

Guidance on the Employee Retention Credit under Section 3134 of the Code and on
Miscellaneous Issues Related to the Employee Retention Credit

Notice 2021-49

I. PURPOSE

This notice provides guidance on the employee retention credit available under section 3134 of the Internal Revenue Code (Code), enacted by section 9651 of the American Rescue Plan Act of 2021 (the ARP), Pub. L. No. 117-2, 135 Stat. 4 (March 11, 2021), which provides a credit for wages paid after June 30, 2021, and before January 1, 2022.

This notice amplifies Notice 2021-20, 2021-11 IRB 922, which provides guidance on the employee retention credit under section 2301 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. No. 116-136, 134 Stat. 281 (2020), as amended by section 206 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Relief Act), enacted as Division EE of the Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, 134 Stat. 1182 (2020). This notice also amplifies Notice 2021-23, 2021-16 IRB 1113, which provides guidance on the employee retention credit under section 2301 of the CARES Act, as amended by section 207 of the Relief Act, for the first and second calendar quarters of 2021.

Specifically, this notice amplifies both Notice 2021-20 and Notice 2021-23 by providing additional guidance on the employee retention credit, applicable to the third

and fourth calendar quarters of 2021. As amplified by this notice, the rules set forth in Notice 2021-20 and Notice 2021-23 addressing CARES Act provisions that are the same as those provided under section 3134 of the Code continue to apply for the third and fourth calendar quarters of 2021. Finally, this notice provides additional guidance on issues regarding the employee retention credit under both section 2301 of the CARES Act and section 3134 of the Code. The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) will continue to monitor potential legislation related to the employee retention credit that may impact certain rules described in this notice.

II. BACKGROUND ON SECTION 2301 OF THE CARES ACT AND SECTION 3134 OF THE CODE

Section 2301 of the CARES Act, as originally enacted, provides for an employee retention credit for eligible employers, including tax-exempt organizations, that pay qualified wages, including certain health plan expenses, to some or all employees after March 12, 2020, and before January 1, 2021. Section 206 of the Relief Act adopted amendments and technical changes to section 2301 for qualified wages paid after March 12, 2020, and before January 1, 2021, primarily expanding eligibility for certain employers to claim the credit. Section 206 is effective retroactive to the effective date of section 2301. Section 207 of the Relief Act, which is effective for calendar quarters beginning after December 31, 2020, further amends section 2301 to extend the application of the employee retention credit to qualified wages paid after December 31, 2020, and before July 1, 2021, and to modify the calculation of the credit amount for

qualified wages paid during that time. Section 9651 of the ARP enacted section 3134 of the Code, effective for calendar quarters beginning after June 30, 2021, to provide an employee retention credit for wages paid after June 30, 2021, and before January 1, 2022.

On March 1, 2021, the Treasury Department and the IRS issued Notice 2021-20, providing guidance on the employee retention credit under section 2301 of the CARES Act, as amended by section 206 of the Relief Act. Notice 2021-20 continues to apply for calendar quarters in 2020.

On April 2, 2021, the Treasury Department and the IRS issued Notice 2021-23, providing guidance on the employee retention credit under section 2301 of the CARES Act, as amended by section 207 of the Relief Act. Notice 2021-23 continues to apply for the first and second calendar quarters in 2021.

Any reference to the “employee retention credit” in this notice generally refers to the employee retention credit under either section 2301 of the CARES Act or section 3134 of the Code, as applicable to the relevant calendar quarter.

III. GUIDANCE ON CHANGES MADE BY SECTION 3134 OF THE CODE

A. Extension of Employee Retention Credit

Section III.A. of Notice 2021-23 describes the extension of the employee retention credit for qualified wages paid by an eligible employer after December 31, 2020, and before July 1, 2021. Section 3134(n) of the Code provides that section 3134 applies to wages paid after June 30, 2021, and before January 1, 2022. Accordingly, an

eligible employer may also claim the employee retention credit for qualified wages paid in the third and fourth calendar quarters of 2021.

B. Applicable Employment Taxes

Under both section 2301(a) of the CARES Act and section 3134 of the Code, the employee retention credit is claimed against “applicable employment taxes.” For purposes of the employee retention credit under the CARES Act, section 2301(c)(1) defines “applicable employment taxes” to mean the taxes imposed on employers by section 3111(a) of the Code (employer’s share of the Old Age, Survivors, and Disability Insurance (social security tax)), or so much of the taxes imposed on employers by section 3221(a) of the Code (Tier 1 tax under the Railroad Retirement Tax Act (RRTA)) that are attributable to the rate in effect under section 3111(a). Section II.A. of Notice 2021-20 provides that, under section 2301, eligible employers are entitled to claim the employee retention credit against the employer’s share of social security tax after these taxes are reduced by any credits claimed under sections 3111(e) and (f), sections 7001 and 7003 of the Families First Coronavirus Response Act (FFCRA), Pub. L. No. 116-127, 134 Stat. 178 (2020), and section 303(d) of the Relief Act. Section II.A. of Notice 2021-20 further provides that, under section 2301, eligible employers subject to the RRTA are entitled to claim the employee retention credit against the portion of Tier 1 tax under the RRTA that is equivalent to the employer’s share of social security tax after these taxes are reduced by any credits allowed under sections 7001 and 7003 of the FFCRA and section 303(d) of the Relief Act.

