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Employee Retention Credit Terminated Early Retroactive to Oct. 1 by Infrastructure Act – No Penalty Relief or Time to Pay Back Advance Credit

The 70% employee retention credit for wages paid that Congress first enacted under the Coronavirus Aid, Relief, and Economic Security (CARES) Act will come to a premature end. Under the infrastructure bill Congress recently passed, the credit expires three months earlier than scheduled. The early repeal of this credit is retroactive to Oct. 1, 2021, and does not provide for any penalty relief for companies that have been monetizing the credit as wages are paid, as IRS guidance allowed. The bill is scheduled to be signed into law Nov. 15.

The 70% refundable tax credit for wages paid (up to a maximum of \$7,000 per employee per quarter) was available to an eligible business (one that employed 500 or fewer full-time employees in 2019) if the business had a greater than 20% reduction in gross receipts for the quarter, compared to the same quarter in 2019. *See April 2021 GT Alert* for details. Due to the infrastructure bill's early termination of the credit, however, there will be no credit for wages paid beginning Oct. 1.

Some companies have been continuing to monetize the credit since Oct. 1 as they have paid wages because the IRS allowed businesses to retain payroll taxes withheld from their employees as an advance payment in anticipation of receiving the credit. This essentially allowed companies to “pocket” the withheld taxes as a credit toward the ultimate retention credit claimed on the quarterly Form 941 payroll tax return. As a

result of the retroactive repeal of the credit, companies may have continued to retain payroll taxes they would otherwise have deposited with the U.S. Treasury if they were not aware of the early repeal.

The infrastructure bill does not provide for penalty relief for the businesses that have been retaining payroll taxes. The penalty goes up to 10% of the amount of payroll taxes that should have been deposited if the deposit is over 15 days late. Furthermore, there is no provision allowing a business to pay back the amount it had expected to claim over time. As a result, interest will accrue on the amount of payroll taxes not deposited, plus the penalty.

In addition to having to repay the payroll taxes, penalties, and interest due on payroll taxes retained in anticipation of the credit for fourth quarter wages already paid, some companies already have deferred the employer's share of Social Security taxes for wages paid between April 1 and Dec. 31, 2020, as allowed under the CARES Act. Companies must repay the first half of these deferred taxes by Dec. 31, 2021. Consequently, some small businesses will now have to: 1) repay advances of the retention credit they have been monetizing by retaining payroll taxes withheld since Oct. 1; and 2) repay their share of Social Security taxes deferred during the second through fourth quarters of 2020. This financial strain will likely distress some companies. Moreover, the result may be that the tax legislation theoretically designed to help small companies which were suffering and potentially dying due to the pandemic may ultimately result in their demise.

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