

A Guide to the 2021 Paycheck Protection Program and Employee Retention Credit

*As Amended by the Consolidated Appropriations Act
and American Rescue Plan*

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Part 1—The Paycheck Protection Program (PPP)

Exactly nine months after signing the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) into law, on December 27, 2020, former President Trump signed the Consolidated Appropriations Act, 2021 (Appropriations Act). The CARES Act established the Paycheck Protection Program (PPP) and the potentially lucrative payroll tax credit known as the Employee Retention Credit (ERC). The Appropriations Act extended and modified the PPP and ERC. Both programs were further revised by the American Rescue Plan (Rescue Plan) signed by President Biden on March 11, 2021.

The information provided is highly abbreviated as there are thousands of pages of statutes, regulations, and other materials related to the PPP and ERC. Thus, the information should not be relied upon as accounting, tax, or legal advice. Before acting, please consult an advisor about your specific situation. If you do not have an advisor or have general questions, you may reach us at COVID19Solutions@deandorton.com.

The information in this guide is current through March 19, 2021.

Through the PPP, small business concerns, nonprofits, and others can obtain low-interest loans to pay employees, rent, utilities, and other critical costs. The loans can function like a grant as Congress's intent is for full forgiveness of the loan. The first round of loans opened to eligible borrowers on April 3, 2020.

2020—Wow, that was fast!

The CARES Act authorized \$342.3 billion in PPP loans, and the entire amount was allocated to borrowers in thirteen days - between April 3 and April 16, 2020. Congress appropriated an additional \$320 billion in late April. This time the money lasted. When the final application deadline passed on August 8, 2020, 5.2 million loans totaling over \$525 billion had been provided to small businesses, nonprofits, and other eligible organizations across the United States. Then, everyone waited. There was a near-unanimous belief that Congress would authorize a second round of PPP loans. The only question was when. In December 2020, that question was answered.

2021—A little slower, please.

A section of the Appropriations Act referred to as the "Economic Aid Act" authorizes PPP loans for first-time borrowers and a second PPP loan for borrowers described as the "hardest-hit." The loans to first-time borrowers are called First Draw loans and have nearly the same eligibility and forgiveness requirements as the 2020 PPP loans. The second loan is called a Second Draw loan. On March 12, 2021, the SBA reported approval of 2.5 million loans totaling \$168.5 billion from the opening of the current PPP round on January 11, 2021. This represents approximately 58% of the \$687 billion in funds authorized, which does not include \$7.5 billion added by the Rescue Plan. Approximately 300,000 loan applications totaling \$24 billion were pending.

PPP—Loan Eligibility

First Draw Loans

Any small business concern (including sole proprietors, independent contractors, and self-employed persons), Internal Revenue Code (IRC) section 501(c)(3) nonprofit organization (including faith-based organizations), 501(c)(19) veterans organization, or Tribal business concern doing business before February 15, 2020 and with 500 or fewer employees qualifies for a First Draw loan. Subject to certain limitations, the Economic Aid Act expanded eligibility for First Draw loans to the following entities with 300 or fewer employees: IRC 501(c)(6) organizations; destination marketing organizations; local newspaper, TV, and radio stations; and housing cooperatives.

The Rescue Plan adds internet publishing organizations assigned an NAICS code of 519130 and some additional IRC 501(c) organizations. Newly eligible nonprofit organizations include labor unions, agricultural organizations, and community locations of larger nonprofits.

Eligible nonprofit organizations other than IRC 501(c)(3) and 501(c)(19) veterans organizations must also meet the following requirements before applying for a loan:

- the organization does not receive more than 15% of receipts from lobbying activities,
- lobbying activities do not compose more than 15% of its activities, and
- the cost of lobbying activities of the organization did not exceed \$1 million during the most recent tax year that ended before February 15, 2020.

When a potential applicant determines its number of employees, the business must include employees of "affiliates." SBA's definitions of "affiliate" are discussed later in this guide.

