incentive for businesses to retain employees. Given the economic challenges faced by child care centers, many are likely to be eligible for the tax credit. Some family child care homes (if they have employees) may be eligible as well. The FY2021 Consolidated Appropriations and COVID Relief Act (P.L. 116-260) enacted in December 2020 expanded the tax credit through June 30, 2021. Most recently, the American Rescue Plan (P.L. 117-2) signed into law on March 11, 2021 extended the credit through December 31, 2021. Therefore, this brief will describe the Employee Retention Tax Credit for both 2020 and 2021 since both tax years are affected.

What employers are eligible for the Employee Retention Tax Credit?

Employers (for-profit and non-profit) are eligible for the Employee Retention Tax Credit if:

- Their business was fully or partially suspended during any calendar quarter in 2020 due to COVID-19, OR
- Their business had a significant decline in gross receipts.

For 2020, a significant decline in gross receipts means an employer’s gross receipts are less than 50% of its gross receipts for the same calendar quarter in 2019. Employers are no longer eligible for the tax credit once quarterly gross receipts exceed 80% of gross receipts for the same calendar quarter in 2019.

For 2021, the December 2020 law broadened eligibility for the tax credit. Employers need only show that gross receipts are less than 80% of gross receipts for the same quarter in 2019 (e.g., a 20% reduction in gross receipts vs. a 50% reduction). In addition, employers can choose to compare the gross receipts from the preceding quarter and compare that quarter to the same quarter in 2019 instead of the current quarter.

How much is the Employee Retention Tax Credit worth?

For 2020, for small employers with 100 or fewer full-time employees (there are different rules for employers of more than 100 employees), the tax credit is worth a maximum of $5,000 per employee for the year (i.e., 50% of $10,000 in wages per year). Qualifying wages are those paid after March 12, 2020 and before January 1, 2021.

For 2021, under the December 2020 law, as modified by the American Rescue Plan, for small employers with 500 or fewer full-time employees, the tax credit is worth a maximum of $28,000 per employee. The amount of the credit
was increased to 70% of wages up to $10,000. However, instead of an annual cap on wages, the $10,000 applies per quarter (e.g., 70% of $10,000 is $7,000 per quarter). The December 2020 law extended the credit through June 30, 2021. The American Rescue Plan extended the credit through December 31, 2021.

The term “wages” means wages earned by employees as well as the cost of employer-provided health care coverage. Employers cannot include any wages paid that reflect paid sick or family leave, which the employer is reimbursed for through payroll tax credits under the Families First Coronavirus Response Act. This is to prevent “double dipping.”

How do employers obtain the Employee Retention Tax Credit?

While individuals generally pay taxes once per year, most employers pay taxes quarterly. Employers that pay wages subject to federal income tax withholding or social security and Medicare taxes file IRS form 941 quarterly. For example, the first quarter of the calendar year represents January through March 31 and IRS form 941 is due by April 30. The Employee Retention Tax Credit is taken against the employer’s share of payroll taxes reflected on form 941. In essence, employers retain amounts that correspond to the Employee Retention Tax Credit that they would otherwise have paid in payroll taxes each quarter.

If the amount of the tax credit in one quarter exceeds payroll taxes, employers can request an advance of the Employee Retention Tax Credit by submitting IRS form 7200. Basically, this means they are advancing themselves a portion of the next quarter’s payroll taxes. If the amount of the actual credit for the next quarter is less than the advance payment, employers will need to repay the excess amount.

Other Major Changes within the FY2021 Consolidated Appropriations and COVID Relief Act (P.L. 116-260)

U.S. Small Business Administration Paycheck Protection Program (PPP). Under the federal CARES Act enacted in March 2020, employers seeking business relief had to choose between taking the Employee Retention Tax Credit or receiving a PPP forgivable loan. Employers could not utilize both forms of federal support. The December 2020 law allows businesses that had a PPP loan in 2020 to also take the Employee Retention Tax Credit.

However, employers with a PPP loan cannot use wages paid through PPP as part of their wage calculation for the Employee Retention Tax Credit (i.e., no “double dipping”). Because PPP loans were used to support payroll for between 8 and 24 weeks, it is likely that some wages during the year may have been paid without the PPP loan. See IRS Guidance 2021-20 for more details. In general, employers that want to claim an Employee Retention Tax Credit for 2020 will need to amend their IRS form 941 by filing an IRS form 941-X for a refund.