

COVID-19-Related Employee Retention Credits: Determining Qualified Wages

FAQs

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Please see [Notice 2021-20](#) [PDF](#) for guidance on the Employee Retention Credit as it applies to qualified wages paid after March 12, 2020, and before January 1, 2021.



These FAQs do not reflect the changes made by the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Relief Act), enacted December 27, 2020, or the American Rescue Plan Act of 2021 (ARP Act), enacted March 11, 2021. The Relief Act amended and extended the employee retention credit (and the availability of certain advance payments of the tax credits) under section 2301 of the CARES Act for the first and second calendar quarters of 2021. The ARP Act modified and extended the employee retention credit for the third and fourth quarters of 2021.

This FAQ is not included in the Internal Revenue Bulletin, and therefore may not be relied upon as legal authority. This means that the information cannot be used to support a legal argument in a court case.

Determining Qualified Wages

Eligible Employers are entitled to an Employee Retention Credit based on the "qualified wages" paid to their employees.

48. What is the definition of "qualified wages"?

Qualified wages are wages (as defined in section 3121(a) of the Internal Revenue Code (the "Code")) and compensation (as defined in section 3231(e) of the Code), both determined without regard to the contribution and benefit base (as determined under section 230 of the Social Security Act), paid by an Eligible Employer to some or all of its employees after March 12, 2020, and before January 1, 2021. Qualified wages include the Eligible Employer's qualified health plan expenses that are properly allocable to the 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 it employed during 2019. For an Eligible Employer that averaged more than 100 full-time employees in 2019, 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 the employer's business operations by a governmental order, or (2) the business experiencing a significant decline in gross receipts. For an Eligible Employer that averaged 100 or fewer full-time employees in 2019, qualified wages are the wages paid 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 any calendar quarter the business is experiencing a significant decline in gross receipts.

49. How does an Eligible Employer identify the average number of full-time employees employed during 2019?

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 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 Internal Revenue Code. An employer that operated its business for the entire 2019 calendar year determines the number of its full-time employees by taking the sum of the number of full-time employees in each calendar month in 2019 and dividing that number by 12.

An employer that started its business operations during 2019 determines the number of its full-time employees by taking the sum of the number of full-time employees in each full calendar month in 2019 in which the employer operated its business and dividing by that number of months.

An employer that started its business operations during 2020 determines the number of its full-time employees by taking the sum of the number of full-time employees in each full calendar month in 2020 in which the employer operated its business and dividing by that number of months, consistent with the approach discussed above for employers that began business operations during 2019.

50. Does an Eligible Employer identify the average number of full-time employees based on the aggregation rule?

Yes. All entities are considered a single employer for purposes of determining the employer's average number of employees if: they are aggregated as a controlled group of corporations under section 52(a) of the Internal Revenue Code (the "Code"); are partnerships, trusts or sole proprietorships under common control under section 52(b) of the Code; or are entities that are aggregated under section 414(m) or (o) of the Code.

Example: Employers O and P each have 75 full-time employees, respectively. Employers O and P are corporations that have each issued a single class of common stock, and a single individual owns more than 80 percent of the common stock of both Employer O and Employer P. Employers O and P are therefore treated as a single Eligible Employer with more than 100 full-time employees for purposes of the Employee Retention Credit. Accordingly, each is eligible for the Employee Retention Credit only for wages paid to an employee that is not providing services due to either (1) a full or partial suspension of operations by governmental order, or (2) a significant decline in gross receipts.

51. May an Eligible Employer that averaged 100 or fewer employees during 2019 treat all wages paid to employees as qualified wages?

Yes. An Eligible Employer that averaged 100 or fewer employees during 2019 may treat all wages paid to its employees after March 12, 2020, and before January 1, 2021, during any period in the calendar quarter in which the employer's business operations are fully or partially suspended due to a governmental order or a calendar quarter in which the employer experiences a significant decline in gross receipts as qualified wages, subject to the maximum of \$10,000 per employee for all calendar quarters.


52. May an Eligible Employer that averaged more than 100 full-time employees during 2019 treat all wages paid to employees as qualified wages?

No. Eligible Employers that averaged more than 100 full-time employees for 2019 may not treat the wages paid to employees for the time that they provide services to the employer as qualified wages. For these employers, only wages paid to employees, after March 12, 2020, and before January 1, 2021, for the time they are not providing services during a calendar quarter in which the employer's business operations are fully or partially suspended due to a governmental order or in which the employer experiences a significant decline in gross receipts may be treated as qualified wages.