Second Draw Loans

Second Draw loans are available to entities and organizations eligible for First Draw loans, subject to three new requirements. Eligible applicants must have:

- 300 employees or less,
- a 25% reduction in gross revenue between 2019 and 2020 or comparable quarters in 2019 and 2020, and
- used or will use all First Draw funds (including any increase of the First Draw) on eligible expenses on or before the expected date of the Second Draw loan disbursement.



PPP—Second Draw Revenue Reduction Requirement

Demonstrating a quarterly or annual revenue reduction, that is, a decline in gross receipts, of 25% or more, is critical to qualify for a Second Draw loan. For loan applicants in operation all four quarters of 2019, gross receipts during the first, second, third, or fourth quarter in 2020 are compared with gross receipts in the same quarter in 2019 to determine if there was a 25% or greater revenue reduction. For example, an applicant that had gross receipts of \$50,000 in the second quarter of 2019 and had gross receipts of \$30,000 in the second quarter of 2020 experienced a 40% revenue reduction and, assuming all other eligibility requirements are met, qualifies for a Second Draw loan. The SBA has stated that only calendar quarters are to be used for this calculation.

Gross receipts?

The first question raised by the revenue reduction requirement is what constitutes "gross receipts?" The SBA has defined gross receipts for both for-profit and nonprofit entities. The rule provides that for all entity types, the amount of a PPP loan forgiven is excluded from gross receipts and that the gross receipts of affiliates must be considered.

The definition of gross receipts for for-profit businesses is all revenue in whatever form received or accrued (following the entity's accounting method), including and excluding the items below:

Including	Excluding
Sales of products or services, reduced by returns and allowances	Net capital gains or losses
Interests, dividends, royalties	Taxes collected for and remitted to a taxing authority if included in gross or total income such as sales or similar taxes
Rents	Proceeds from transactions between a concern and its domestic or foreign affiliates
Fees or commissions	Amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder, or customs broker

For nonprofit organizations, gross receipts include, but are not limited to:

- contributions, gifts, and grants
- dues or assessments
- sales or receipts from unrelated business activities
- sales of assets
- and investment income, e.g., interest dividends, rents, and royalties

Gross receipts are not reduced for any associated costs or expenses.

SBA's "Second Draw Paycheck Protection Program (PPP) Loans: How To Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide" document provides detailed instructions on calculating the decline in gross receipts and required documentation.

PPP—Second Draw Documentation

A Bad Quarter, a Good Year, and Documentation

Other questions related to the revenue reduction requirement include what happens if a business does badly in one quarter but recovers later, and what documentation must be provided to demonstrate the decline? Nothing in the current guidance expressly prohibits a business from applying for a Second Draw loan if it had a decline in one quarter in 2020, but other quarters in 2020 are equal to or better than the same quarter in 2019. However, all borrowers must certify that "current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." Although other factors may be relevant, a financial recovery in the third and fourth quarters of 2020 may call into question whether the loan is necessary.

The AICPA has asked for clarification about whether other relief funds, such as Provider Relief Funds, Higher Education Emergency Relief Funds, state and local grants, should be included—stay tuned.

For loans greater than \$150,000, documentation of the revenue reduction must be submitted with the Second Draw loan application. SBA says one of the three following sets of documents is sufficient:

Required Documents	Notes
Quarterly financial statements for the entity	If the financial statements are not audited, the applicant must sign and date the first page of the financial statements and initial all other pages, attesting to their accuracy. If the financial statements do not specifically identify the line items that constitute gross receipts, the applicant must annotate which line items constitute gross receipts.
Quarterly or monthly bank statements for the entity showing deposits from relevant quarters	The applicant must annotate, if it is not clear, which deposits listed on the bank statement constitute gross receipts.
Annual IRS income tax filings of the entity (required if comparing 2019 and 2020 annually)	If the 2020 tax return has not yet been filed, then the applicant must fill out the return, and sign and date the return, attesting that the values that enter into the gross receipts computation are the same values that will be filed on the entity's tax return.

For loans of \$150,000 or less, documentation of the revenue reduction must be submitted before or when applying for loan forgiveness.

