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## Guidance on the Employee Retention Credit under the CARES Act for the First and Second Calendar Quarters of 2021

Notice 2021-23

### I. PURPOSE

This notice amplifies Notice 2021-20, 2021-11 I.R.B. 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 (March 27, 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 (December 27, 2020). Specifically, this notice expands on the guidance provided in Notice 2021-20 by providing guidance with respect to the amendments made to section 2301 of the CARES Act by section 207 of the Relief Act, which are effective beginning January 1, 2021.

### II. BACKGROUND

Section 2301 of the CARES Act, as originally enacted, provides for an employee retention credit for eligible employers, including tax-exempt organizations, that pay qualified wages, including certain health plan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 of the CARES Act for qualified

wages paid after March 12, 2020, and before January 1, 2021, primarily relating to who may claim the credit. Section 206 of the Relief Act is retroactive to the enactment of the CARES Act. Section 207 of the Relief Act, which is prospective only, further amends section 2301 of the CARES Act 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.

On March 1, 2021, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) issued Notice 2021-20, providing guidance on the employee retention credit under section 2301 of the CARES Act, taking into account the amendments made by section 206 of the Relief Act. Notice 2021-20 continues to apply to all employee retention credits for calendar quarters in 2020. This notice amplifies Notice 2021-20 by providing additional guidance on section 2301 of the CARES Act and addressing the amendments made by section 207 of the Relief Act, applicable to the first and second calendar quarters of 2021. As amplified by this notice, the applicable provisions of Notice 2021-20 addressing rules that were not changed by section 207 of the Relief Act, continue to apply to employee retention credits for the first and second calendar quarters of 2021.

Section 9651 of the American Rescue Plan Act of 2021 (ARP Act), Pub. L. No. 117-2, 135 Stat. 4 (March 11, 2021), enacted section 3134 of the Internal Revenue Code (Code), which provides an employee retention credit for wages paid after June 30, 2021, and before January 1, 2022. This notice does not address the employee

retention credit provided by section 3134 of the Code.<sup>1</sup> The employee retention credit governed by section 3134 of the Code will be addressed in future guidance.

### III. GUIDANCE

#### **A. Extension of Employee Retention Credit**

Section III.G. of Notice 2021-20 provides rules related to the determination of qualified wages paid by an eligible employer for purposes of the employee retention credit for 2020. Section 2301(m) of the CARES Act, as amended by section 207(a)(1) of the Relief Act, provides that section 2301 of the CARES Act applies to wages paid after March 12, 2020, and before July 1, 2021.<sup>2</sup> Accordingly, an eligible employer may also claim the employee retention credit for qualified wages paid in the first and second calendar quarters of 2021.

#### **B. Eligible Employers**

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<sup>1</sup> Section 3134 of the Code generally maintains the structure of the employee retention credit as provided under section 2301 of the CARES Act, as amended, with certain changes. Among other changes, section 3134 of the Code (1) makes the employee retention credit available for eligible employers that pay qualified wages after June 30, 2021, and before January 1, 2022; (2) applies the credit against taxes imposed under section 3111(b) of the Code, or so much of the taxes imposed under section 3221(a) of the Code as are attributable to the rate in effect under section 3111(b) of the Code; (3) expands the types of eligible employers to include a “recovery startup business” (as defined under section 3134(c)(5) of the Code) with a separate maximum credit amount; (4) modifies the definition of qualified wages for “severely financially distressed employers” (as defined under section 3134(c)(3)(C) of the Code); (5) modifies the definition of qualified wages to exclude any wages taken into account under sections 41, 45A, 45P, 45S, 51, 1396, 3131, and 3132 of the Code; (6) provides that the employee retention credit shall not apply to so much of the qualified wages paid by an eligible employer 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 grant under section 324 of the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act, or a restaurant revitalization grant under section 5003 of the ARP Act; and (7) extends the limitation on the time period for assessment from 3 years to 5 years.

<sup>2</sup> Although section 207(a)(1) of the Relief Act extends the credit to wages paid before July 1, 2021, section 207(k) of the Relief Act provides that the amendments made by section 207 of the Relief Act apply to calendar quarters beginning after December 31, 2020.

Section III.A. of Notice 2021-20 provides rules for determining whether an employer is an eligible employer for purposes of the employee retention credit for 2020. Section 2301(c)(2) of the CARES Act defines the term “eligible employer.” Section 2301(c)(2)(A)(i) of the CARES Act, as amended by section 207(a)(2) of the Relief Act, provides that, in order to be an eligible employer, an employer must have been carrying on a trade or business during the calendar quarter for which the credit is determined under section 2301(a) of the CARES Act.