Example 1: Employer Q, a local chain of full service restaurants in State X that averaged more than 100 full-time employees in 2019, is subject to a governmental order for restaurants to discontinue sit-down service to customers inside the restaurant, but may continue food or beverage sales to the public on a carry-out, drive-through, or delivery basis. Employer Q continues to pay wages to kitchen staff and certain wait staff needed to facilitate fulfillment of carry-out orders. Wages paid to these employees for the time that they provide carry-out service are not qualified wages.

Example 2: Employer R averaged more than 100 full-time employees in 2019 and was forced to suspend operations at the end of the first calendar quarter in 2020. Its employees performed services during the first part of the calendar quarter but then stopped due to the suspension of operations; however, Employer R continued to pay the employees' normal wages for the entire quarter, including the period during which they were not providing services. The wages paid during the period when employees were not providing services are qualified wages.


53. May an Eligible Employer that averaged more than 100 full-time employees during 2019 claim an Employee Retention Credit for an increase in the amount of wages it paid its employees during the time that employees are not providing services?

No. For Eligible Employers that averaged more than 100 full-time employees during 2019, 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. For a variable hour employee, the amount paid for working an equivalent duration during that 30-day period may be determined using any reasonable method. The method(s) that the Department of Labor has prescribed to determine the amount to pay an employee with an irregular schedule who is entitled to paid sick leave under the FFCRA would be considered reasonable for this purpose. For more information, see Department of Labor's [Temporary Rule: Paid Leave under the Families First Coronavirus Response Act](#) .

Example: Employer S, a grocery store chain that averaged more than 100 full-time employees in 2019, is subject to a governmental order limiting store hours. In response, Employer S has reduced the hours its employees work, but in order to incentivize those employees who continue to provide services, the employer increases the

employees' rate of pay by \$1 an hour. Only the amounts paid to employees for time they are not providing services, and at the rate of pay in effect prior to the increase, would be considered qualified wages.

54. May an Eligible Employer that averaged more than 100 full-time employees during 2019 treat the wages paid to hourly and non-exempt salaried employees for hours for which they are not providing services as qualified wages for purposes of the Employee Retention Credit?

Yes. For an Eligible Employer that averaged more than 100 full-time employees in 2019, wages paid to hourly and non-exempt salaried employees for hours that the employees were not providing services would be considered qualified wages for the purposes of the Employee Retention Credit. For an employee who does not have a fixed schedule of work, the hours for which the employee is not providing services may be determined using any reasonable method. The method that the Eligible Employer would use to determine the employee's entitlement to leave under the Family and Medical Leave Act would be a reasonable method for this purpose. Similarly, the method(s) that the Department of Labor has prescribed to determine the number of hours for which an employee with an irregular schedule is entitled to paid sick leave under the FFCRA would be considered reasonable for this purpose. For more information, see Department of Labor's [Temporary Rule: Paid Leave under the Families First Coronavirus Response Act](#) .

It is not reasonable for the employer to treat an employee's hours as having been reduced based on an assessment of the employee's productivity levels during the hours the employee is working.

Wages paid to the employees for hours for which they provided services are not considered qualified wages for purposes of the Employee Retention Credit.

Example 1: Employer T, a manufacturing business, that averaged more than 100 full-time employees in 2019, has several locations that are closed during the second quarter of 2020 due to a governmental order. Employer T continues to pay hourly employees who are not providing services at the closed locations 50 percent of their normal hourly wage rates. Employer T also reduced headquarters' administrative staff hours by 40 percent, but continues to pay them at 100 percent of their normal hourly wage rates. For employees who are not providing services due to the closure of their location, but are receiving 50 percent of their normal hourly wage rates, Employer T may treat the wages paid as qualified wages for purposes of the Employee Retention Credit. For the administrative staff whose hours were reduced by 40 percent, but who are paid for 100 percent of the normal wage rate, Employer T may treat the 40 percent of wages paid for time that these employees are not providing services as qualified wages for purposes of the Employee Retention Credit. The 60 percent of wages that Employer T pays the administrative staff for hours during which the employees are actually providing services is not considered qualified wages for purposes of the Employee Retention Credit.