PPP—Affiliation Rules

Affiliation rules apply for determining loan eligibility. Specifically, the rules apply to calculating the number of employees and, for Second Draw loans, the reduction in gross revenue. In general, SBA determines "affiliation" based on several tests that focus on whether another entity or individual has power over the applicant and others. "Power to control" exists when (1) an individual or another entity has more than 50% of an applicant's voting equity, (2) a CEO, president, officer, managing member, or partner controls the management of both a loan applicant and another entity or entities, or (3) there is an identity of interest between close relatives with identical or substantially identical business or economic interests and the applicant. The SBA also uses other tests to determine affiliation, including looking at the totality of an entity's circumstances and considering equity and merger agreements. For PPP loan purposes, the affiliation rules are waived for some businesses, including hotels and restaurants and businesses operating as a franchise that the SBA has assigned a franchise identifier code.

PPP—Ineligible Businesses



Numerous types of businesses are ineligible for a PPP loan. A partial list of ineligible businesses includes: businesses permanently closed, publicly-traded businesses, lobbying organizations, hedge funds or private equity funds, businesses that obtain more than one-third of their annual gross income from legal gambling activities, household employers, private clubs and businesses that limit the number of memberships for reasons other than capacity, and entities in bankruptcy.

Certain entities organized under the laws of the People's Republic of China or the Special Administrative Region of Hong Kong are also ineligible.

PPP—Loan Amounts

For both First Draw and Second Draw loans, the PPP loan amount is 2.5 times average monthly payroll costs for applicants with employees. Payroll costs for either calendar year 2019 or 2020 may be used. Average monthly payroll must be adjusted for employee compensation over \$100,000 on an annualized basis. Payroll costs include gross wages, plus employer contributions to employee group health, life, disability, vision, and dental insurance, plus employer retirement contributions, plus state unemployment insurance paid. Contributions to group life, disability, vision, and dental insurance are new eligible costs added by the Economic Aid Act. First Draw loans are capped at \$10 million, while Second Draw loans are capped at \$2 million.

Starting with loan applications filed after March 3, 2021, self-employed individuals that file a Form 1040, Schedule C (Schedule C filers) may calculate their loan amount using either line 31 of Schedule C, net income, or line 7, gross income. This new filing methodology is available to Schedule C filers with or without employees.

The change for Schedule C filers was made by the SBA over two months after the same change was made for farmers and ranchers that file a Form 1040, Schedule F. The gross income or net profit of both Schedule C and Schedule F filers is capped at \$100,000.

One other provision of note relates to businesses in the Accommodation and Food Services sector, which are businesses that have an NAICS code that begins with 72. These businesses may obtain a larger Second Draw loan amount by multiplying their average payroll costs by 3.5, rather than 2.5.

PPP—Increased First Draw Loans



A narrow category of 2020 borrowers may qualify for an increase to their First Draw loan. Generally speaking, increases may be requested by borrowers that fall within one of the following categories:

- Partnerships that did not include any amount for partner compensation as part of the calculation of their loan amount
- Seasonal employers that want to select an alternative 12-week period between February 15, 2019 and February 15, 2020 to calculate their loan amount
- Farmers or ranchers that want to utilize gross income for calculating their maximum loan amount
- Borrowers that returned a part of their loan
- Borrowers that did not accept the full amount of the loan for which they were approved

If a borrower has received full forgiveness of its First Draw loan, the borrower is not eligible for an increase.

Borrowers wanting to explore a 2020 loan increase should contact their lender.

PPP—Forgiveness

For both First and Second Draw loans, borrowers can qualify for forgiveness up to the full principal amount of the loan and accrued interest if:

- the loan proceeds are used for forgivable purposes during the borrower's covered period,
- the number of full-time equivalent employees (FTEs) and employee compensation levels are maintained or an applicable safe harbor or exemption applies, and
- at least 60% of the PPP loan proceeds are used for payroll costs.