For purposes of the employee retention credit under section 3134 of the Code, section 3134(c)(1) defines “applicable employment taxes” to mean the taxes imposed under section 3111(b) of the Code (employer’s share of Hospital Insurance (Medicare) tax), or so much of the portion of Tier 1 tax under the RRTA that is equivalent to the employer’s share of Medicare tax. Section 3134(b)(2) provides that the credit allowed under section 3134(a) with respect to a calendar quarter will not exceed the applicable employment taxes, reduced by any credits allowed under sections 3131 and 3132 of the Code (tax credits under the ARP for qualified sick leave wages and qualified family leave wages, respectively, paid with respect to leave taken by employees beginning on April 1, 2021, through September 30, 2021), on the wages paid with respect to the employment of all the employees of the eligible employer for such calendar quarter. Section 3134(b)(3) provides that if any amount of the credit under section 3134(a) exceeds the limitation under section 3134(b)(2) for any calendar quarter, such excess will be treated as an overpayment that will be refunded under sections 6402(a) and 6413(b) of the Code.

Accordingly, for the third and fourth quarters of 2021, eligible employers are entitled to claim the employee retention credit against the employer’s share of Medicare tax, or the portion of Tier 1 tax under the RRTA that is equivalent to the employer’s share of Medicare tax, after these taxes are reduced by any credits allowed under sections 3131 and 3132 of the Code, with the excess refunded under section 6402 or 6413 of the Code.

C. Maximum Amount of Employer’s Employee Retention Credit

Section III.D. of Notice 2021-23 provides the rules related to the maximum amount of an eligible employer's employee retention credit for the first and second calendar quarters in 2021. The employee retention credit equals 70 percent of qualified wages (including allocable qualified health plan expenses), and the amount of qualified wages (including allocable qualified health plan expenses) taken into account with respect to any employee is limited to \$10,000 for any calendar quarter, for a maximum credit of \$7,000 per employee for each of the first and second calendar quarter of 2021. Under section 3134(a) and (b)(1)(A) of the Code, these limits continue to apply in the third and fourth calendar quarters in 2021; however, a separate credit limit under section 3134(b)(1)(B) applies to "recovery startup businesses" as discussed in section III.D. of this notice.

D. Recovery Startup Businesses

Section 2301(c)(2) of the CARES Act, as amended by section 206 of the Relief Act, and sections III.A., III.D, and III.E. of Notice 2021-20 provide the rules for determining whether an employer is an eligible employer for purposes of the employee retention credit for 2020; section 2301(c)(2), as amended by section 207 of the Relief Act, and sections III.B. and III.C. of Notice 2021-23 provide those rules for the first and second calendar quarters of 2021.

Applying the same rules as for the first two quarters of 2021, sections 3134(c)(2)(A)(ii)(I) and (II) of the Code provide that, for the third and fourth calendar quarters of 2021, an employer may be eligible for the employee retention credit with respect to a calendar quarter if (i) the operation of the employer's trade or business is

fully or partially suspended 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 19 (COVID-19), or (ii) the employer

experiences a decline in gross receipts.¹ Section 3134 adds a third category of

employers that are eligible for the employee retention credit for the third and fourth

calendar quarters of 2021. Specifically, section 3134(c)(2)(A)(ii)(III) provides that

“recovery startup businesses” may be eligible employers for those calendar quarters.

Section 3134(c)(5) of the Code defines a “recovery startup business” as an

employer (i) that began carrying on any trade or business after February 15, 2020, (ii)

for which the average annual gross receipts of the employer (as determined under rules

similar to the rules under section 448(c)(3) of the Code) for the 3-taxable-year period

ending with the taxable year that precedes the calendar quarter for which the credit is

determined does not exceed \$1,000,000, and (iii) that is not otherwise an eligible

employer due to a full or partial suspension of operations or a decline in gross receipts.

Section 3134(b)(1)(B) provides that in the case of an eligible employer that is a recovery

startup business, the amount of the credit allowed under subsection 3134(a) (after

application of the limit under subsection 3134(b)(1)(A)) for each of the third and fourth

calendar quarters of 2021 cannot exceed \$50,000.

¹ The rules for determining a significant decline or decline in gross receipts are set forth in section III.E. of Notice 2021-20 and section III.C. of Notice 2021-23, respectively. As with the first and second calendar quarters of 2021, the determination of whether an employer is an eligible employer due to a decline in gross receipts is made separately for each of the third and fourth calendar quarters of 2021 and is based on an 80 percent threshold as set forth in section III.C. of Notice 2021-23.

Section III.A. of Notice 2021-20 provides that for purposes of the employee retention credit, “trade or business” has the same meaning as when used in section 162 of the Code other than the trade or business of performing services as an employee.

Section 3134(c)(5)(A) of the Code provides that a recovery startup business is an employer that began carrying on a trade or business after February 15, 2020.

Therefore, the determination of when an employer “began carrying on a trade or business” is made in the same manner as for purposes of section 162. In general, for purposes of section 162, a taxpayer has not begun carrying on a trade or business “until such time as the business has begun to function as a going concern and performed those activities for which it was organized.” *Richmond Television Corp. v. U.S.*, 345 F.2d 901, 907 (4th Cir. 1965), vacated and remanded on other grounds per curiam, 382 U.S. 68 (1965), on remand, 354 F.2d 410 (4th Cir. 1965), overruled on other grounds; *NCNB Corporation v. United States*, 684 F.2d 285 (4th Cir. 1982); see also Rev. Rul. 81-150, 1981-1 C.B. 119.

Section 3134(c)(5) of the Code indicates that the average annual gross receipts of an employer is determined by applying rules similar to the rules in section 448(c)(3) of the Code and that the 3-taxable-year period ends with the taxable year preceding the calendar quarter for which the employer is claiming the employee retention credit.

