CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Phillip L. Swagel, Director

July 16, 2021

Honorable Kyrsten Sinema
United States Senate
Washington, DC 20510

Re: The Budgetary Effects of the Employee Retention Tax Credit During the Coronavirus Pandemic

Dear Senator:

As you requested, I am writing to provide information about the budgetary effects of the employee retention tax credit.

Original Cost Estimates

The Coronavirus Aid, Relief, and the Economic Security (CARES) Act established a tax credit for wages paid from March 13, 2020, through December 31, 2020, by employers that were subject to a governmental order restricting their businesses as a result of the coronavirus pandemic or that had experienced a significant decline in revenue. The tax credit equals 50 percent of qualified wages plus the employer's contributions for health insurance premiums, subject to specific limits, and it is allowed against the employer's share of payroll taxes. Near the time of enactment, CBO and the staff of the Joint Committee on Taxation (JCT) estimated that the provision would increase federal deficits by $55 billion over fiscal years 2020 to 2031.[1]

Subsequent legislation—the Consolidated Appropriations Act, 2021, and the American Rescue Plan Act of 2021—expanded the credit and extended

1. That cost was expected to be incurred mostly as a reduction in revenues, but also in part as an increase in direct spending. See Congressional Budget Office, letter to the Honorable Mike Enzi providing a preliminary estimate of the effects of H.R. 748, the CARES Act, Public Law 116-136, revised, with corrections to the revenue effect of the Employee Retention Credit and to the modification of a limitation on losses for taxpayers other than corporations (April 27, 2020), www.cbo.gov/publication/56334.

it through December 30, 2021. JCT estimated that those changes would increase the cost of the tax credit by about $31 billion.[2]

CBO's estimates of the credit's effects on revenues and outlays prepared near the time the CARES Act and subsequent legislation were enacted were reflected in its budget projections (often called its baseline) over the past year. On the basis of those original estimates of claims for the credit and the related behavioral responses, CBO increased projected deficits by approximately $85 billion in total—$54.6 billion upon the enactment of the CARES Act and an additional $30.8 billion following the enactment of the CAA and ARPA. Those amounts were attributed to legislative changes in CBO's updates to the baseline following those enactments.

Implications of Recent Information

Since then, some additional information has become available. Over the past year, tax revenues have been significantly stronger than CBO anticipated. CBO's most recent report on the budget outlook noted that tax collections in 2020 and 2021 have been more than would be expected given current data on economic activity.[3] The specific reasons for those greater-than-anticipated collections will become clearer as detailed information from tax returns becomes available.

Recent information from Internal Revenue Service (IRS) administrative records indicates that as of July 15, 2021, the IRS has processed employers' claims for this credit totaling $10.5 billion in the second, third, and fourth quarters of 2020 and $7.9 billion in the first quarter of 2021.

The actual budgetary cost of the provisions that provided this credit remains uncertain, however, and, similar to what was reported by the Government Accountability Office in March 2021, the "IRS continues to process a paper return backlog, which makes the data … incomplete, particularly for small employers."[4] In addition, taxpayers may still file additional claims and update the amounts on prior claims.

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2. See Joint Committee on Taxation, *Estimated Revenue Effects of H.R. 1319, the "American Rescue Plan Act of 2021, as Amended by the Senate, Scheduled for Consideration by the House of Representatives,* JCX-14-21 (March 9, 2021), www.jct.gov/publications/2021/jcx-14-21, and *Estimated Budget Effects of the Revenue Provisions Contained in Rules Committee Print 116-18, the "Consolidated Appropriations Act, 2021"* (December 21, 2020), www.jct.gov/publications/2020/jcx-24-20.

3. See Congressional Budget Office, *An Update to the Budget and Economic Outlook* (July 2021), www.cbo.gov/publication/57218.

4. See Government Accountability Office, *COVID-19: Sustained Federal Action Is Crucial as Pandemic Enters Its Second Year,* GAO-21-387, p. 421 (March 2021), www.gao.gov/products/gao-21-387.

This recent information is not directly comparable with the original estimate for the CARES Act for several reasons. Subsequent legislation is one reason that the use of tax credit for employee retention may be less than was anticipated near the time of the enactment of the CARES Act. The incentives to claim this credit are complicated because of the interaction between it and other policies put in place in response to the pandemic, such as enhanced unemployment insurance and the Paycheck Protection Program (PPP). In particular, before the CAA was enacted, the employee retention credit was not available for employers that had taken out PPP loans. Those interactions were accounted for in estimates for the later legislation. For example, the Paycheck Protection Program and Health Care Enhancement Act was enacted after the CARES Act and represented a large expansion of the PPP program. In addition, CBO's projections of the economy have changed significantly since the provision was first enacted.

CBO's most recent baseline projections, which reflect current law and incorporate information available through May 18, 2021, show larger-than-anticipated receipts. Less use of this credit than was anticipated near the time of enactment may be one of the factors supporting the recent strength in revenues.

Differences in outcomes from earlier estimates for legislation are not unusual, and those differences may be reflected in increases or decreases in the estimated costs of various provisions. That type of change, like other changes for economic and technical factors, is regularly reflected by CBO as a baseline adjustment and is not attributed to legislation. CBO regularly assesses the reasons actual collections differ from those previously projected.[5]

5. See Congressional Budget Office, *The Accuracy of CBO's Budget Projections for Fiscal Year 2020* (December 2020), www.cbo.gov/publication/56885, and *An Evaluation of CBO's Past Revenue Projections* (August 2020), www.cbo.gov/publication/56499.

I hope this information is useful. If you have any questions, please contact me.

Sincerely,

Phillip L. Swagel
Director

cc: Honorable Ron Wyden
Chairman, Committee on Finance

Honorable Mike Crapo
Ranking Member

Honorable Bernie Sanders
Chairman, Committee on the Budget

Honorable Lindsey Graham
Ranking Member

Honorable Mark R. Warner