Forgivable Costs

"Payroll costs" remain the primary component of forgivable costs. In addition to defining what is and is not included in payroll costs, the SBA has also capped the amount of "payroll costs" available for owner-employees and self-employed individuals' own payroll compensation. These "payroll costs" are known as owner compensation replacement. The caps vary by entity type (S corporation, partnership, etc.), and the Interim Final Rule should be consulted to understand the caps.

Other forgivable costs with which most borrowers are familiar include interest on secured debt, rent or lease payments, and utility costs. Debt, leases, and utilities must have been in place before February 15, 2020, and, depending on circumstances, payments of interest or rent to related parties are not forgivable.

The Economic Aid Act includes four additional categories of non-payroll forgivable costs. The new categories are: "covered operations expenditures," "covered property damage costs," "covered supplier costs," and "covered worker protection expenditures." The expanded costs can be included in forgivable costs for both First and Second Draw loans.

Covered Period

To qualify for forgiveness, costs must be paid or incurred during the borrower's covered period. The covered period begins when the borrower receives the loan proceeds and ends on a date of the borrower's choice between eight and 24 weeks. For example, if loan proceeds were received on February 1, 2021, the borrower may choose:

- an 8-week covered period, which would end March 28, 2021
- a 24-week covered period, which would end July 18, 2021
- any date between March 28 and July 18, 2021

Because of this flexibility, there is no longer an "alternative payroll covered period" option for payroll costs.

Limits on Full Forgiveness

Generally, a reduction in the number of employees or their pay rates affects a loan's forgiveness. If a borrower decreases the salaries and wages of certain employees by more than 25% during the covered period, loan forgiveness may be reduced. The same is true if the number of FTEs decreases during the covered period compared to a reference period. Safe harbors and exceptions to both of these reductions are available in some circumstances.

Borrowers not qualifying to use Form 3508S must provide the lender documentation verifying payroll costs, and other covered expenses. Payroll documents required include payroll tax documents for the quarters within the covered period, including Form 941, state and quarterly wage withholding and unemployment tax forms, payroll reports of the borrower or its third-party payroll provider for the pay periods in the covered period, and evidence of payment of insurance and retirement benefits.

PPP—When to Apply for Forgiveness

A borrower can apply for forgiveness as soon as the loan proceeds for which the borrower seeks forgiveness have been spent up until the loan's maturity date. However, if borrowers do not apply for forgiveness within ten months after the last day of the covered period, the borrower must begin making principal and interest payments on the loan.

Borrowers of Second Draw loans exceeding \$150,000 must submit their First Draw forgiveness application (even if no amount of forgiveness is requested) either before or simultaneously with the Second Draw forgiveness application. A separate form must be used for each loan.

Forgiveness Application—Loans \$150,000 or less

First Draw and Second Draw borrowers with loans of \$150,000 or less can use the newly amended simplified forgiveness form, [Form 3508S](#). Previously SBA provided Form 3508S to streamline the forgiveness of loans, which were \$50,000 or less, but the form is now used for loans equal to or less than \$150,000. The following is required of the borrower:

- Sign and submit a one-page form
- Attest to complying with PPP requirements
- Report loan amount
- Report number of employees retained
- Report estimate of loan amount spent on payroll
- Retain records

The document retention period for these loans is four years for employment records and three years for other required documentation. As with any PPP loan, SBA may review and audit loans of \$150,000 or less and access any records the borrower must retain.

Forgiveness Application—Loans greater than \$150,000

Borrowers with loans over \$150,000 can use Form [3508EZ](#) if the form criteria are met. If not, the borrower must use [Form 3508](#). Borrowers that can use Form 3508EZ must certify that either:

- The borrower did not reduce the salary or hourly wages of any employee by more than 25% during the covered period AND did not reduce the number of employees, or the average paid hours of employees between January 1, 2020 and the end of the covered period; or
- The borrower did not reduce the salary or hourly wages of any employee by more than 25% during the covered period, AND the borrower was unable to operate during the covered period at the same level of business activity as before February 15, 2020, because of a government order.