Section III.A. of Notice 2021-20 states that, for purposes of the employee retention credit, a tax-exempt organization described in section 501(c) of the Code that is exempt from tax under section 501(a) is deemed to be engaged in a “trade or business” with respect to all operations of the organization, as provided in section

2301(c)(2)(C) of the CARES Act. Similar to the rule in section 2301(c)(2)(C), section 3134(c)(2)(C)(i) provides that, in the case of an organization described in section 501(c) and exempt from tax under section 501(a), the requirement in section 3134(c)(2)(A)(i) of carrying on a trade or business to be an eligible employer and the requirement in section 3134(c)(2)(A)(ii)(I) that a trade or business has been fully or partially suspended due to an appropriate governmental order to be an eligible employer apply to all operations of the organization. Section 3134(c)(2)(C)(ii) further provides that, in the case of a tax-exempt organization, any reference to gross receipts will be treated as a reference to gross receipts within the meaning of section 6033 of the Code. While section 3134(c)(2)(C)(i) does not specifically reference the trade or business requirement in the definition of a recovery startup business in section 3134(c)(5)(A), because of the broad language in section 3134(c)(2)(C)(ii) for measuring gross receipts and the other language in section 3134(c)(2)(C)(i) indicating an intent by Congress to fully include tax-exempt organizations within the three categories of an eligible employer, the Treasury Department and the IRS have determined that it is appropriate for an organization described in section 501(c) and exempt from tax under section 501(a) to be able to be treated as an eligible employer due to being a recovery startup business based on all of its operations and average annual gross receipts determined under section 6033 as defined in section III.E. of Notice 2021-20.

The Treasury Department and the IRS have also determined that it is appropriate for the term “qualified wages” to include wages paid by a recovery startup business. The definition of “qualified wages” in section 3134(c)(3)(A) of the Code is identical to the

definition in section 2301(c)(3)(A) of the CARES Act. Section 3134(c)(3)(A)(i), the large eligible employer rule, defines qualified wages as wages paid with respect to which an employee is not providing services due to circumstances described in section 3134(c)(2)(A)(ii)(I) (relating to a full or partial suspension) or section 3134(c)(2)(A)(ii)(II) (relating to a decline in gross receipts). Section 3134(c)(3)(A)(ii), the small eligible employer rule, defines qualified wages as wages paid during any period described in section 3134(c)(2)(A)(ii)(I) (relating to a full or partial suspension) or paid with respect to any employee during a quarter described in section 3134(c)(2)(A)(ii)(II) (relating to a decline in gross receipts). Neither the large eligible employer rule in section 3134(c)(3)(A)(i) nor the small eligible employer rule in section 3134(c)(3)(A)(ii) was updated to include section 3134(c)(2)(A)(ii)(III) (relating to a recovery startup business). Thus, the language of the statute does not include a definition of qualified wages applicable to a recovery startup business. However, the inclusion of recovery startup businesses as a new category of eligible employer and the provision of a specific limitation on the amount of the employee retention credit to which recovery startup businesses are entitled indicates that Congress intended that this new category of eligible employer be able to claim the employee retention credit. In order to carry out this intent, the Treasury Department and the IRS have concluded that it is appropriate to read the small eligible employer rule in section 3134(c)(3)(A)(ii)(II) as if section 3134(c)(2)(A)(ii)(III) were included after the reference to section 3134(c)(2)(A)(ii)(II).²

² Based on the definition of a recovery startup business as requiring average annual gross receipts for the prior 3 taxable years of not more than \$1,000,000, the Treasury Department and the IRS

Accordingly, in the third and fourth calendar quarters of 2021, a recovery startup business that is a small eligible employer within the meaning of section 3134(c)(3)(A)(ii) may treat all wages paid with respect to an employee during the quarter as qualified wages.

The determination of whether an employer is a recovery startup business is made separately for each calendar quarter. For example, if an eligible employer is a recovery startup business in the third quarter of 2021 but is not a recovery startup business in the fourth quarter of 2021 because it is an eligible employer due to a full or partial suspension or a decline in gross receipts during the fourth quarter of 2021, the \$50,000 limitation applies to the third quarter of 2021 but does not apply to the fourth quarter of 2021.

The aggregation rules described in section III.B. of Notice 2021-20 apply when determining whether an employer's trade or business is fully or partially suspended or the employer experiences a decline in gross receipts. Similarly, the aggregation rules described in section III.B. of Notice 2021-20 apply when determining if an employer is a recovery startup business. The aggregation rules also apply with respect to the \$50,000 limitation on the credit.

E. Qualified Wages

Section III.G. of Notice 2021-20 and section III.E. of Notice 2021-23 set forth the rules for determining qualified wages paid after March 12, 2020, and before January 1,

do not anticipate that any recovery startup business would be a large eligible employer within the meaning of section 3134(c)(2)(A)(i).

2021, and qualified wages paid after December 31, 2021, and before July 1, 2021, respectively. Section 3134 of the Code generally includes the same rules for determining qualified wages as the rules for wages paid in the first and second calendar quarters of 2021, with a few exceptions, discussed below.

Section 3134(c)(3)(A) of the Code defines the term “qualified wages” and provides the distinction in treatment between large eligible employers and small eligible employers. Section 3134(c)(3)(B) provides that in the case of any employer that was not in existence in 2019, section 3134(c)(3)(A) is applied by substituting “2020” for “2019” each place it appears and requires eligible employers not in existence in 2019 to determine the average number of full-time employees in 2020 instead of 2019. Section III.G. of Notice 2021-20 provides rules for determining the average number of full-time employees, including for employers that came into existence in 2020. Accordingly, the rules set forth in section III.G. of Notice 2021-20 for determining the average number of full-time employees continue to apply in the third and fourth calendar quarters of 2021.³

Section 3134(c)(3)(C) of the Code provides a different rule for qualified wages paid by “severely financially distressed employers.” Section 3134(c)(3)(C)(ii) defines a “severely financially distressed employer” as an employer that is an eligible employer based on a decline in gross receipts, but the gross receipts for the eligible employer for the calendar quarter are less than 10 percent of the gross receipts as compared to the same calendar quarter in calendar year 2019, instead of less than 80 percent.

³ Questions have arisen about whether full-time equivalents are included in determining the average number of full-time employees. See section IV.A. of this notice for a clarification.

