

American Rescue Plan Act Extensions, Changes to Select Tax Credit, Compensation Deduction Provisions

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The American Rescue Plan Act of 2021 expands upon some popular tax credit provisions and makes other changes to a key tax provision regarding compensation deduction limitations. These changes are summarized below.

Tax Credits for Qualified Paid Sick Leave and Family Leave

The Act extends the tax credits that were originally implemented as part of the Families First Coronavirus Response Act (and then extended until March 31, 2021, under the Consolidated Appropriations Act of 2021 (CAA)) for qualified paid sick leave (PSL) and qualified paid family leave (PFL) wages. The Act extends these credits through September 30, 2021, with certain modifications.

Covered employers are not required to provide PSL or PFL in 2021; however, employers who choose to do so will be eligible for tax credits on wages paid for such leave, subject to certain limitations.

Expansion of Leave

The Act expands the types of leave that qualify for tax credits between April 1, 2021, and September 30, 2021. PSL and PFL now include leave provided to an employee to obtain a COVID-19 vaccine, recover from injury, disability, illness, or condition related to a COVID-19 vaccine or to await COVID-19 test results or diagnosis due to exposure or employer request. The Act also expands other reasons PFL can be provided for tax credit purposes. For more detail, see [The American Rescue Plan Extends FFCRA Tax Credit, But Not the Mandate](#).

Wages taken into account for PSL are capped at \$511 a day (but may be lower, depending on the reason for the PSL) for a maximum of 10 days during the period between April 1, 2021, and September 30, 2021. Wages taken into account for PFL are capped at \$12,000 under the Act. The tax credits for such PSL and PFL are capped at the level of the employer's Medicare taxes for such quarter, but any excess is treated as an overpayment to be refunded. The credits previously were applied (prior to April 1, 2021) against the employer's Social Security taxes. Advanced credits are permitted under the Act.

Qualified Health Plan Expenses

Qualified wages continue to include qualified health plan expenses that are properly allocable to the PSL and PFL wages. For this purpose, "qualified health plan expenses" means amounts paid or incurred by an employer to provide or maintain a group health plan, but only to the extent such amounts are excludable from the gross income of employees. While the allocation must comply with applicable regulations, an allocation

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will be *deemed properly made* if made on a pro rata basis among covered employees on the basis of periods of coverage (relative to the time periods of leave to which the wages relate). The Act also includes special provisions for amounts paid under collective bargaining agreements.

Limitations

The Act precludes “double dipping.” Thus, wages paid to provide PSL or PFL for which a tax credit is taken may not be taken into account for purposes of certain other credits, including Section 45S (employer credit for paid family and medical leave), Section 51 (work opportunity credit) and Section 3134 (Employee retention credit for employers subject to closure due to COVID-19 after June 30, 2021). Additionally, to the extent wages are taken into account for purposes of the employee retention credit prior to July 1, 2021, the credit for wages paid to provide PSL or PFL is reduced by the portion attributable to the employee retention credit. Similarly, a credit may not be taken for wages paid by an employer that are taken into account as payroll costs in connection with forgiven payroll protection program loans.

Governmental employers are not eligible for tax credits for wages paid to provide PSL or PFL.

Nondiscrimination

The Act adds a nondiscrimination requirement for employers to receive the tax credits made available under the Act. Employers may not claim a tax credit on any PSL or PFL wages paid in any calendar quarter if the employer discriminates in favor of highly compensated employees (within the meaning of Section 414(q) of the Internal Revenue Code), full-time employees, or employees on the basis of employment tenure in providing the PSL or PFL, as applicable. This requirement was not included in the CAA, which extended the tax credit through March 31, 2021, for covered employers who voluntarily provided the leave. Presumably, this is a reaction to employers selectively providing the leave.

Extension of Limitations Period Applicable to Credits

Finally, the Act extends the period of limitations on assessment of any amount attributable to a credit claimed for wages paid to provide PSL or PFL to five years after the later of the date the original return with respect to which the credit is determined is filed or the date on which the return is treated as filed under the tax law. Such extended limitations period makes it even more important that employers properly determine eligibility for the tax credits and maintain sufficient records for the requisite period of time.

We anticipate additional guidance from the Internal Revenue Service related to these credits in the form of Frequently Asked Questions or Treasury Regulations.

Employee Retention Credit Extension

Originally enacted under Section 2301 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and extended by the CAA, the Employee Retention Credit (ERC) affords certain employers a tax credit for qualified wages paid to employees. Under the CARES Act, the ERC was capped at \$5,000 per employee for 2020. The CAA expanded the ERC to apply to payments of qualified wages made between January 1,

2021, and June 30, 2021, and increased the maximum amount of the credit to \$7,000 per employee per quarter.

The Act extends the ERC for an additional two quarters through the end of 2021 and expands the potential applicability of the ERC to certain employers. Thus, when added to the \$5,000 per employee credit provided under the CARES Act for 2020 and the \$7,000 per employee credit provided under the CAA for the first two quarters of 2021, most eligible employers can potentially take an ERC of up to \$33,000 per employee.

