

IRS Addresses Retroactive Termination of the Employee Retention Credit

Some employers retained payroll taxes, expecting a tax credit for 4th-quarter wages

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The employee retention credit (ERC), also referred to as the employee retention tax credit (ERTC), was created in March 2020 (<https://www.irs.gov/newsroom/new-employee-retention-credit-helps-employers-keep-employees-on-payroll>) to encourage eligible businesses to keep employees on payroll. It had been set to expire on Jan. 1, 2022, but the Infrastructure Investment and Jobs Act signed into law in November accelerated the end of the credit retroactive to Oct. 1, 2021—except for wages paid by a recovery startup business (<https://www.btcpa.net/2021/10/25/employee-retention-credit-recovery-startup-businesses/>) (RSB), for which the expiration date stayed unchanged.

On Dec. 6, the IRS issued Notice 2021-65 ([Notice 2021-65 also provides guidance regarding how the rules apply to RSBs during the fourth quarter of 2021.](https://urldefense.proofpoint.com/v2/url?u=https-3A__lnks.gd_l_eyJhbGciOiJIUzI1NiJ9.eyJidWxsZXRpbI9saW5rX2lkjoxMjcsInVyaSI6ImJwMjpbGJjaylslmJ1bGxldGluX2lkjoiMjAyMTEyMDYuNDk4NTY4MzEiLCJ1cmwiOiJodHRwczovL3d3dy5pcnMuZ292L3B1Yi9pcnMtZlZlLnBkZiJ9.-5FmKNGf8ulHikefGhA7-2DSicu0pCf52EqbuwYpofItqa8_s_7454309_br_122398046596-2DI&d=DwMFAA&c=nQOnw6HHAeKBNxj23OXhOw&r=BO0HZIQJ7bjQ58Ey6XwV61XB5hLwjp8fW6_k3EPxjKQ&m=P1ZISo9BOjgSXahQaUj-Ry032_GC98GMOaHi-eoryQ7BTpRTUCFjuOIHnHUR2BBU&s=hyC7AHEDNYBkLFpZns_lzyFHe0VtQUq4phUPCdxB5Yc&e=), which clarifies steps eligible employers should take if they paid wages after Sept. 30, 2021, received an advance payment of the ERC for those wages or reduced employment tax deposits in anticipation of the credit for the fourth quarter of 2021, and are now ineligible for the credit due to the change in the law.</p>
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Qualifying Employers

Employers eligible for the ERC included those forced to suspend operations due to the pandemic and those that experienced a significant decline in gross receipts. Qualifying employers could claim up to 70 percent (\$7,000) of the first \$10,000 in pay and health benefits in each qualifying quarter. Small employers that received a Paycheck Protection Program loan could also claim the ERC.

New Guidance

Notice 2021-65 addresses steps employers can take to avoid IRS penalties in the following situations:

- **Employers that received advance payments.** Generally, employers that are not RSBs and received advance payments for fourth-quarter wages of 2021 will avoid failure-to-pay penalties if they repay those amounts by the due date of their employment tax returns.
- **Employers that reduced employment tax deposits.** Employers, excluding RSBs, that reduced deposits on or before Dec. 20, 2021, for wages paid during the fourth calendar quarter of 2021 in anticipation of receiving the ERC will not be subject to a failure-to-deposit penalty with respect to the retained deposits if:
 - **The employer reduced deposits** in anticipation of the ERC consistent with the rules in Notice 2021-24 (<https://www.irs.gov/pub/irs-drop/n-21-24.pdf>).
 - **The employer deposits the amounts initially retained in anticipation of the ERC** on or before the relevant due date for wages paid on Dec. 31, 2021 (regardless of whether the employer actually pays wages on that date). Deposit due dates will vary based on the deposit schedule of the employer.
 - **The employer reports the tax liability** resulting from the termination of the employer's ERC on the applicable employment tax return or schedule that includes the period from Oct. 1, 2021, through Dec. 31, 2021.

The IRS advised employers to refer to the instructions on their employment tax return or schedule for additional information on how to report the tax liability.

"Due to the termination of the ERC for wages paid in the fourth quarter of 2021 for employers that are not recovery startup businesses, failure to deposit penalties are not waived for these employers if they reduce deposits after Dec. 20, 2021," the IRS said.

If an employer does not qualify for relief under Notice 2021-65, it may reply to an IRS penalty notice with an explanation and the IRS will consider reasonable cause relief, the guidance states.

Late Claims for the ERC

Brent Johnson, co-founder and CEO of Clarus R+D, a maker of tax credit software, noted that although the eligibility period for the credit was ended retroactive to the end of the third quarter of 2021, "the time frame for making a claim under the program will continue for at least three years."

Eligible businesses can file a claim for a retroactive ERC refund on previously paid qualified wages for past calendar quarters by filing Form 941-X (<https://www.irs.gov/forms-pubs/about-form-941-x>), Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, he noted.

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