Accordingly, for purposes of the employee retention credit for the third and fourth calendar quarters of 2021, an eligible employer with gross receipts that are less than 10 percent of the gross receipts for the same calendar quarter in calendar year 2019 (or 2020, if the employer was not in existence in 2019) is a severely financially distressed employer.

The rules for how an employer determines whether it has experienced a decline in gross receipts for purposes of the employee retention credit are set forth in section III.C. of Notice 2021-23. Whether an employer has met the decline in gross receipts test generally is determined by comparing the quarter in 2020 or 2021 to the same quarter in 2019. Notice 2021-23 also provides rules that address the circumstance in which the employer was not in existence as of the beginning of a calendar quarter in 2019 and rules for how an employer may elect to use an alternative quarter to determine whether it has experienced a decline in gross receipts. These rules that apply for purposes of determining whether an employer is an eligible employer based on a decline in gross receipts also apply, in the third and fourth calendar quarters of 2021, for purposes of determining whether an eligible employer is a severely financially distressed employer based on the 10 percent threshold.⁴ For example, an eligible employer that has gross receipts of 5 percent in the second quarter of 2021 compared to gross receipts in the

⁴ These rules apply for determining whether an eligible employer that has already met the decline in gross receipts test will be treated as a severely financially distressed employer with respect to qualified wages; a severely financially distressed employer is not a separate category of eligible employer. An employer should first determine whether it satisfies the definition of eligible employer before determining whether it is considered a severely financially distressed employer.

second quarter of 2019 is a severely financially distressed employer for the third quarter of 2021 based on the alternative quarter election.

If an employer is a severely financially distressed employer, section 3134(c)(3)(C)(i) of the Code provides that, notwithstanding section 3134(c)(3)(A)(i) (which limits qualified wages for large eligible employers to wages paid to an employee for time the employee is not providing services due to a full or partial suspension or a decline in gross receipts), the term “qualified wages” means wages paid by such employer with respect to an employee during any calendar quarter.⁵ Accordingly, for the third and fourth calendar quarters of 2021, a severely financially distressed employer that is a large eligible employer may treat all wages paid to its employees during the quarter in which the employer is considered severely financially distressed as qualified wages.

Example: Employer A is a large eligible employer with gross receipts in the third quarter of 2021 equal to 15 percent of its gross receipts in the third quarter of 2019. Employer A is not a severely financially distressed employer for the third quarter of 2021 based on the third quarter’s gross receipts. However, Employer A’s gross receipts in the second quarter of 2021 are less than 10

⁵ The language of section 3134(c)(3)(C)(i) of the Code is ambiguous as to the calendar quarter in which wages paid by a severely financially distressed employer may be treated as qualified wages. Due to the reference to section 3134(c)(3)(A)(i) of the Code, however, the Treasury Department and the IRS have determined that Congress intended section 3134(c)(3)(C)(i) to extend the small eligible employer rule to a severely financially distressed employer that is also a large eligible employer, and not to change the timing of when qualified wages are paid for purposes of claiming the employee retention credit. Therefore, a severely financially distressed employer may claim the employee retention credit only with respect to qualified wages the employer paid in the same calendar quarter in which it is claiming the credit.

percent of its gross receipts in the second quarter of 2019; therefore, Employer A may elect to use the alternative election rule to meet the definition of a severely financially distressed employer under section 3134(c)(3)(C)(ii) of the Code in the third quarter of 2021.

In the third quarter of 2021, Employer A pays Employee B \$10,000 in wages for services Employee B provided during the third quarter. Employer A may claim the employee retention credit in the third quarter of 2021 (the quarter in which Employer A is determined to be severely financially distressed under the alternative election rule) and may treat all of the wages paid to Employee B during the third quarter of 2021 as qualified wages.

In the fourth quarter of 2021, Employer A's gross receipts equal 20 percent of its gross receipts in the fourth quarter of 2019. Employer A is not a severely financially distressed employer for the fourth quarter of 2021 based on the fourth quarter's gross receipts. In addition, Employer A cannot use the alternative election rule in the fourth quarter of 2021 to qualify as a severely distressed employer because Employer A's gross receipts in the third quarter of 2021 are not less than 10 percent of its gross receipts in 2019; therefore, Employer A is not a severely financially distressed employer (though it is still an eligible employer) in the fourth quarter of 2021.

Employer A pays Employee B \$10,000 in wages in the fourth quarter of 2021 for services Employee B provided during the fourth quarter of 2021. Employer A may not treat any of the wages paid to Employee B for services

provided during the fourth quarter as qualified wages because Employer A is a large eligible employer and does not meet the definition of a severely financially distressed employer for the fourth quarter of 2021.

Section 3134(c)(3)(D) of the Code provides that for the third and fourth calendar quarters of 2021, the term “qualified wages” does not include any wages taken into account under sections 41, 45A, 45P, 45S, 51, 1396, 3131, and 3132 of the Code. That is, if wages are taken into account for purposes of those sections, those wages cannot be taken into account for purposes of the employee retention credit.⁶

F. Coordination with Certain Programs

Section 3134(h)(1) of the Code provides that section 3134 does not apply to qualified wages paid by an eligible employer if the qualified wages are taken into account as payroll costs in connection with certain programs. Section 3134(h)(1)(A) provides that section 3134 does not apply to so much of the qualified wages as are taken into account as payroll costs in connection with a covered loan under section 7(a)(37) or 7A of the Small Business Act (a first or second draw PPP loan). Section 3134(h)(1)(B) provides that section 3134 does not apply to so much of the qualified wages as are taken into account as payroll costs in connection with a grant under section 324 of the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act (shuttered venue operators grant), enacted as Title III of Division N of the

⁶ These Code sections, with the exception of sections 3131 and 3132, were included in the denial of double benefit provisions for the first and second calendar quarters of 2021 and applied in the inverse order, meaning that any wages taken into account as qualified wages for the employee retention credit could not be taken into account for those sections. See section III.E. of Notice 2021-23.