Section 2301(f) of the CARES Act, as amended by section 207(d)(3)(A) of the Relief Act, provides that the employee retention credit is not available to the Government of the United States, the government of any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing (governmental entity). However, amended section 2301(f)(2)(A) provides an exception for any organization described in section 501(c)(1) of the Code and exempt from tax under section 501(a) of the Code, and amended section 2301(f)(2)(B) provides an exception for any governmental entity if the entity is a college or university or the principal purpose or function of the entity is providing medical or hospital care. The flush language of amended section 2301(f)(2) provides that in the case of any governmental entity that is a college or university, or the principal purpose or function of which is providing medical or hospital care, the entity shall be treated as satisfying the trade or business requirement in section 2301(c)(2)(A)(i). Accordingly, these entities may be eligible employers for the first and second calendar quarters of 2021, assuming they satisfy the other requirements to be eligible employers.

The Treasury Department and the IRS have determined that, for purposes of amended section 2301(f)(2)(B) of the CARES Act, a college or university means an educational organization as defined in section 170(b)(1)(A)(ii) of the Code and Treas. Reg. § 1.170A-9(c)(1) that is a college or university, and an entity that has the principal purpose or function of providing medical or hospital care means an entity that has the principal purpose or function of providing medical or hospital care within the meaning of section 170(b)(1)(A)(iii) of the Code and Treas. Reg. § 1.170A-9(d)(1).

### **C. Decline in Gross Receipts**

Section III.E. of Notice 2021-20 provides rules for determining when an employer experiences a significant decline in gross receipts. For 2020, the period during which there is a significant decline in gross receipts is generally determined by identifying the first calendar quarter in 2020 (if any) in which an employer's gross receipts are less than 50 percent of its gross receipts for the same calendar quarter in 2019. The period during which there is a significant decline in gross receipts ends with the earlier of January 1, 2021 or the calendar quarter following the first calendar quarter in which an employer's 2020 quarterly gross receipts are greater than 80 percent of its gross receipts for the same calendar quarter in 2019.

Section 2301(c)(2)(A)(ii)(II) of the CARES Act, as amended by section 207(d)(1)(A) of the Relief Act, provides that an employer is an eligible employer with respect to any calendar quarter for which its gross receipts (within the meaning of section 448(c) of the Code, or, for an eligible employer which is described in section 501(c) of the Code and exempt from tax under section 501(a) of the Code, within the

meaning of section 6033 of the Code) for the calendar quarter are less than 80 percent of its gross receipts for the same calendar quarter in 2019. Accordingly, for purposes of the employee retention credit for the first and second calendar quarters of 2021, the determination of whether an employer is an eligible employer based on a decline in gross receipts is made separately for each calendar quarter and is based on an 80 percent threshold.

In addition, section 2301(c)(2)(A) of the CARES Act, as further amended by section 207(d)(1)(B) of the Relief Act, states that with respect to any employer for any calendar quarter, if the employer was not in existence as of the beginning of the same calendar quarter in calendar year 2019, section 2301(c)(2)(A)(ii)(II) of the CARES Act is applied by substituting “2020” for “2019.” Accordingly, if an employer was not in existence as of the beginning of the first calendar quarter of 2019, that employer generally determines whether the decline in gross receipts test is met in the first calendar quarter of 2021 by comparing its gross receipts in the first calendar quarter of 2021 to its gross receipts in the first calendar quarter of 2020. Similarly, if an employer was not in existence as of the beginning of the second calendar quarter of 2019, that employer generally determines whether the decline in gross receipts test is met in the second calendar quarter of 2021 by comparing its gross receipts in the second calendar quarter of 2021 to its gross receipts in the second calendar quarter of 2020.

However, section 2301(c)(2)(B) of the CARES Act, as amended by section 207(d)(2) of the Relief Act, permits an employer to elect to use an alternative quarter to calculate gross receipts. Under this election, an employer may generally determine if

the decline in gross receipts test is met for a calendar quarter in 2021 by comparing its gross receipts for the immediately preceding calendar quarter with those for the corresponding calendar quarter in 2019 (substituting 2020 for 2019 if the employer did not exist as of the beginning of that quarter in 2019).

Accordingly, for the first calendar quarter of 2021, an employer may elect to use its gross receipts for the fourth calendar quarter of 2020 compared to those for the fourth calendar quarter of 2019 to determine if the decline in gross receipts test is met. If an employer was not in existence as of the beginning of the fourth calendar quarter of 2019, then the alternative quarter election will not be available for the first calendar quarter of 2021.

