

IRS Issues Guidance on 2020 Employee Retention Credit, Including Interaction with Paycheck Protection Program



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Over two months ago, the Consolidated Appropriations Act, 2021 (Appropriations Act) brought welcome news to many Paycheck Protection Program (PPP) borrowers. Until then, PPP borrowers were prohibited from claiming the employee retention credit (ERC), a refundable payroll tax credit created by the CARES Act. The Appropriations Act changed the law to allow PPP borrowers who meet the ERC eligibility criteria to claim the ERC, with the caveat that the same wages cannot be used to calculate the ERC and also obtain PPP loan forgiveness. This change was *retroactive* to the CARES Act's effective date, giving PPP borrowers who had not claimed the ERC in 2020 but qualified for the credit the opportunity to claim it for periods beginning March 13, 2020, and ending December 31, 2020.

Despite this favorable development, questions surfaced regarding the interaction between ERC and PPP wages. When the Appropriations Act became law in late December 2020, many borrowers had already applied for forgiveness of their PPP loan. To ensure full forgiveness, some borrowers reported gross wages on their forgiveness application in excess of their loan amount. It was unclear whether gross wages included on a forgiveness application, but unnecessary for full forgiveness, were eligible for the ERC. Also, while many borrowers paid or incurred eligible non-payroll costs during the covered period, they often excluded those costs from their application to streamline the lender and SBA review processes.

On March 1, 2021, these questions were finally answered by the IRS in [Notice 2021-20](#). Per the notice, PPP borrowers may use wages reported on a loan forgiveness application in excess of the amount necessary to support full forgiveness as qualified wages for the ERC. However, borrowers cannot use wages in an amount equal to other eligible non-payroll expenses (such as mortgage interest, rent, or utilities) that they did not include on their submitted application.

To understand the IRS guidance, let's consider two examples.

Example 1

Employer A received a PPP loan of \$200,000 and paid \$250,000 of wages that would qualify for the ERC in 2020. Employer A submitted a forgiveness application and reported the \$250,000 of qualified wages as PPP forgivable wages. Employer A did not report any other eligible expenses on its application. Employer A's entire loan was forgiven.

Employer A may not use \$200,000 of the qualified wages necessary for forgiveness for ERC purposes. However, Employer A may use the \$50,000 of qualified wages reported on the forgiveness application that were not necessary for full forgiveness.

Example 2

Employer B received a PPP loan of \$200,000. Employer B paid \$200,000 of qualified wages that would qualify for the ERC in 2020. Employer B also paid other eligible non-payroll expenses of \$70,000. Employer B submitted a forgiveness application and reported the \$200,000 of qualified wages to support the loan's forgiveness. Employer B did not report the other eligible expenses of \$70,000. Employer B's entire loan was forgiven.

Employer B may not use the \$200,000 of qualified wages for purposes of the ERC. Additionally, although Employer B could have reported \$70,000 of eligible expenses other than wages, no portion of this amount may be used for loan forgiveness to free up qualified wages for the ERC.

The IRS notice states that PPP borrowers that are eligible businesses can claim the ERC for eligible quarters in 2020 by filing Form 941-X, but only for qualified wages not necessary and used for loan forgiveness.

The notice also formalizes and expands upon many Frequently Asked Questions (FAQs) about the ERC previously posted on the IRS's website. The formalization of the FAQs allows taxpayers to rely on the guidance for penalty protection.

The Appropriations Act extended the ERC into the first and second quarters of 2021. The IRS intends to issue separate guidance on the 2021 ERC.

For general information on the ERC, follow the link below:

[Employee Retention Credit](#)

Do you have questions about the new law? Contact your Dean Dorton advisor, or contact us at:

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