

PUBLICATION

PPP Recipients May Qualify For Expanded Employee Retention Credit

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Multiple federal laws enacted during the pandemic have provided assistance to struggling employers, including assistance through the Paycheck Protection Program (PPP) and the employee retention tax credits (ERC). PPP and ERC, once considered mutually exclusive, are now complimentary and jointly useable by employers with some conditions.

CARES Act Created PPP and ERC

In The CARES Act, signed by President Trump on March 27, 2020, Congress provided, among other things, for forgivable loans under the PPP and also for refundable ERC for employers experiencing a reduction in gross receipts or a partial or full shutdown as a result of a COVID-19 related governmental order. As initially enacted, PPP loan recipients were not eligible for the ERC.

CAA Allows PPP Loan Recipients to Be Eligible for ERC

The Consolidated Appropriations Act (CAA), signed by President Trump on December 27, 2020, made significant enhancements to the ERC, including extending availability to the first two quarters of 2021, increasing the credit from 50 percent to 70 percent, and allowing it to be claimed in each quarter and reducing the 50 percent decline in revenues requirement to 20 percent (compared to the same period in 2019) as well as increasing the employment threshold from 100 employees to 500 to be eligible to obtain the credit for all employees rather than just those employees not working.

Importantly, the CAA allows PPP loan recipients to claim the ERC, retroactive to the effective date of The CARES Act, March 27, 2020, although the same wages cannot be counted for both. Claiming the ERC in 2020 will require amendment to [Form 941, Employer's Quarterly Federal Tax Return](#) as discussed below. The CAA also clarified that otherwise deductible expenses paid with loan proceeds of a forgiven PPP loan are deductible and the tax basis and other attributes of the borrower's assets will not be reduced as a result of loan forgiveness.

ARPA Extends ERC Until 12/31/21 and Expands Eligibility

On March 11, 2021, President Biden signed into the law the [American Rescue Plan Act of 2021 \(ARPA\)](#). Included among many pandemic relief provisions in ARPA is a further expansion of the ERC through December 31, 2021. Under the expanded ERC, an employer is now eligible for ERC in all four quarters and thus can obtain \$28,000 in credit per employee in 2021.

In addition, ARPA also expands eligibility for the ERC for up to \$50,000 per calendar quarter to a "recovery start-up business." A recovery start-up business is an employer that began carrying on a trade of business after February 15, 2020, with annual gross receipts of up to \$1 million.

Another new category of eligibility is a "severely financially distressed employer," which is defined as a company that has experienced gross receipts that are less than 10% of what they were in the same quarter in 2019. Similar to the current ERC rules, an election is available to use the immediately preceding calendar quarter for purposes of the gross receipts test. A severely financially distressed employer who meets this test

will be able to treat all wages paid to employees during a quarter as qualified wages, even if it exceeds the 500 fulltime employee threshold.

IRS Notice 2021-20

The IRS issued this additional guidance on March 1, 2021 for employers claiming the ERC for calendar quarters in 2020. The guidance is similar to the information posted in IRS FAQs issued in 2020, but this Notice makes clarifications and describes retroactive changes under the new law that applied in 2020, including eligibility for the ERC for taxpayers who took a PPP loan. The notice states that the service will look to wages reported on the application for PPP forgiveness to determine what wages remain eligible for the ERC. To the extent wages are included as payroll costs on the PPP loan forgiveness application, the taxpayer is deemed to have made the election not to claim the ERC with respect to such wages. The deemed election out of ERC applies to the minimum amount of wages necessary to achieve PPP loan forgiveness. The taxpayer appears to have the flexibility in determining what eligible wages are allocated to PPP versus the ERC to maximize their respective benefits. Taxpayers shall also be aware that using a longer covered period (24 weeks versus 8 weeks) could allow payroll earlier in the year (e.g., when a government shutdown order was in place) to be eligible for ERC and wages paid later eligible for PPP. If an employer only reported wages on the application for forgiveness and omitted other eligible expenses, then the employer may have inadvertently reduced the amount of wages eligible for the ERC. This could be a problem for some employers who omitted expenses out of administrative convenience. Hopefully, the IRS will issue additional guidance that will allow some remedy for these situations.

Is the ERC Subject to Income Tax?

The answer is no, but the ERC does have some impact on calculation of taxable income. While the ERC will not be a taxable income it is subject to the expense disallowance rules. There is an example provided in the Notice essentially as follows:

IRS Notice 2021-20 provides that an employer who receives \$200,000 in ERC would be required to reduce its deductible wage expenses including qualified and health plan expenses by \$200,000. In other words, a taxpayer cannot claim both the credit and an expense deduction for the same wages. There is no reduction in the employer's deduction for its share of Social Security and Medicare taxes imposed on the qualified wages eligible for the ERC.

How to Claim the ERC

An eligible employer that after March 12, 2020, and before January 1, 2022, paid qualified wages is entitled to claim the ERC against the taxes imposed on employers by the Social Security tax after those taxes are reduced by any credits the employer claims for the payment of sick leave and family leave provided for under the [Family First Coronavirus Response Act](#), passed March 18, 2020, as amended.

If the ERC exceeds the applicable employment taxes for any quarter, then the excess is treated as an overpayment of tax and is refunded to the employer. Such refund can be applied for on [Form 941](#) or if it is claimed after the filing of the 941, by the filing of a [941-X](#). In anticipation of receiving the ERC, eligible employers may (1) reduce their deposits of federal employment taxes, including withheld taxes, that would otherwise be required, up to the amount of the anticipated ERC and (2) request an advance of the amount of the anticipated ERC that exceeds the reduced federal employment tax deposits by filing [Form 7200](#). The reduction in deposits and advance payments will be reconciled on the employer's quarterly 941.

Summary

The provisions discussed in this alert are significant. Further guidance from the Internal Revenue Service and action by a taxpayer will be necessary to take advantage of the expanded ERC and its interaction with the PPP. Our team of attorneys and advisors continue to monitor these changes and will provide further updates

about these matters. For additional guidance, please contact [David Webb](#) and [Carl Hartley](#), or your Baker Donelson attorney.