

# IRS RELEASES GUIDANCE ON ERC

## NEW NOTICE EXPLAINS CHANGES MADE IN

### DECEMBER'S STIMULUS

On Monday, March 1, 2021, the Internal Revenue Service (IRS) released Notice 2021-20 (Guidance on the Employee Retention Credit under Section 2301 of the Coronavirus Aid, Relief, and Economic Security Act). The Employee Retention Credit (ERC) was created under the Coronavirus Aid, Relief, and Economic Security (CARES) Act and was amended in December as part of the Consolidated Appropriations Act. One major change is that Paycheck Protection Program (PPP) participants are now allowed to take advantage of ERC. Notice 2021-20 provides guidance on key questions about how PPP participants may retroactively claim ERC for wages paid in 2020.

#### Background on ERC

In January, we sent out an article explaining changes that have been made to ERC by the December stimulus package, the Consolidated Appropriations Act. In short, ERC are available to eligible employers suffering a significant decline in gross receipts and/or continuing to pay their employees, even though the business might be closed due to a COVID-19 lockdown.

If you are considering claiming ERC, please see our article via the following link for more information, including a brief overview of ERC, eligibility requirements, changes regarding the PPP, and a high-level explanation of how to claim credits:

<https://files.constantcontact.com/9701cdba401/7dfc65fc-bf16-4f71-89fe-4a94eca1b4f9.pdf>.

Note for BFG payroll clients: We are prepared to calculate any tax credits you may be due and will be reaching out to you under a separate email to explain the process and associated costs.

#### IRS Notice 2021-20

The Consolidated Appropriations Act changed the rules so that PPP participants may take advantage of ERC, both going forward in 2021 and retroactively for 2020. The IRS has indicated that any wages that could count toward eligibility for the ERC or PPP loan forgiveness can be applied to either of these two programs, but not both.

While the Consolidated Appropriations Act also extended and modified ERC for the first two quarters in 2021, Notice 2021-20 addresses only the rules applicable to 2020. The IRS plans to release more guidance on the changes for 2021.

IRS Notice 2021-20 is a 102-page document that explains how this interplay works. Here's a hyperlink to the full document: <https://www.irs.gov/pub/irs-drop/n-21-20.pdf>.

The following sections describe some of the key takeaways we identified in our review of Notice 2021-20.

## Reconciling ERC and PPP

Prior to the release of Notice 2021-20, it was known that the same wages could not be used for both PPP loan forgiveness and ERC, but there were questions about how this would actually work. For example, were all payroll funds used during the PPP covered period excluded? Were all payroll funds reported on the PPP Loan Forgiveness Application excluded even if they were in excess of the forgiven amount?

Notice 2021-20 provides some excellent examples that help to explain. Given the 2 examples below, which are copied directly from Notice 2021-20, it appears that a borrower is bound to what they provided on their PPP Loan Forgiveness Application to determine the amount of eligible payroll costs available for ERC during the loan covered period. In most cases, borrowers used a 24-week loan period and reported only payroll-related expenses to qualify for forgiveness because there was more than enough to qualify, and doing so helped to simplify the process. If borrowers had known that ERC would later become available to them and that including non-payroll-related costs would have lowered the amount of payroll costs used for PPP forgiveness, they may have considered including those other costs in their forgiveness application.

The current IRS guidance indicates that if a business did not report other allowable, non-payroll expenses on their PPP Loan Forgiveness Application, they cannot apply them after submitting their loan forgiveness application. We may see some guidance from SBA allowing borrowers to revise their PPP forgiveness applications to take better advantage of both ERC and PPP, but at this point, we do not know if that will be announced.

However, the guidance and the examples also make clear that only the amount of costs needed to qualify for the PPP loan forgiveness is considered deemed to have been elected. Therefore, any payroll costs that were reported on the PPP Loan Forgiveness Application, together with other allowable expenses, that were in excess of the amount of the loan, are not considered to be elected for that purpose and, therefore are still available for ERC. This development is very positive for many employers and helps to clarify that payroll-related expenses paid during the covered period could still be available for ERC based on the caveats explained above and in the IRS's examples below.

The examples that we've seen do not appear to indicate the timeframe over which to apply the PPP forgiveness expenses during the 24-week loan period. Our interpretation without further guidance, therefore, is that the amounts would be spread over the entire period. If the total payroll costs deemed to be elected for the PPP loan forgiveness, that is, the amount of the loan, are less than the total payroll costs reported on the forgiveness application, then we expect to calculate a ratio to determine what percentage of each payroll during the loan covered period was applied to the PPP and what percentage is available for ERC. This ratio could then be applied to each employee's pay during the loan covered period. The ERC can be applied to 100% of all ERC-eligible wages and benefits costs before and after the loan period, as long as it stops calculating at the \$10,000 cap per employee.

