

IRS Issues Formal Guidance on ERC/PPP

What is the ERC?

The employee retention credit (ERC) was first introduced by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) with retroactive changes being made by the Consolidated Appropriations Act, 2021 (CAA). For 2020, the ERC can be claimed by employers who paid qualified wages after March 12, 2020, and before January 1, 2021, and who experienced a full or partial suspension of their operations or a greater than 50% decline in gross receipts. The credit is equal to 50% of qualified wages paid, including qualified health plan expenses, on up to \$10,000 of wages per employee in 2020. Please refer to our alert from [February 9, 2021](#) for more details. The CAA expanded the ERC through June 30, 2021 to provide a credit equal to 70% of qualified wages paid, including qualified health plan expenses, on up to \$10,000 of wages per employee per 2021 quarter, to employers who experience a full or partial suspension of their operations or a greater than 20% decline in gross receipts.

On March 1, 2021, the IRS released [Notice 2021-20](#), providing guidance on the retroactive changes made to the ERC consisting mostly of 71 questions and answers, most of which are similar to the previously published IRS FAQs. As previously communicated, a significant change for 2020 permits eligible employers that received a Paycheck Protection Program (PPP) loan to claim the ERC, although the same wages cannot be counted for both. Notice 2021-20 explains when and how employers that received a PPP loan can claim the employee retention credit for 2020. The IRS plans to release additional guidance soon, to address the changes for 2021 per [IR-2021-48](#).

Some Definitions and Clarifications

“Full-time employee”

The same definition found in the IRS FAQs is retained, which seems to limit employees to those who performed at least 30 hours of service per week or 130 hours of service in the month and is used to determine an employer’s headcount to assess whether it is a large or small employer. There are no references to either seasonal or part-time employees. For 2020, large employers are those with more than 100 full-time employees in 2019 (the 2021 threshold increased to 500).

“More than a nominal portion” of an employer’s operations

An employer operating an essential business may be considered to have a partial suspension of operations if, under the facts and circumstances, more than a nominal portion of its business operations are suspended by a government order. Solely for purposes of ERC, an employer’s business operations will be deemed to constitute more than a nominal portion of its business operations if either:

1. Gross receipts from that portion of the business operations are not less than 10% of total gross receipts (both using the same 2019 quarter), or
2. Hours of service performed by employees in that portion of the business are not less than 10% of the total number of hours of service performed by all employees in the employer's business (both using the same 2019 quarter)

“More than a nominal effect” on an employer’s operations

An employer can qualify under the partial suspension test if its operations are not shut down but the employer instead is subject to a government mandate that has “more than a nominal effect” on its operations. A mandate will have such an effect if it results in not less than a 10% reduction in the employer's ability to provide goods or services in the normal course of the employer's business. Note that the employer's “ability to provide goods or services” is not defined as of the date of this communication.

How to determine if an employer is able to continue “comparable operations”

An employer under a government mandated closure will not be eligible for the ERC under the partial suspension test if the employer can maintain comparable operations via working from home and other modifications. Four factors were provided to better determine if an employer is able to continue operations comparable to its operations prior to closure:

1. Does the employer have adequate support (IT and otherwise) such that operations can continue via work from another location?
2. Does the employer's trade or business operations have work that is portable, or otherwise adaptable to be performed from a remote location?
3. If the employer's physical work space is so critical to its operations that tasks central to the operations are unable to be performed remotely, this factor alone indicates that the employer is not able to continue comparable operations.
4. If an employer incurs a significant delay (i.e., beyond 2 weeks) in moving operations to comparable telework, then the operations may be deemed subject to a partial suspension during the transition period.

Interaction with Paycheck Protection Program (PPP) Loans

Qualified wages for PPP loan recipients

ERC does not apply to qualified wages for which an election or deemed election is made to include in PPP forgiveness. This is not a good result for employers that already filed their PPP Loan Forgiveness Applications and included more payroll costs (in lieu of other costs) than required to achieve full forgiveness. Eligible employers are deemed to have made that election for qualified wages paid that are included in payroll costs reported on a PPP Loan Forgiveness Application, up to the minimum payroll required for full forgiveness.

- Regardless of a deemed election, if an eligible employer reports wages as payroll costs on a PPP Forgiveness Application to obtain forgiveness, but the loan is not forgiven, those qualified wages may subsequently be taken into account for ERC.
- If an eligible employer obtains forgiveness of only a portion of the PPP loan, the employer is deemed to have made an election for the minimum amount of qualified wages included in the payroll costs reported on the PPP Forgiveness Application necessary to obtain the forgiveness of that amount of the PPP loan.

Examples for PPP loan recipients that have applied for forgiveness

Assume each employer is an eligible employer for ERC purposes, and each PPP loan is fully forgiven.