PPP—Taxation

The Appropriations Act brought welcome news for borrowers by stating that expenses paid with a PPP loan are deductible for federal income tax purposes if otherwise eligible. The forgiveness of the PPP loan is not taxable either. The IRS issued Revenue Ruling 2021-02 on January 6, 2021, acknowledging the deductibility of expenses. Each state decides whether it will follow the federal law on the taxability of PPP loans.

Part 2—The Employee Retention Credit



Also in March of 2020, the CARES Act created the ERC, a refundable payroll tax credit for eligible employers. The ERC was designed to provide financial support to businesses that kept employees on their payroll despite experiencing economic hardship. However, there was one big exception. Employers that received a PPP loan were not eligible for the ERC.

That changed at the end of December, when the Appropriations Act was signed into law. The Appropriations Act extended the ERC, originally set to expire at the end of 2020, into the first and second quarters of 2021. It also expanded eligibility for the credit to include employers that received a PPP loan, with the caveat that any wages used for PPP loan forgiveness cannot also be used for the ERC. This change was retroactive to the effective date of the CARES Act, meaning any employer that received a PPP loan should evaluate its eligibility for the ERC in both 2020 and 2021.

The Rescue Plan extends the ERC through the third and fourth quarters of 2021.

Different rules apply to the ERC available for 2020 and the ERC available for 2021. This guide distinguishes between the two periods by referring to the "2020 ERC" and the "2021 ERC," respectively. Where applicable, differences between the 2020 ERC and the 2021 ERC are discussed.

The ERC—The Basics

Eligible employers can claim a refundable credit against payroll taxes equal to a percentage of qualified wages paid with respect to each employee. In 2020, the credit is available for wages paid by eligible employers from March 13, 2020 through and including December 31, 2020. In 2021, eligible employers can claim the credit for wages paid from January 1, 2021 through and including December 31, 2021.

From March 13, 2020 through June 30, 2021, the credit is claimed against the employer portion of Social Security tax. From July 1 through December 31, 2021, the credit is claimed against the employer portion of Medicare tax.

An eligible employer is any employer, including a tax-exempt organization, that was carrying on a trade or business during calendar year 2020 and meets one of the following economic hardship criteria during the calendar quarter:

1. The operation of the business is fully or partially suspended due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings because of COVID-19; or
2. The employer experiences a significant decline in gross receipts.

The 2020 ERC is equal to 50% of qualified wages up to a maximum of \$10,000 in qualified wages per employee for all calendar quarters (for a maximum credit of \$5,000 per employee). The 2021 ERC is equal to 70% of qualified wages up to a maximum of \$10,000 in qualified wages per employee per calendar quarter (for a maximum credit of \$28,000 per employee).

The ERC—Gross Receipts

What constitutes a “significant decline in gross receipts” differs for the 2020 ERC and the 2021 ERC. A significant decline in gross receipts for the 2020 ERC is the period that:

- begins with the first calendar quarter in 2020 for which gross receipts are less than 50% of gross receipts for the same calendar quarter in 2019; and
- ends with the calendar quarter following the first calendar quarter for which gross receipts are greater than 80% of gross receipts for the same calendar quarter in 2019.

For the 2021 ERC, an employer experiences a significant decline in gross receipts if its gross receipts for the relevant calendar quarter in 2021 are less than 80% of gross receipts for the same calendar quarter in 2019. Also, for the 2021 ERC only, employers can elect to determine their eligibility by comparing their gross receipts for the immediately preceding calendar quarter to the corresponding quarter in 2019. For example, an employer could elect to determine eligibility for the first quarter of 2021 by comparing its gross receipts for the fourth quarter of 2020 to the fourth quarter of 2019.

For employers other than tax-exempt organizations, gross receipts include total sales (net of returns and allowances) and amounts received for services. In addition, gross receipts include any income from investments and incidental or outside sources. Gross receipts generally are not reduced by cost of goods sold but generally are reduced by the taxpayer’s adjusted basis in capital assets sold. Gross receipts do not include the repayment of a loan or amounts received with respect to sales tax if the tax is legally imposed on the purchaser and the taxpayer merely collects and remits the sales tax to the taxing authority.