Example 2: Employer U, in the business of staging homes that are for sale, averaged more than 100 full-time employees in 2019. Employer U's non-exempt salaried employees cannot perform their usual services of delivering and installing furniture to be used in staging houses because open houses are prohibited in its service area during the second quarter of 2020. However, the employees are required to provide Employer U with periodic status updates about furniture that has been leased out and other administrative matters. Employer U continues to pay wages to employees at their normal rates even though the employees cannot provide their normal services. Employer U has determined that its employees are working 20 percent of the time. Employer U is entitled to treat 80 percent of the wages paid as qualified wages and claim an Employee Retention Credit for 80 percent of the wages paid.

55. May an Eligible Employer that averaged more than 100 full-time employees during 2019 treat wages paid to exempt salaried employees for time for which they are not providing services as qualified wages for purposes of the Employee Retention Credit?

Yes. For an Eligible Employer that averaged more than 100 full-time employees during 2019, the wages paid after March 12, 2020, and before January 1, 2021, to exempt salaried employees for the time that they are not providing services would be considered qualified wages for purposes of the Employee Retention Credit. An Eligible Employer may use any reasonable method to determine the number of hours that a salaried employee is not providing services, but for which the employee receives wages either at the employee's normal wage rate or at a reduced wage rate. Reasonable methods include the method (or methods) the employer uses to measure exempt employees' entitlement to leave on an intermittent or reduced leave schedule under the Family and Medical Leave Act, or the method the employer uses to measure exempt employees' entitlement to and usage of paid leave under the employer's usual practices. It is not reasonable for the employer to treat an employee's hours as having been reduced based on an assessment of the employee's productivity levels during the hours the employee is working.

Example 1: Employer V, a large fitness club business that employed an average of more than 100 full-time employees in 2019, closed all of its locations in City B by order of City B's mayor. Employer V continues to pay its exempt managerial employees their regular salaries. While the clubs are closed and there is not sufficient administrative work to occupy the managerial employees full-time, they continue to perform some accounting and similar administrative functions. Employer V has determined, based on the time records maintained by employees, that they are providing services for 10 percent of their typical work hours. In this case, 90 percent of wages paid to these employees during the period the clubs were closed are qualified wages.

Example 2: Employer W, a large consulting firm that employed an average of more than 100 full-time employees in 2019, closed its offices due to various governmental orders and required all employees to telework. Although Employer W believes that some of its employees may not be as productive while working remotely, employees are working their normal business hours. Because employees' work hours have not changed, no portion of the wages paid to the employees by Employer W are qualified wages.

56. May an Eligible Employer treat wages paid to employees pursuant to a pre-existing vacation, sick and other personal leave policy as qualified wages for purposes of the Employee Retention Credit?

If the Eligible Employer averaged more than 100 full-time employees in 2019, the employer may not treat as qualified wages amounts paid to employees for paid time off for vacations, holidays, sick days and other days off. These wages are paid pursuant to existing leave policies that represent benefits accrued during a prior period in which the employees provided services and are not wages paid for time in which the employees are not providing services.

However, if the Eligible Employer averaged 100 or fewer full-time employees in 2019, all wages paid to employees during the period of the full or partial suspension of operations or the significant decline in gross receipts, even if under a pre-existing vacation, sick and other leave policy, may be qualified wages for purposes of the Employee Retention Credit (unless the wages are qualified sick and/or family leave wages under sections 7001 and 7003 of the FFCRA).

57. May an Eligible Employer treat payments made to former employees who have terminated employment as qualified wages for purposes of the Employee Retention Credit?

No. Payments, including severance payments, made to a former employee following termination of employment are not considered qualified wages for purposes of the Employee Retention Credit. Payments may be considered qualified wages only if the payments are made to an employee who continues to be employed by the Eligible Employer. Payments made in connection with a former employee's termination of employment are not qualified wages because they are payments for the past employment relationship and thus are not attributable to the time for which the Employee Retention Credit may be claimed. See *United States v. Quality Stores, Inc.*, 572 U.S. 141 (2014). Whether an employee has terminated employment is based on all of the facts and circumstances, including whether the employer has treated the employment relationship as terminated for purposes other than the continuation of wage payments.

58. If an amount an Eligible Employer pays to an employee is exempt from social security and Medicare taxes, can the Eligible Employer still claim the Employee Retention Credit on the amount paid to that employee? (updated June 19, 2020)

No. The Employee Retention Credit is allowed on qualified wages paid to employees; an amount must constitute wages within the meaning of section 3121(a) of the Internal Revenue Code (the "Code") (or must constitute qualified health plan expenses allocable to such wages) in order to fall within the definition of qualified wages.