We'll share 2 examples taken directly from Notice 2021-20, and if you're curious about the others (there are 7), you may find them starting on page 75 of the Notice.

**Example 2:** Employer B received a PPP loan of \$200,000. Employer B is an eligible employer and paid \$250,000 of qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. In order to receive forgiveness of the PPP loan in its entirety, Employer B was required, under the SBA rules, to report a total of \$200,000 of payroll costs and other eligible expenses (and a minimum of \$120,000 of payroll costs). Employer B submitted a PPP Loan Forgiveness Application and reported the \$250,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan. Employer B received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000.

Employer B is deemed to have made an election not to take into account \$200,000 of the qualified wages for purposes of the employee retention credit, 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. It may not treat that amount as qualified wages for purposes of the employee retention credit. Employer B is not treated as making a deemed election with respect to \$50,000 of the qualified wages (\$250,000 reported on the PPP Loan Forgiveness Application, minus \$200,000 reported on the PPP Loan Forgiveness Application up to the amount of the loan that is forgiven), and it may treat that amount as qualified wages for purposes of the employee retention credit.

**Example 3:** Employer C received a PPP loan of \$200,000. Employer C is an eligible employer and paid \$200,000 of qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. Employer C also paid other eligible expenses of \$70,000. In order to receive forgiveness of the PPP loan in its entirety, Employer C was required, under the SBA rules, to report a total of \$200,000 of payroll costs and other eligible expenses (and a minimum of \$120,000 of payroll costs). Employer C submitted a PPP Loan Forgiveness Application and reported the \$200,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan, but did not report the other eligible expenses of \$70,000. Employer C received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000.

Employer C is deemed to have made an election not to take into account \$200,000 of qualified wages for purposes of the employee retention credit, 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. Although Employer C could have reported \$70,000 of eligible expenses (other than payroll costs) and \$130,000 of payroll costs, Employer C reported \$200,000 of qualified wages as payroll costs on the PPP Loan Forgiveness Application. As a result, no portion of those qualified wages reported as payroll costs may be treated as qualified wages for purposes of the employee retention credit.

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.

## Calculating Full-Time Equivalent Employees (FTEs)

While the PPP calculates FTEs based on a 40-hour work week, ERC uses a 30-hour work week based on full and fractional employees.

Below is the passage from Notice 2021-20 (page 10):

Section 2301(c)(3)(A) of the CARES Act provides different definitions of “qualified wages” depending on the size of the employer, which is measured by the average number of full-time employees (within the meaning of section 4980H of the Code) employed by the eligible employer during 2019.

Here’s the relevant portion from Notice 2014-49 on Section 4980H, which was referenced in the previous excerpt and can be found at the following location: <https://www.irs.gov/pub/irs-drop/n-14-49.pdf>. This information can be found at the top of page 3:

Section 4980H(c)(4) provides that a full-time employee for any month is an employee who is employed on average at least 30 hours of service per week.

**Why is this important?** For ERC in 2020, companies with more than 100 FTEs cannot receive credits for employees who were working (even if they were working reduced hours), while companies with 100 FTEs or fewer were eligible if employees were working. The new law raises the threshold for ERC in 2021 from 100 to 500 employees, so wages for businesses with 500 or fewer employees will be eligible even if employees are working. Please note that employee counts for affiliated companies sharing more than 50% common ownership are aggregated.

## Other Items

IRS Notice 2021-20 contains a summary of the provisions of the CARES Act, as amended by the Consolidated Appropriations Act, that apply to qualified wages paid in 2020. In addition, it contains an in-depth question-answer section, starting at the bottom of page 16, on the following topics:

- ✿ Eligible Employers
- ✿ Aggregation Rules
- ✿ Governmental Orders
- ✿ Full or Partial Suspension of Trade or Business Operations
- ✿ Significant Decline in Gross Receipts
- ✿ Maximum Amount of Employer’s Employee Retention Credit
- ✿ Qualified Wages
- ✿ Allocable Qualified Health Plan Expenses
- ✿ Interaction with Paycheck Protection Program (PPP) Loans
- ✿ Claiming the Employee Retention Credit
- ✿ Special Issues for Employees: Income and Deduction
- ✿ Special Issues for Employers: Income and Deduction
- ✿ Special Issues for Employers: Use of Third-Party Payers
- ✿ Substantiation Requirements

While this Notice is a lengthy document, it is a great resource if you have any questions on your particular situation, from qualifying for to claiming the credit.

## For More Information

We will continue to monitor this situation and release updates. For more information or assistance, please contact our Payroll team at **210-293-6620**, toll-free at **1-888-757-2104**, or [PayrollServices@BFGonline.com](mailto:PayrollServices@BFGonline.com).



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