For the second calendar quarter of 2021, an employer may elect to use its gross receipts for the first calendar quarter of 2021 compared to those for the first calendar quarter of 2019 to determine if the decline in gross receipts test is met. If an employer was not in existence as of the beginning of the first calendar quarter of 2019, then that employer may elect to measure the decline in gross receipts for the second calendar quarter of 2021 using its gross receipts for the first calendar quarter of 2021 compared to those for the first calendar quarter of 2020.

Eligible employers must maintain documentation to support the determination of the decline in gross receipts, including which calendar quarter an eligible employer elects to use in measuring the decline. An election to use an alternative quarter to calculate gross receipts is made by claiming the employee retention credit for the quarter using the alternative quarter to calculate gross receipts.

#### **D. Maximum Amount of Employer's Employee Retention Credit**

Section III.F. of Notice 2021-20 provides rules related to the maximum amount of an employer's employee retention credit. For 2020, the employee retention credit equals 50 percent of qualified wages (including allocable qualified health plan expenses) that an eligible employer pays in a calendar quarter. The maximum amount of qualified wages (including allocable qualified health plan expenses) taken into account with respect to each employee for all calendar quarters in 2020 is \$10,000; thus, the maximum credit for qualified wages (including allocable qualified health plan expenses) paid to any employee in 2020 is \$5,000.

For the first and second calendar quarters of 2021, section 2301(a) of the CARES Act, as amended by section 207(b) of the Relief Act, provides that the employee retention credit equals 70 percent of qualified wages (including allocable qualified health plan expenses) that an eligible employer pays in a calendar quarter. Section 2301(b)(1) of the CARES Act, as amended by section 207(c) of the Relief Act, limits the amount of qualified wages (including allocable qualified health plan expenses) with respect to any employee that may be taken into account under section 2301(a) of the CARES Act to \$10,000 for any calendar quarter; thus the maximum credit for qualified wages (including allocable qualified health plan expenses) paid to an employee is \$7,000 for each of the first and second calendar quarters in 2021 (for a total of \$14,000).

#### **E. Qualified Wages**

As previously noted, section III.G. of Notice 2021-20 provides rules for determining qualified wages. The specific circumstances in which wage payments by an eligible employer will be considered qualified wages depend, in part, on the average number of full-time employees an eligible employer employed during 2019. For purposes of the employee retention credit for 2020, for an eligible employer with an average number of full-time employees<sup>3</sup> greater than 100 during 2019 (2020 large eligible employers), qualified wages are the wages paid to an employee for time that the employee is not providing services due to either (1) a full or partial suspension of an employer's business operations due to a governmental order, or (2) the business experiencing a significant decline in gross receipts. For purposes of the employee retention credit for 2020, for an eligible employer with an average number of full-time employees not greater than 100 during 2019 (2020 small eligible employers), qualified wages are the wages paid with respect to any employee during any period in the calendar quarter in which the business operations are fully or partially suspended due to a governmental order or during any calendar quarter in which the business is experiencing a significant decline in gross receipts.

Section 2301(c)(3)(A)(i) of the CARES Act, as amended by section 207(e)(1) of the Relief Act, provides that large eligible employers are eligible employers for which the average number of full-time employees during 2019 was greater than 500 (2021 large

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<sup>3</sup> In accordance with section 4980H(c)(4) of the Code and as provided by Notice 2021-20, the term "full-time employee" for purposes of the employee retention credit 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 hours of service in a month is treated as the monthly equivalent of at least 30 hours of service per week).

eligible employers). Section 2301(c)(3)(A)(ii) of the CARES Act, as amended by section 207(e)(1) of the Relief Act, provides that small eligible employers are eligible employers for which the average number of full-time employees during 2019 was not greater than 500 (2021 small eligible employers).

The aggregation rules described in section III.B. of Notice 2021-20 apply when determining whether an employer is a 2021 large eligible employer or 2021 small eligible employer, just as they do for determining 2020 large eligible employers and 2020 small eligible employers. Accordingly, the rules provided in section III.G of Notice 2021-20 are applied using the revised definitions of large eligible employer and small eligible employer for purposes of the employee retention credit for the first and second calendar quarters of 2021.

Section III.G. of Notice 2021-20 describes the rule in section 2301(c)(3)(B) of the CARES Act, as originally enacted, that for 2020 large eligible employers, qualified wages paid to an employee may not exceed what the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the commencement of the full or partial suspension of the operation of the trade or business or the first day of the calendar quarter in which the employer experienced a significant decline in gross receipts. Section 207(e)(2) of the Relief Act amended section 2301(c)(3)(B) of the CARES Act to remove this limitation on qualified wages paid during the first and second calendar quarters of 2021. Accordingly, that rule in section III.G. of Notice 2021-20 does not apply for determining the employee retention credit for the first and second calendar quarters of 2021.