Example 1: A church in State X employs an ordained minister; the minister is a common law employee of the church. The governor of State X issues an executive order limiting gatherings of more than 10 people. As a result, the church suspends Sunday worship services, but continues to pay the minister's salary and parsonage allowance. The minister's salary and parsonage allowance do not constitute wages within the meaning of section 3121(a) of the Code and therefore are not qualified wages for purposes of the Employee Retention Credit.

Example 2: A group of licensed real estate agents at Real Estate Brokerage Firm Y receive substantially all their payments for services directly related to home sales and perform services under a written contract providing that they will not be treated as employees for federal tax purposes. Therefore, the licensed real estate agents at Real Estate Brokerage Firm Y are treated as statutory nonemployees under the Code. Amounts paid to the licensed real estate agents at Real Estate Brokerage Firm Y do not constitute wages within the meaning of section 3121(a) of the Code and therefore are not qualified wages for purposes of the Employee Retention Credit.

Example 3: Employer Z offers its employees various benefits that provide for pre-tax salary reduction contributions, including a qualified 401(k) plan, a fully-insured group health plan, a dependent care assistance program satisfying the requirements of section 129 of the Internal Revenue Code (Code), and qualified transportation benefits satisfying the requirements of section 132(f) of the Code. Employer Z also makes matching and nonelective contributions to the qualified 401(k) plan and pays the portion of the cost of maintaining the group health plan remaining after the employees' share.

Employer Z may treat as qualified wages the amounts its employees contribute as pre-tax salary reduction contributions to the qualified 401(k) plan because those amounts are wages within the meaning of section 3121(a) of the Code.

Employer Z may also treat all amounts paid toward maintaining the group health plan (including any employee pre-tax salary reduction contribution) as qualified health plan expenses that may be allocated to wages. See [“Does the amount of qualified health plan expenses include both the portion of the cost paid by the Eligible](#)

Employer and the portion of the cost paid by the employee?"

Employer Z may not treat as qualified wages the amounts Employer Z contributes as matching or nonelective contributions to the qualified 401(k) plan, nor may it treat as qualified wages any employee pre-tax salary reduction contributions toward the dependent care assistance program or qualified transportation benefits. These amounts do not constitute wages within the meaning of section 3121(a) of the Code and therefore are not qualified wages for purposes of the Employee Retention Credit.

59. Are wages paid by an employer to employees who are related individuals considered qualified wages?

No. Wages paid to related individuals, as defined by section 51(i)(1) of the Internal Revenue Code (the "Code"), are not taken into account for purposes of the Employee Retention Credit. A related individual is any employee who has of any of the following relationships to the employee's employer who is an individual:

- A child or a descendant of a child;
- A brother, sister, stepbrother, or stepsister;
- The father or mother, or an ancestor of either;
- A stepfather or stepmother;
- A niece or nephew;
- An aunt or uncle;
- A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

In addition, if the Eligible Employer is a corporation, then a related individual is any person that bears a relationship described above with an individual owning, directly or indirectly, more than 50 percent in value of the outstanding stock of the corporation.

If the Eligible Employer is an entity other than a corporation, then a related individual is any person that bears a relationship described above with an individual owning, directly or indirectly, more than 50 percent of the capital and profits interests in the entity.

If the Eligible Employer is an estate or trust, then a related individual includes a grantor, beneficiary, or fiduciary of the estate or trust, or any person that bears a relationship described above with an individual who is a grantor, beneficiary, or fiduciary of the estate or trust.

60. Are there other limits on the amounts that are considered qualified wages?

The Eligible Employer may not treat as qualified wages for purposes of the Employee Retention Credit any wages for which the employer received a credit for qualified sick and/or family leave wages (sections 7001 and 7003 of the FFCRA). In addition, any qualified wages taken into account for purposes of the Employee Retention Credit cannot be taken into account for the credit for paid family medical leave under section 45S of the Internal Revenue Code (the "Code").

Further, an employee included for purposes of the Work Opportunity Tax Credit under section 51 of the Internal Revenue Code may not be included for purposes of the Employee Retention Credit.

For more information about the limits on what amounts are considered qualified wages, see [Determining the Maximum Amount of an Eligible Employer's Employee Retention Credit](#).

For more details on how the Employee Retention Credit relates to other tax credits, see [Interaction with Other Credit and Relief Provisions](#).

61. Do "qualified wages" include taxes imposed on or withheld from the wages?

Qualified wages are calculated without regard to federal taxes imposed or withheld, including the employee's or employer's shares of social security taxes, the employee's and employer's shares of Medicare tax, and federal income taxes required to be withheld.

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