

# Paycheck Protection Program (PPP) Update: IRS Clarifies PPP Questions With the Employee Retention Credit (ERC)

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Recently the Internal Revenue Service (IRS) issued Notice 2021-20 addressing a long-standing question faced by Paycheck Protection Program (PPP) loan recipients: Can a business receive a loan and also take advantage of the Employee Retention Credit (ERC)? The short answer: most likely 'yes' if you received a loan in 2020. However, the IRS declined to address situations where the PPP loan was received in 2021.

The ERC was originally created under the Coronavirus Aid, Relief, and Economic Security (CARES) Act to be a fully refundable tax credit for employers as an incentive to retain employees during the COVID-19 pandemic. The ERC applied to wages paid from March 12, 2020, through the end of the year and equaled 50% of "qualified" wages, or a maximum tax credit of \$5,000 per employee.

An employer, including a tax-exempt organization, can qualify for the ERC if the business had a significant decline in gross receipts and had to suspend operations due to a state or Federal COVID-19 order. Moreover, the ERC can act as an offset of an employer's share of Social Security taxes. Previously, however, the IRS stated in their FAQ that businesses could not receive both the ERC and a PPP loan.

Notice 2021-20 reverses the IRS' previous position with newly issued Question and Answer 49. Now a business which received a PPP loan can also take the ERC, but with limitations. A business cannot use the same qualified wages to apply for PPP loan forgiveness and to calculate any potential ERC. In the CARES Act, an employer may elect to set aside certain wages and not include those wages in calculating any potential ERC. The IRS takes this one step further by deeming a business to make the election for any qualified wages the business attributes to the PPP loans where the business is also seeking PPP loan forgiveness.

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The IRS argues both of these points prevent any double dipping effect. The IRS gives several examples to explain how businesses can take advantage of PPP loan forgiveness and the ERC.

In Example 1, the business has \$100,000 in wages and needs \$100,000 of eligible expenses in order to qualify for PPP loan forgiveness. Under the CARES Act, the employer is deemed to make the election discussed above and cannot use the \$100,000 in wages to calculate an ERC.

In Example 2, the business has \$250,000 in wages and needs \$200,000 of eligible expenses in order to qualify for PPP loan forgiveness. Under the CARES Act, only \$200,000 is subject to the election and the business can use the remaining \$50,000 in wages to calculate an ERC.

In Example 3, the business has \$200,000 in wages and \$70,000 in other eligible expenses. However, when the business applied for the PPP loan forgiveness, it only reported the \$200,000 in eligible wages. Therefore, the business is deemed to have made the election regarding the \$200,000 in wages and cannot use those wages to calculate an ERC. The \$70,000 in other eligible expenses cannot be used in the ERC calculation.

In Example 4, similar facts to Example 3, except the business includes both the \$200,000 in wages and \$70,000 in other eligible expenses on its PPP loan forgiveness application. Therefore, the IRS deems the election is made regarding \$130,000 of the eligible wages and the business can use the remain \$70,000 in wages to calculate an ERC.

In Example 5, the business has \$200,000 in wages and \$90,000 in other eligible expenses. The business includes both in their PPP loan forgiveness application. However, in this case the business is deemed to have made an election regarding \$120,000 and not \$110,000 because the PPP loan forgiveness program requires a minimum of \$120,000 be attributed to payroll costs. Therefore, the business can use the remain \$80,000 in wages to calculate an ERC.

In Example 6, the business has \$150,000 in qualified wages, \$100,000 of other payroll costs, and \$70,000 in other eligible expenses. The business received a PPP loan for \$200,000 and was required to have a minimum of \$120,000 in eligible payroll costs. The business reports \$130,000 in payroll costs and \$70,000 in other expenses. If the business can show that \$100,000 of the reported \$130,000 in payroll costs were not from the other payroll costs and the remaining \$30,000 were from the \$150,000 in qualified wages, then the business can use the remaining \$120,000 in qualified wages to calculate the ERC.

In Example 7, the PPP loan is not forgiven. In that case, the business may use all qualified wages to calculate the ERC.

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The Notice does not address the second round of PPP loans or any changes made to the ERC from the Taxpayer Certainty and Disaster Tax Relief Act of 2020. However, we anticipate further guidance from the IRS regarding 2021 PPP loans and ERCs.

If you have any questions regarding the PPP Loan Forgiveness Program, applying for the Employee Retention Credit, or any round of the PPP loan program, Bailey Glasser stands by ready to assist.

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### **Practice Areas**

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