Consolidated Appropriations Act, 2021. Section 3134(h)(1)(C) provides that section 3134 does not apply to so much of the qualified wages as are taken into account as payroll costs in connection with a restaurant revitalization grant under section 5003 of the ARP (restaurant revitalization grant).

Section 3134(h)(2) of the Code states that the Secretary will issue guidance providing that payroll costs paid during the covered period will not fail to be treated as qualified wages under section 3134 to the extent that a first or second draw PPP loan is not forgiven by reason of a decision under section 7(a)(37)(J) or section 7A(g) of the Small Business Act.

Section III.I. of Notice 2021-20 provides rules related to the interaction between PPP loans and the employee retention credit; under those rules, the employee retention credit does not apply to the qualified wages for which an election or deemed election to not take the wages into account for purposes of the credit is made. These rules are derived from section 2301(g)(1) and (g)(2) of the CARES Act, as amended by the Relief Act. Section 3134(g) of the Code retains the same language as section 2301(g)(1) of the CARES Act and section 3134(h)(1) and (h)(2) is similar in operation to section 2301(g)(1) and (g)(2); accordingly, the rules related to the interaction between PPP loans and the employee retention credit under section III.I. of Notice 2021-20 continue to apply in the third and fourth calendar quarters of 2021. Thus, the determination of whether section 3134 applies to amounts of qualified wages taken into account as payroll costs for PPP loans for purposes of section 3134(h)(1)(A) and (h)(2) are made in

the same manner and under the same principles as prescribed in section III.I. of Notice

2021-20.

The shuttered venue operators grant was established by section 324 of the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act and amended by the ARP. The restaurant revitalization grant was established by the ARP.

Coordination between the employee retention credit and these grants is not required under section 2301 of the CARES Act, which governs the employee retention credit for 2020 and the first two quarters of 2021. However, pursuant to section 3134(h)(1)(B) and (C) of the Code, an eligible employer receiving a shuttered venue operators grant or restaurant revitalization grant may not treat any amounts reported to the Small Business Administration (SBA) or otherwise taken into account as payroll costs in connection with either program as qualified wages for purposes of the employee retention credit in the third and fourth quarters of 2021. An eligible employer receiving a shuttered venue operators grant or restaurant revitalization grant must retain in its records support for the employee retention credit claimed, which includes any documentation supporting that the eligible employer did not claim the employee retention credit on amounts taken into account as payroll costs paid in the third and fourth quarters of 2021 in connection with the shuttered venue operators grant or restaurant revitalization grant programs.

G. Claiming the Credit

Section III.J. of Notice 2021-20 and section III.F. of Notice 2021-23 set forth the rules for claiming the employee retention credit in 2020 and the first and second calendar quarters in 2021, respectively. The rules as set forth in Notice 2021-20 and

Notice 2021-23, including the rules pertaining to claiming an advance and relevant

limitations, continue to apply for the third and fourth quarters in 2021.

Section 3134(j)(3)(B) of the Code provides for the reconciliation of the employee retention credit with advance payments of the credit. If an employer receives excess advance payments of the credit, then the tax imposed under section 3111(b) of the Code or so much of the tax imposed under section 3221(a) of the Code as is attributable to the rate in effect under section 3111(b), as applicable, for the calendar quarter is increased by the amount of the excess. Section 2301 of the CARES Act, as amended by section 207 of the Relief Act, also provides for the reconciliation of the credit with advance payments, but the reconciliation under section 3134(j)(3)(B) is modified due to the change in the definition of applicable employment taxes as discussed in section III.B of this notice and to specifically provide that excess advances for employers described in section 3134(j)(2) are treated as an additional tax.⁷

Section 3134(l) of the Code extends the limitation on assessment. Section 3134(l) provides that, notwithstanding section 6501 of the Code, the limitation on the time period for the assessment of any amount attributable to a credit claimed under section 3134 will not expire before the date that is 5 years after the later of (i) the date on which the original return that includes the calendar quarter with respect to which the

⁷ On July 29, 2020, the Treasury Department and the IRS issued temporary regulations (T.D. 9904) amending the employment tax regulations under sections 3111 and 3221 of the Code to provide for the recapture of erroneous refunds of the credits under section 2301 of the CARES Act pursuant to the authority granted under section 2301 of the CARES Act (81 FR 45514). A notice of proposed rulemaking cross-referencing the temporary regulations was published in the Federal Register on the same day as the temporary regulations (85 FR 45551).

credit is determined is filed, or (ii) the date on which the return is treated as filed under section 6501(b)(2). The extension of limitation on assessment applies to the employee retention credit claimed for the third and fourth calendar quarters of 2021 under section 3134 but does not apply to the employee retention credit under section 2301 of the CARES Act.

IV. GUIDANCE ON MISCELLANEOUS ISSUES APPLICABLE TO THE EMPLOYEE RETENTION CREDIT FOR BOTH 2020 AND 2021

This section IV addresses several issues related to the employee retention credit available during both 2020 and 2021. Unless otherwise provided below in this section, the provisions of this section IV apply to, and are intended to clarify the application of, the employee retention credit under both section 2301 of the CARES Act, as amended by the Relief Act, and section 3134 of the Code for calendar quarters in 2020 and 2021.

To the extent that an employer files an adjusted or amended return to reflect these clarifications and consequently owes additional tax, any penalties for failure to timely pay or deposit tax will not apply if the taxpayer can show reasonable cause and not willful neglect for those failures.