Similarly, section III.G. of Notice 2021-20 explains that an amount must constitute “wages” within the meaning of section 3121(a) of the Code (or must constitute qualified health plan expenses properly allocable with respect to an employee) to be qualified wages. In general, “wages” for purposes of section 3121(a) of the Code means all remuneration for employment. Section 3121(b) of the Code defines “employment.” For certain governmental employers, amounts paid as remuneration are not wages because the services provided to these governmental employers are excepted from the definition of “employment.” Section 2301(c)(5)(A) of the CARES Act, as amended by section 207(d)(3)(B) of the Relief Act, provides that, in the case of any organization described in section 2301(f)(2) of the CARES Act, as amended by section 207(d)(3)(A) of the Relief Act, (that is, an organization described in section 501(c)(1) of the Code and exempt from tax under section 501(a) of the Code, or a governmental entity that is a college, university, or entity whose principal purpose or function is providing medical or hospital care), “wages” as defined in section 3121(a) of the Code will be determined without regard to paragraphs (5), (6), (7), (10), and (13) of section 3121(b) of the Code (except with respect to services performed in a penal institution by an inmate thereof). These specific exclusions from “employment,” which are disregarded for purposes of the employee retention credit for the first and second calendar quarters of 2021, relate to certain services performed for governmental or educational entities. Accordingly, for eligible employers described in section 2301(f)(2) of the CARES Act, as amended, remuneration for services described in paragraphs (5), (6), (7), (10), and (13) of section 3121(b) of the Code (except with respect to services

performed in a penal institution by an inmate thereof) constitutes wages for purposes of determining the employee retention credit for the first and second calendar quarters of 2021.

Section III.G. of Notice 2021-20 also provides that an employer may not claim a credit under section 45S of the Code (employer credit for paid family and medical leave) with respect to the qualified wages for which it claims the employee retention credit, but it may be able to take a credit under section 45S of the Code with respect to wages for which it did not claim an employee retention credit, provided the requirements of section 45S of the Code are met with respect to those wages. Section 2301(h)(1) of the CARES Act, as amended by section 207(f) of the Relief Act, adds sections 41, 45A, 45P, 51, and 1396 of the Code to the rule applicable to section 45S of the Code. Accordingly, the same rule described in section III.G. of Notice 2021-20 with respect to section 45S of the Code also applies with respect to sections 41, 45A, 45P, 51, and 1396 of the Code for the first and second calendar quarters of 2021.

Finally, section II.F. of Notice 2021-20 states that under section 2301(h)(1) of the CARES Act, an employee will not be included for purposes of computing the employee retention credit for any period that an employer is allowed a work opportunity credit under section 51 with respect to that employee. Section 207(f) of the Relief Act removed this restriction from section 2301(h) of the CARES Act. Accordingly, the rule discussed in section II.F. of Notice 2021-20 does not apply to employee retention credits claimed for the first and second calendar quarters of 2021.

## **F. Claiming the Employee Retention Credit**

Section III.J. of Notice 2021-20 provides various rules related to claiming the employee retention credit, including the circumstances under which an eligible employer may request an advance payment of the employee retention credit. For calendar quarters in 2020 there was no restriction on the types of eligible employers that could claim an advance, nor was there a maximum advance amount other than the amount of the employee retention credit eligible to be claimed, subject to the requirement that an eligible employer reduce deposits in anticipation of the credit before requesting an advance. The Relief Act did not amend section 2301(k) of the CARES Act, which provides for waiver of penalties for failure to deposit employment taxes if the failure was due to the reasonable anticipation of the employee retention credit. Thus, eligible employers may continue to access the employee retention credit for the first and second calendar quarters of 2021 prior to filing their employment tax returns by reducing employment tax deposits in anticipation of the employee retention credit, in accordance with the requirements of Notice 2020-22, 2020-17 I.R.B. 664.<sup>4</sup>

Section 2301(j) of the CARES Act, as amended by section 207(g) of the Relief Act, prohibits the advance payment of the employee retention credit except to 2021 small eligible employers. Section 2301(j)(2) of the CARES Act, as amended, provides that 2021 small eligible employers may elect to receive an advance payment of the employee retention credit in an amount not to exceed 70 percent of the average quarterly wages paid in calendar year 2019 (the 70 percent advance rule). The

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<sup>4</sup> The Treasury Department and IRS will issue separate guidance on the specific application of this penalty relief related to the employee retention credit for the 2021 calendar year.

requirement to reduce deposits in anticipation of the credit before requesting an advance continues to apply to 2021 small eligible employers.