Gross receipts for tax-exempt employers include gross receipts from all operations, not only from activities that constitute unrelated trades or businesses. Gross receipts include (1) the organization’s investment income; (2) the gross amount received as contributions, gifts, grants, and similar amounts; and (3) the gross amount received as dues or assessments from members or affiliated organizations.

The ERC—Qualified Wages

Qualified wages are wages subject to Social Security tax and paid during a calendar quarter in which the employer (1) experiences a significant decline in gross receipts; or (2) has operations that are fully or partially suspended by a government COVID-19 order, but only during the period the order is in force. Allocable health plan expenses also can be treated as wages when computing the credit. Qualified health plan expenses are amounts paid by an employer to provide and maintain a group health plan, but only to the extent those amounts are excluded from employees' gross income. The IRS has issued guidance on qualified health plan expenses and how to allocate those expenses to qualified wages.

Qualified wages do not include sick and family leave wages for which an employer has received payroll tax credits under the Families First Coronavirus Response Act, wages paid to certain related individuals, or wages taken into account for various other tax credits. As discussed below, qualified wages also do not include wages used for PPP loan forgiveness. Finally, the Rescue Plan clarifies that for the third and fourth quarters of 2021, qualified wages do not include wages used in connection with a Shuttered Venue Operator Grant or a Restaurant Revitalization Grant.

The definition of qualified wages is more restrictive for large employers. Qualified wages for large employers include only wages paid when the employee is not providing services. For the 2020 ERC, a large employer is an employer that averaged more than 100 full-time employees during 2019. In addition, for the 2020 ERC only, qualified wages taken into account for an employee of a large employer cannot exceed the amount the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period of the employer's economic hardship (the 30-day rule).

For the 2021 ERC, a large employer is an employer that averaged more than 500 full-time employees during 2019. In addition, the 30-day rule is eliminated for the 2021 ERC. Employers that are not large employers can count all wages paid during the period of economic hardship as qualified wages.

The Rescue Plan created a special rule for "severely financially distressed employers," which applies to qualified wages paid in the third and fourth quarters of 2021 only. A severely financially distressed employer is an employer whose gross receipts for the relevant calendar quarter in 2021 are less than 10% of gross receipts for the same calendar quarter in 2019. Large employers that qualify as a severely financially distressed employer can count all wages paid to employees as qualified wages rather than only wages paid to employees when they do not provide services.

A full-time employee for any month is defined under the ERC as any employee who is employed on average at least 30 hours of service per week.

The ERC—Other Eligibility Considerations

Self-employed individuals are not eligible for the ERC with respect to their own self-employment earnings. However, self-employed individuals who employ other individuals in their business may be eligible for the ERC with respect to wages paid to employees.

Governmental employers, including the federal government, state and local governments, and governmental agencies and instrumentalities, are not eligible for the 2020 ERC. Certain governmental instrumentalities, including 501(c)(1) organizations, colleges and universities, and entities providing medical or hospital care, are eligible for the 2021 ERC.

For the third and fourth quarters of 2021, the Rescue Plan expanded eligibility for the ERC to “recovery startup businesses.” A recovery startup business is any employer that began carrying on any trade or business after February 15, 2020. Guidance on additional eligibility requirements is expected. The credit allowed for recovery startup businesses for any calendar quarter cannot exceed \$50,000.

Aggregation rules require certain related employers and affiliated service groups to be treated as a single employer for all aspects of the ERC. For example, these employers are treated as a single employer for purposes of determining the employer’s eligibility, i.e., whether the employer’s operations were fully or partially suspended due to COVID-19 orders from the government, or whether the employer has a significant decline in gross receipts, and whether the employer qualifies as a large employer. The IRS has issued guidance on which related employers must be treated as a single employer.

The ERC—Claiming the Credit

Because the ERC is a payroll tax credit, it is claimed on an employer’s payroll tax return. For most employers, this is Form 941, which is filed quarterly. IRS guidance about the 2020 ERC permits employers to benefit from the ERC in advance of filing Form 941 by reducing their employment tax deposits in anticipation of the credit. To the extent the credit exceeds the amount the employer is required to deposit, the employer can claim an advance credit by filing [Form 7200](#). For the 2021 ERC, only employers with an average of 500 or fewer full-time employees in 2019 may request an advance payment of the credit by filing Form 7200.