A. Full-time Employees and Full-time Equivalents

The Treasury Department and the IRS have been asked about the definition of "full-time employee"⁸ for the purpose of the employee retention credit, including (i)

⁸ The term "full-time employee" means an employee who, with respect to any calendar month in 2019, had an average of at least 30 hours of service per week or 130 hours of service in the month (130

whether “full-time equivalents” (within the meaning of section 4980H(c)(2)(E) of the Code) are required to be included in the determination of whether an eligible employer is a large eligible employer or small eligible employer and (ii) whether wages paid to employees who are not full-time employees may be treated as qualified wages if all other requirements to treat the amounts as qualified wages are satisfied. For purposes of determining whether an eligible employer is a large eligible employer or a small eligible employer, eligible employers are not required to include full-time equivalents when determining the average number of full-time employees. However, for purposes of identifying qualified wages, an employee’s status as a full-time employee is irrelevant and wages paid to an employee who is not full-time may be treated as qualified wages if all other requirements to treat the amounts as qualified wages are satisfied.

B. Treatment of Tips and the Section 45B Credit

The Treasury Department and the IRS have been asked whether tips are qualified wages. In general, qualified wages are limited to wages as defined in section 3121(a) of the Code and compensation as defined in section 3231(e) of the Code, with certain modifications relating to the inclusion of qualified health plan expenses and, for calendar quarters in 2021, remuneration paid for services to certain governmental employers. In addition, under section 2301(c)(6) of the CARES Act and section

hours of service in a month is treated as the monthly equivalent of at least 30 hours of service per week), as determined in accordance with section 4980H of the Code. See Q/A-31 of Notice 2021-20 and section III.E. of Notice 2021-23.

3134(c)(6) of the Code, any term used in section 2301 or section 3134, respectively, has the same meaning as when used in chapter 21 or chapter 22 of the Code.

Section 3121(a)(12) of the Code excludes from the definition of “wages” tips paid in any medium other than cash and cash tips received by an employee in any calendar month in the course of employment by an employer unless the amount of the cash tips is \$20 or more. Accordingly, if cash tips received by an employee in a calendar month amount to \$20 or more, all of the cash tips received by the employee in that calendar month are included in wages. Similarly, section 3231(e)(3) of the Code provides that the term “compensation” includes cash tips received by an employee in any calendar month in the course of employment by an employer unless the amount of such cash tips is less than \$20. Under section 3121(q), tips received by an employee in the course of the employee’s employment are considered remuneration for that employment (*i.e.*, wages) and are deemed to have been paid by the employer for purposes of the taxes imposed by section 3111(a) and (b) of the Code. Thus, for purposes of chapters 21 and 22 of the Code, cash tips of \$20 or more in a month are treated as wages paid by the employer.

Therefore, any cash tips treated as wages within the definition of section 3121(a) of the Code or compensation within the definition of section 3231(e)(3) of the Code are treated as qualified wages if all other requirements to treat the amounts as qualified wages are satisfied.

The Treasury Department and the IRS have also been asked whether an eligible employer may claim both the employee retention credit and the credit available under section 45B of the Code on the same wages. Section 45B(a) provides that, for purposes

of the general business credit under section 38 of the Code, the credit for employer social security and Medicare taxes paid on certain employee tips is an amount equal to the “excess employer social security tax” paid or incurred by the employer. The term “excess employer social security tax” means any tax paid by an employer under section 3111 of the Code (both social security tax and Medicare tax) on its employees' tip income without regard to whether the employees reported the tips to the employer pursuant to section 6053(a) of the Code. Consequently, the section 45B credit is available with respect to unreported tips in an amount equal to the “excess employer social security tax” paid or incurred by the employer. No credit, however, is allowed to the extent tips are used to meet the federal minimum wage rate. For purposes of this limitation, the federal minimum wage rate is the rate that was in effect on January 1, 2007. The credit is available with respect to Federal Insurance Contributions Act (FICA) taxes paid on tips received from customers in connection with the providing, delivering, or serving of food or beverages for consumption, if it is customary for customers to tip the employees.

Section 2301 of the CARES Act and section 3134 of the Code cross-reference specific provisions in the Code, the CARES Act, the FFCRA, the Consolidated Appropriations Act, 2021, and the ARP that prevent the receipt of a double benefit with respect to wages for which the employee retention credit is claimed. Neither section 2301 nor section 3134 cross-references section 45B of the Code. Section 45B(c) denies a deduction under chapter 1 of the Code for any amount taken into account in determining the credit under section 45B; however, this provision does not prevent the

receipt of both the employee retention credit and the section 45B credit for the same wages. Therefore, eligible employers are not prevented from receiving both the employee retention credit and the section 45B credit for the same wages.

C. Timing of Qualified Wages Deduction Disallowance

Section 2301(e) of the CARES Act, as explained in section III.L. of Notice 2021-20, and section 3134(e) of the Code provide the general rule that an employer's deduction for qualified wages, including qualified health plan expenses, is reduced by the amount of the employee retention credit. The Treasury Department and the IRS have been asked about the timing of the reduction, specifically in the circumstance in which a taxpayer files an adjusted employment tax return to claim the employee retention credit for prior calendar quarters and has already filed a federal income tax return for the tax year in which the credit is claimed on the adjusted return.

Under section III.L. of Notice 2021-20, a reduction in the amount of the deduction allowed for qualified wages, including qualified health plan expenses, caused by receipt of the employee retention credit occurs for the tax year in which the qualified wages were paid or incurred. When a taxpayer claims the employee retention credit because of the retroactive amendment of section 2301 of the CARES Act by section 206(c) of the Relief Act (relating to eligibility of PPP borrowers to claim the employee retention credit, or otherwise files an adjusted employment tax return to claim the employee retention credit, the taxpayer should file an amended federal income tax return or administrative adjustment request (AAR), if applicable, for the taxable year in which the qualified wages were paid or incurred to correct any overstated deduction taken with respect to

those same wages on the original federal tax return. Section 2301(e) generally provides, in relevant part, that rules similar to the rules of section 280C(a) of the Code shall apply. Section 280C(a) requires tracing to the specific wages generating the applicable credit. See, generally, Treas. Reg. § 1.280C-1. To satisfy this tracing requirement, the taxpayer must file an amended return or AAR, as applicable.