Section 2301 of the CARES Act does not define the term “average quarterly wages.” The Treasury Department and the IRS have determined that for purposes of the 70 percent advance rule the term “average quarterly wages” generally means the average of wages (as defined in section 3121(a) of the Code), or compensation (as defined in section 3231(e) of the Code), both determined without regard to the social security wage base, paid in each calendar quarter in 2019. The aggregation rules described in section III.B. of Notice 2021-20 apply to the determination of an eligible employer’s average quarterly wages. Accordingly, the average quarterly wages for the 70 percent advance rule are calculated based on the quarterly wages paid by all members of the aggregated group.

For 2021 small eligible employers who file Form 941, *Employer’s Quarterly Federal Tax Return*, average quarterly wages for the 70 percent advance rule are calculated by averaging the amount required to be reported on Line 5c, “Taxable Medicare wages & tips,” on all Forms 941 required to be filed by a small eligible employer for wages paid in 2019. For 2021 small eligible employers that file an annual federal employment tax return, “average quarterly wages” for the 70 percent advance rule are calculated by dividing the amount required to be reported on the following forms and lines, as applicable, by four:

- Line 4, “Total wages subject to Medicare tax,” on the 2019 Form 943, *Employer’s Annual Federal Tax Return for Agricultural Employees*;

- Line 4c, “Taxable Medicare wages and tips,” on the 2019 Form 944, *Employer’s Annual Federal Tax Return*;
- The sum of the amounts in the “Compensation” columns of Line 2, “Tier 1 Employer Medicare Tax – Compensation (other than tips and sick pay),” and Line 9, “Tier 1 Employer Medicare Tax – Sick Pay,” on the 2019 Form CT-1, *Employer’s Annual Railroad Retirement Tax Return*.

Section 2301(j)(2) of the CARES Act provides special rules for determining average quarterly wages for 2021 small eligible employers that are seasonal employers and 2021 small eligible employers not in existence in 2019. Under section 2301(j)(2)(B), 2021 small eligible employers that employ seasonal workers (as defined in section 45R(d)(5)(B) of the Code) may elect to determine the average quarterly wages based on the wages for the calendar quarter in 2019 which corresponds to the calendar quarter to which the election relates rather than the average quarterly wages paid in calendar year 2019. A 2021 small eligible employer that employs seasonal workers elects to use the special rule by requesting an advance based on the amount of wages for the calendar quarter in 2019 corresponding to the calendar quarter to which the election relates. Under section 2301(j)(2)(C), 2021 small eligible employers not in existence in 2019 may look to the average quarterly wages paid in 2020 for purposes of applying the 70 percent advance rule. A 2021 small eligible employer that was not in existence in 2019 elects to use the special rule by requesting an advance based on the average quarterly wages paid in 2020.

The special rules provided by section 2301(j)(2) of the CARES Act do not provide a method for determining average quarterly wages for a 2021 small eligible employer that comes into existence in 2021. Accordingly, 2021 small eligible employers that come into existence in 2021 are ineligible to receive advance payment of the employee retention credit; however, these 2021 small eligible employers, like all eligible employers, may reduce their deposits of employment taxes in anticipation of claiming the employee retention credit on Form 941 (or other applicable federal employment tax return) in accordance with Notice 2020-22.

If an eligible employer was in existence for some, but not all, calendar quarters of 2019 or 2020, average quarterly wages should be determined by dividing the sum of the wages paid in 2019 or 2020, as applicable, by the number of calendar quarters in 2019 or 2020, as applicable, in which that eligible employer existed. For example, an eligible employer that existed in only the second, third, and fourth calendar quarters of 2019 would add the wages paid in each of those calendar quarters and divide the total by 3. If an eligible employer existed for only part of a calendar quarter, that eligible employer should estimate the wages paid in the entire calendar quarter based on the wages paid in the portion of the calendar quarter in which it existed using any reasonable method. For example, if an eligible employer existed for two out of three months in a calendar quarter, that eligible employer may multiply the wages paid in those two months by 1.5 before averaging the wages for that quarter with the wages for the other calendar quarters. If an eligible employer filing a Form 943, 944, or CT-1 existed for only part of

2019 or 2020, that eligible employer may use any reasonable method to annualize the wages paid (or compensation for Form CT-1 filers) prior to dividing the amount by four.

#### IV. EFFECT ON OTHER DOCUMENTS

Notice 2021-20 is amplified as provided in this notice. This notice does not affect the guidance provided in Notice 2021-20 as applied to calendar quarters in 2020.

#### V. 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.

#### VI. 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 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).