Example 1 - Wages reported for PPP forgiveness for full loan amount, no other eligible expenses reported

- Employer A received a PPP loan of \$100,000 and paid \$100,000 in qualified wages that would qualify for ERC during Q2 and Q3 of 2020.
- Employer A was required to report \$100,000 of payroll costs and other eligible expenses, with a minimum of \$60,000 (60%) of payroll costs.
- Employer A submitted a PPP Loan Forgiveness Application and reported the \$100,000 of wages as payroll costs in support of the forgiveness of the PPP loan.
- Employer A is deemed to have made an election not to take into account \$100,000 of the wages for purposes of the ERC. In other words, the \$100,000 of wages are not available for calculating the ERC.

Example 2 – Wages reported for PPP forgiveness in excess of loan amount, no other eligible expenses reported

- Employer B received a PPP loan of \$200,000 and paid \$250,000 in qualified wages that would qualify for ERC during Q2 and Q3 of 2020.
- Employer B was required to report \$200,000 of payroll costs and other eligible expenses, with a minimum of \$120,000 (60%) of payroll costs.
- Employer B submitted a PPP Loan Forgiveness Application and reported the \$250,000 of wages as payroll costs in support of the forgiveness of the PPP loan.
- Employer B is deemed to have made an election not to take into account \$200,000 of the wages for purposes of the ERC; however, Employer B is not treated as making a deemed election with respect to the \$50,000 of qualified wages that were in excess of the PPP loan, so it may treat the \$50,000 as qualified wages for purposes of the ERC.

Example 3 – Other eligible expenses not reported on forgiveness application

- Employer C received a PPP loan of \$200,000 and paid \$200,000 in qualified wages that would qualify for ERC during Q2 and Q3 of 2020. Employer C also paid \$70,000 of other eligible expenses during Q2 and Q3 of 2020.
- Employer C was required to report \$200,000 of payroll costs and other eligible expenses, with a minimum of \$120,000 of payroll costs.
- Employer C submitted a PPP Loan Forgiveness Application and reported the \$200,000 of wages as payroll costs in support of the forgiveness of the PPP loan. Employer C did not report the other eligible expenses of \$70,000.
- Employer C is deemed to have made an election not to take into account \$200,000 of the wages for purposes of the ERC. In other words, the \$200,000 of wages are not available for calculating the ERC.
- **Employer C cannot reduce the deemed election by the amount of the other eligible expenses that it could have reported on its PPP Loan Forgiveness Application.**

Example 4 – Other eligible expenses were reported on forgiveness application

- Employer D received a PPP loan of \$200,000 and paid \$200,000 in qualified wages that would qualify for ERC during Q2 and Q3 of 2020. Employer D also paid \$90,000 of other eligible expenses during Q2 and Q3 of 2020.
- Employer D was required to report \$200,000 of payroll costs and other eligible expenses, with a minimum of \$120,000 of payroll costs.

- Employer D submitted a PPP Loan Forgiveness Application and reported the \$200,000 of wages as payroll costs in support of the forgiveness of the PPP loan, and in addition reported the other eligible expenses of \$90,000.
- Employer D is deemed to have made an election not to take into account \$120,000 of the wages for purposes of the ERC. Thus, the remaining \$80,000 of wages are available for calculating the ERC.

Example 5 – Both qualified ERC wages and nonqualified ERC wages reported on forgiveness application

- Employer E received a PPP loan of \$200,000 and paid \$150,000 in qualified wages that would qualify for ERC during Q2 and Q3 of 2020. Employer E also had \$100,000 of other payroll costs that are not qualified wages for ERC and \$70,000 of other eligible expenses during Q2 and Q3 of 2020.
- Employer E was required to report \$200,000 of payroll costs and other eligible expenses, with a minimum of \$120,000 of payroll costs.
- Employer E submitted a PPP Loan Forgiveness Application and reported \$130,000 of wages as payroll costs in support of the forgiveness of the PPP loan, and in addition reported the other eligible expenses of \$70,000. Employer E can demonstrate that the payroll costs reported on the PPP Loan Forgiveness Application consist of \$100,000 of payroll costs that are not qualified wages for ERC and \$30,000 of payroll costs that are qualified wages for ERC.
- Employer E is deemed to have made an election not to take into account \$30,000 of the wages for purposes of the ERC, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. Accordingly, Employer E may take into account \$120,000 of qualified ERC wages (\$150,000 of qualified ERC wages paid minus \$30,000 of qualified ERC wages included in the payroll costs reported on the PPP Loan Forgiveness Application) for purposes of the ERC.

If you believe you qualify for this credit, you should reach out to your payroll company to find out next steps. Payroll companies are ready to amend payroll tax returns to claim this credit. If you have questions on whether or not you qualify or which periods you qualify for, we'd be happy to assist.

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