D. Related Individuals

The Treasury Department and the IRS have been asked whether wages paid to an employee who owns more than 50 percent (majority owner) of the value of a corporation may be treated as qualified wages, as well as whether wages paid to a spouse of a majority owner may be treated as qualified wages.

Section 2301(e) of the CARES Act and section 3134(e) of the Code provide, in relevant part, that rules similar to the rules of section 51(i)(1) of the Code apply. Section 51(i)(1) generally provides that wages paid to certain related individuals are not taken into account for purposes of the work opportunity credit. Specifically, section 51(i)(1) and Treas. Reg. § 1.51-1(e)(1) provide that wages are not taken into account with respect to an individual who bears any of the relationships described in section 152(d)(2)(A)-(H) of the Code to the following:

- (i) the taxpayer, or
- (ii) 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 (majority owner of a corporation), or

- (iii) 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 (majority owner of a noncorporate entity).

Section 51(i)(1)(A) includes a parenthetical at the end of the subparagraph stating that an individual's ownership is determined with the application of section 267(c) of the Code. The Treasury Department and the IRS have concluded that the section 267(c) ownership attribution rules apply for purposes of determining both an individual's ownership of stock of a corporation and an individual's capital and profits interests in a partnership or other entity, consistent with the language in Treas. Reg. § 1.51-1(e)(1)(iii) and section 51(i)(1)(A).

Initially, simply applying the rules of section 152(d)(2)(A)-(H) of the Code for purposes of the employee retention credit, before taking into consideration the attribution rules of section 267(c), the wages paid to employees with the following relationships to a majority owner of a corporation or of a partnership or other entity are not qualified wages:

- (A) A child or a descendant of a child.
- (B) A brother, sister, stepbrother, or stepsister.
- (C) The father or mother, or an ancestor of either.
- (D) A stepfather or stepmother.
- (E) A niece or nephew.
- (F) An aunt or uncle.

- (G) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.
- (H) An individual (other than a spouse, determined without regard to section 7703 , of the taxpayer) who, for the taxable year of the taxpayer, has the same principal place of abode as the taxpayer and is a member of the taxpayer's household.

Section 267(c) of the Code provides rules regarding the constructive ownership of stock for purposes of determining whether an individual is considered a majority owner of a corporation.⁹ Section 267(c) sets forth the following rules to determine whether an individual has constructive ownership of stock of a corporation:

- (1) stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust is considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;
- (2) an individual is considered to own the stock owned, directly or indirectly, by or for the individual's family;
- (3) an individual owning (otherwise than by the application of (2)) any stock in a corporation is considered to own the stock owned, directly or indirectly, by or for his partner;

⁹ This discussion is limited to a majority owner of a corporation because the owner of a partnership, or other noncorporate entity, generally cannot be an employee of that entity, and therefore cannot be paid wages within the meaning of section 3121(a) of the Code. A partner or other self-employed individual is not eligible for the employee retention credit on the individual's earned income.

- (4) the family of an individual includes only his brothers and sisters (whether by the whole or half-blood), spouse, ancestors, and lineal descendants; and
- (5) stock constructively owned by a person by reason of the application of (1) will be treated, for the purpose of applying (1), (2), or (3), as actually owned by that person. Stock constructively owned by an individual by reason of the application of (2) or (3) will not be treated as owned by the individual to again apply either rule to reattribute and make another individual the constructive owner of the stock.

Applying the rules of sections 152(d)(2)(A)-(H) and 267(c) of the Code, a majority owner of a corporation is a related individual for purposes of the employee retention credit, whose wages are not qualified wages, if the majority owner has a brother or sister (whether by whole or half-blood), ancestor, or lineal descendant. That is, applying the constructive ownership rules of section 267(c), the direct majority owner's ownership of the corporation is attributed to each of the owner's family members with a relationship described in section 267(c)(4); further, because each of those family members is considered to own more than 50 percent of the stock of the corporation after applying section 267(c), the direct majority owner of the corporation would have a relationship as defined in section 152(d)(2)(A)-(H) to the family member who is a constructive majority

owner. Therefore, the direct majority owner is a related individual for purposes of the employee retention credit.¹⁰

The spouse of a majority owner is a related individual for purposes of the employee retention credit, whose wages are not qualified wages, if the majority owner has a family member who is a brother or sister (whether by whole or half-blood), ancestor, or lineal descendant (and thus is deemed to own the majority owner's shares under section 267(c) of the Code) and the spouse bears a relationship described in section 152(d)(2)(A)-(H) of the Code to the family member. For example, a direct majority owner's brother would be a constructive majority owner under section 267(c)(2) and (4) and the spouse of the direct majority owner would be considered a related individual to the constructive majority owner by virtue of the in-law relationship described in section 152(d)(2)(G).

In the event that the majority owner of a corporation has no brother or sister (whether by whole or half-blood), ancestor, or lineal descendant as defined in section 267(c)(4) of the Code, then neither the majority owner nor the spouse is a related individual within the meaning of section 51(i)(1) of the Code and the wages paid to the majority owner and/or the spouse are qualified wages for purposes of the employee retention credit, assuming the other requirements for qualified wages are satisfied.

The following examples illustrate the application of these rules:

¹⁰ Depending on the facts, the application of the rules of sections 152(d)(2)(A)-(H) and 267(c) may also result in a minority owner of a corporation being a related individual for purposes of the employee retention credit. See, example 4.