Extension of the ERC Through All of 2021

The ERC is codified in the Act as Section 3134 of the Internal Revenue Code. As so codified, the ERC is extended to apply to qualified wages paid after June 30, 2021, and before January 1, 2022 (that is, for the third and fourth quarters of 2021). For such period, and consistent with the CAA, the amount of the credit is generally 70 percent of qualified wages. Since qualified wages are generally limited to \$10,000 per employee per quarter, the amount of the ERC under Section 3134 of the Code is generally limited to a maximum of \$7,000 per employee per quarter.

Importantly, Section 3134 of the Code applies only to “wages paid after June 30, 2021 and before January 1, 2021.” For 2020 and the first and second quarters of 2021, the applicable provisions of the CARES Act and the CAA govern the ERC.

Amount of the ERC

The Act modifies the amount of the ERC in two respects. First, the Act increases the amount of the ERC available to “severely financially distressed employers.” A “severely financially distressed employer” is an employer that experienced a gross receipts reduction of more than 90 percent as compared to the same quarter in 2019. Such employers may treat all wages paid to employees as qualified wages, regardless of the size of the employer and number of employees. The ERC, therefore, is uncapped with respect to such entities. Further, the amount of the ERC is limited to \$50,000 per quarter in the aggregate for certain new businesses (called recovery startup businesses, discussed below).

Eligible Employers

Consistent with the CAA, under Section 3134 of the Code, an eligible employer for any calendar quarter is any employer engaged in a trade or business and either fully or partially suspended as a result of COVID-19-related government orders limiting commerce, travel, or group meetings or having gross receipts for such quarter that are less than 80 percent of the gross receipts for the same calendar quarter in 2019 (subject to a special alternative rule). In addition, the Act adds a recovery startup business as an additional category of eligible employers. A recovery startup business is a business established after February 15, 2020, with annual gross receipts of \$1 million or less. A recovery startup business is eligible even if it does not otherwise meet the general eligible employer ERC requirements (suspension by government order, reduction in gross receipts, and so on). However, the amount of ERC available to a recovery startup business is limited to \$50,000 *per quarter*.

Qualified Wages

Consistent with the CAA, the amount of “qualified wages” depends on the average number of employees an eligible employer had during 2019. For large employers (employers whose average number of full-time employees during 2019 was greater than 500), qualified wages are the W-2 wages and allocable health plan expenses that are paid to employees for periods that the employee is not providing services because the employer’s operations were fully or partially suspended or because of the significant decline of the employer’s gross receipts. For small employers (employers whose average number of full-time employees during 2019 was 500 or less), qualified wages mean wages paid to any employee during a COVID-19 suspension of business operations or the significant decline in gross receipts, regardless of whether or not the employee is providing services during that period. Qualified wages are generally limited to \$10,000 per employee per quarter. As noted above, the amount of qualified wages for severely financially distressed employers is not subject to any cap. Similar to the PSL and PFL rules discussed above, certain wages taken into account for purposes of certain other tax credit provisions are excluded from the definition of qualified wages.

Application of the Credit

The ERC is limited to the amount of applicable employment taxes on the wages paid during the applicable quarter. To the extent that the amount of the ERC otherwise provided exceeds such amount, the excess is treated as an overpayment available for refund. Applicable employer taxes are defined as the employer’s share of Medicare tax. This represents a change from the treatment of the ERC under the CAA, where the amount of the credit was applied to the employer’s share of Social Security tax.

As under the CAA, advance payments of the ERC are available to electing eligible employers whose average number of full-time employees during 2019 was not greater than 500. Such advance payments are limited to 70 percent of the average quarterly 2019 wages. Special rules apply to seasonal employers and employers not in existence in 2019.

Extension of Limitations Period Applicable to ERC

One potential dark cloud among all of the largesse bestowed upon employers by the Act: as with the credit for PSL and PFL wages described above, the period of limitations on assessment of any amount attributable to an ERC credit claimed is extended to five years.

Importantly, while the IRS has recently [issued guidance](#) on the ERC, such guidance does not apply to the ERC for qualified wages paid after December 31, 2020. Future guidance is anticipated on the ERC for both the ERC provisions under the CAA (Q1 and Q2 of 2021) and under Section 3134 of the Code as enacted by the Act (Q3 and Q4 of 2021.)

Expanded Definition of Covered Employee under Section 162(m) of the Code
Section 162(m) of the Code generally denies a corporate tax deduction for compensation in excess of \$1 million paid to top executive officers of publicly traded companies, known as covered employees. The Act expands the group of employees considered a covered employee. Beginning in 2027, covered employees also will include the five highest compensated employees, not including the employees considered a covered employee without this new rule. While covered employee status was recently changed to include employees formerly a covered employee, that perpetual

designation does not apply to the employees considered a covered employee under this new rule.

Please reach out if you have questions or need assistance.

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