Employers that did not claim the credit in a prior quarter and later determine they were eligible can file [Form 941-X](#) for the prior quarter. This includes PPP borrowers who are now eligible for the 2020 ERC if they otherwise meet the eligibility criteria.

If you work with a third-party payroll provider to file payroll tax returns, you should reach out to your provider to determine how they are implementing the ERC and what information they need.

Employers claiming the ERC must keep the following records for at least four years:

- Documentation showing how they calculated the amount of the ERC, including calculation of the amount of qualified health plan expenses included in the credit;
- Documentation showing eligibility for the ERC based on a suspension of business operations or a decline in gross receipts;
- Amount of all advances received and copies of completed Form(s) 7200 filed with the IRS; and
- If the employer uses more than one third-party payer or also files its own returns for some wages, documentation showing which wages related to the ERC were paid by which third-party payer or the employer.

The ERC—2020 to 2021 Comparison

As noted, there are several differences between the 2020 ERC and the 2021 ERC. In addition, a few changes made by the Rescue Plan apply only to the third and fourth quarters of 2021. The chart below compares the major aspects of the ERC across these periods.

	2020 ERC	Jan. 1 - Jun. 30, 2021	Jul. 1 - Dec. 31, 2021
Qualified Wages threshold	\$10,000 for all quarters	\$10,000 per quarter	\$10,000 per quarter
Credit calculation	50% of qualified wages	70% of qualified wages	70% of qualified wages
"Large" employer threshold	>100 FTEs in 2019	>500 FTEs in 2019	>500 FTEs in 2019
30-day rule for large employers	Yes	No	No
Governmental employers	Governmental employers, including governmental agencies and instrumentalities, are ineligible	501(c)(1) organizations, colleges and universities, and entities providing medical or hospital care are eligible	501(c)(1) organizations, colleges and universities, and entities providing medical or hospital care are eligible
Gross receipts decline	Begins with >50% decline compared to 2019 quarter	>20% decline compared to 2019 quarter	>20% decline compared to 2019 quarter
Election to use prior quarter gross receipts to determine eligibility?	No	Yes	Yes
PPP borrowers eligible?	Yes*	Yes*	Yes*
Period during which eligible employers can claim credit	Wages paid from 3/13/2020 – 12/31/2020	Wages paid from 1/1/2021 – 6/30/2021	Wages paid from 7/1/2021 – 12/31/2021
Tax against which credit is claimed	Employer portion of Social Security tax	Employer portion of Social Security tax	Employer portion of Medicare tax
Recovery startup businesses eligible?	No	No	Yes
Special rule for severely financially distressed employers?	No	No	Yes

*The same wages cannot be used for both PPP loan forgiveness and the ERC.



The ERC—IRS Guidance on Interaction with PPP Loans

IRS Guidance on the ERC and PPP Interaction

As noted, PPP borrowers are eligible for the ERC, but forgivable payroll costs do not include qualified wages used in determining the credit. This caveat initially created uncertainty for PPP borrowers who had already submitted a PPP loan forgiveness application when the Appropriations Act was signed into law. To ensure full forgiveness, many 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 2020 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, the IRS issued guidance on the 2020 ERC in the form of 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.

* * *

PPP borrowers that have not submitted a forgiveness application for their First Draw loan, or who are currently using proceeds from a Second Draw loan, should consider how they can maximize the benefit of both the PPP and the ERC. For example, borrowers should evaluate whether they have eligible non-payroll costs for which they could use PPP loan proceeds to maximize the wages available for the ERC, keeping in mind that at least 60% of the proceeds must be used for payroll costs.

Although this guide attempts to cover the major aspects of the ERC, it is not possible to address every circumstance. For more information, please work with your professional advisor or contact us at the email link below.

Contact us:  covid19solutions@deandorton.com