Example 1: Corporation A is owned 80 percent by Individual E and 20 percent by Individual F. Individual F is the child of Individual E. Corporation A is an eligible employer with respect to the first calendar quarter of 2021. Both Individual E and Individual F are employees of Corporation A. Pursuant to the attribution rules of section 267(c) of the Code, both Individual E and Individual F are treated as 100 percent owners of Corporation A. Individual E has the relationship to Individual F described in section 152(d)(2)(C) of the Code, and Individual F has the relationship to Individual E described in section 152(d)(2)(A). Accordingly, Corporation A may not treat as qualified wages any wages paid to either Individual E or Individual F because both Individual E and Individual F are each related individuals for purposes of the employee retention credit.

Example 2: Corporation B is owned 100 percent by Individual G. Individual H is the child of Individual G. Corporation B is an eligible employer with respect to the first calendar quarter of 2021. Individual G is an employee of Corporation B, but Individual H is not. Pursuant to the attribution rules of section 267(c) of the Code, Individual H is attributed 100 percent ownership of Corporation B, and both Individual G and Individual H are treated as 100 percent owners. Individual G has the relationship to Individual H described in section 152(d)(2)(C) of the Code. Accordingly, Corporation B may not treat as qualified wages any wages paid to Individual G because Individual G is a related individual for purposes of the employee retention credit.

Example 3: Corporation C is owned 100 percent by Individual J.

Corporation C is an eligible employer with respect to the first calendar quarter of 2021. Individual J is married to Individual K, and they have no other family members as defined in section 267(c)(4) of the Code. Individual J and Individual K are both employees of Corporation C. Pursuant to the attribution rules of section 267(c), Individual K is attributed 100 percent ownership of Corporation A, and both Individual J and Individual K are treated as 100 percent owners. However, Individuals J and K do not have any of the relationships to each other described in section 152(d)(2)(A)-(H) of the Code. Accordingly, wages paid by Corporation C to Individual J and Individual K in the first calendar quarter of 2021 may be treated as qualified wages if the amounts satisfy the other requirements to be treated as qualified wages.

Example 4: Corporation D is owned 34 percent by Individual L, 33 percent by Individual M, and 33 percent by Individual N. Individual L, Individual M, and Individual N are siblings. Corporation D is an eligible employer with respect to the first calendar quarter of 2021. Individual L, Individual M, and Individual N are employees of Corporation D. Pursuant to the attribution rules of section 267(c) of the Code, Individual L, Individual M, and Individual N are treated as 100 percent owners. Individual L, Individual M, and Individual N have the relationship to each other described in section 152(d)(2)(B) of the Code. Accordingly, Corporation D may not treat as qualified wages any wages paid to Individual L, Individual M, or Individual N.

E. Alternative Quarter Election for Calendar Quarters in 2021

Section III.C. of Notice 2021-23 provides rules for determining whether an employer had a decline in gross receipts for purposes of the employee retention credit for the first and second calendar quarters of 2021. Section 3134 of the Code extends the same rules to the third and fourth calendar quarters of 2021; thus, the rules provided in section III.C. of Notice 2021-23 continue to apply for these quarters.

Section III.C. of Notice 2021-23 also provides rules for using the alternative quarter election when determining whether there has been a decline in gross receipts for purposes of the employee retention credit for a calendar quarter in 2021. The Treasury Department and the IRS have been asked whether an eligible employer must consistently use the alternative quarter election once it has made the election.

As noted in section III.C. of Notice 2021-23, the determination of whether an employer is an eligible employer based on a decline in gross receipts is made separately for each calendar quarter. Thus, employers are not required to use the alternative quarter election consistently. For example, an employer may be an eligible employer due to a decline in gross receipts for the second quarter of 2021 if its gross receipts for the second quarter are equal to 75 percent of its gross receipts in the second quarter of 2019 (i.e., the employer does not rely on the alternative quarter election for the second quarter); the employer could then use the alternative quarter election to be an eligible employer for the third quarter of 2021.

F. Gross Receipts Safe Harbor in Notice 2021-20

Section III.E. of Notice 2021-20 permits an employer that acquires a business in 2020 to include the gross receipts of the acquired business in its gross receipts for 2019 to determine whether the employer experienced a significant decline in gross receipts. The safe harbor allows the employer to include the gross receipts of the acquired business regardless of the fact that the employer did not own the acquired business during a calendar quarter in 2019. The Treasury Department and the IRS have been asked whether this rule continues to apply to employers that acquire businesses in 2021. This rule continues to apply to employers that acquire businesses in 2021 for purposes of measuring whether a decline in gross receipts occurred.

The Treasury Department and the IRS have also been asked how to calculate gross receipts of employers that came into existence in the middle of a calendar quarter in 2020. Section III.E. of Notice 2021-20 provides rules for determining gross receipts for an employer that came into existence in 2019. The same rule set forth in section III.E. of Notice 2021-20 continues to apply for 2021. For example, an employer that came into existence in the third quarter of 2020 should use that quarter as the base period to determine whether it experienced a significant decline in gross receipts for the first three quarters in 2021 and should use the fourth quarter of 2020 for comparison to the fourth quarter of 2021 to determine whether it experienced a significant decline in gross receipts.

V. EFFECT ON OTHER DOCUMENTS

Notice 2021-20 and Notice 2021-23 are amplified and clarified as provided in this notice.

VI. PAPERWORK REDUCTION ACT

Any collection of information associated with this notice has been submitted to the Office of Management and Budget for review under OMB control number 1545-0029 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). An agency may not conduct or sponsor and a person is not required to respond to a collection of information unless it displays a valid OMB control number.

VII. DRAFTING INFORMATION

The principal authors of this notice are Dixie Pond and Danchai Mekadenaumporn, of the Office of the Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes), although other Treasury Department and IRS officials participated in its development. For further information on the provisions of this notice, please contact Ms. Pond or Mr. Mekadenaumporn at 202-317-6798 (not a toll-free call).