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What you need to know about PPP loans and the employee retention credit

If Congress had stuck to the original Paycheck Protection Plan (PPP) rules — holders of loans forgiven under the Paycheck Protection Program couldn't also take the employee retention credit — we wouldn't find ourselves with the problem we have today.

But Congress didn't. Holders of forgiven PPP loans may take the employee retention credit, provided the payroll costs covered by the forgiven loan aren't included as creditable costs. This, in turn, has opened up yet another can of worms.

How do holders of forgiven PPP loans who take the employee retention credit based on a significant decline in their gross receipts account for those gross receipts? For this dilemma, the IRS has created yet another safe harbor. This safe harbor applies to the employee retention credit retroactive to March 12, 2020, through Dec. 31, 2021.

All of this drama may be for very little, however, since, for most employers, the employee retention credit is likely headed for the scrap heap one quarter early—at the end of the third quarter, instead of the fourth quarter—as the Senate has included its repeal as a pay-for in its gigantic infrastructure bill.

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The law of unintended consequences, again

One way to become eligible for the employee retention credit is if you suffered a significant decline in gross receipts. The decline doesn’t have to be pandemic-related. For 2020, the significant decline in gross receipts was 50% when compared to the same quarter in 2019. For 2021, the significant decline is generally 20% when compared to the same quarter in 2019. Gross receipts are defined in reference to IRC § 448 and include:

- Total sales (i.e., net of returns and allowances).
- Amounts received for services.
- Income from investments and from incidental or outside sources of income, regardless of whether the income is included in your gross income.

And here’s the unintended consequence of defining gross receipts by referencing IRC § 448: If your PPP loan is forgiven, you don’t include the forgiven amount in the company’s gross income. That, after all, is the entire purpose of the forgiven loan.

But you must include the amount of the forgiven loan in your gross receipts, and doing so could cause your gross receipts to rise, thus impacting your eligibility for the credit.

It’s a small but vicious circle.

Safe harbor

The safe harbor is optional for you to use. Under it, you may exclude the amount of your forgiven PPP loan from your gross receipts solely for purposes of determining your eligibility for the credit. You make this election by simply taking the credit on your Form 941. Using it may increase your chances of qualifying for the credit.

If you choose not to use the safe harbor, you must include the amount of your forgiven PPP loan in your gross receipts.

Warning: Solely means solely. The concept of gross receipts is used throughout the tax code for various purposes and the IRS stressed the safe harbor can’t be used for any other tax purpose.

Eligibility for the credit is determined separately for each calendar quarter and so is this safe harbor. If you opt to use it, you must use it consistently for each calendar quarter. In addition, you must apply it to all employers treated as a single employer under the employee retention credit aggregation rules.

You may also revoke the use of the safe harbor. But the consistency rule applies here, too. *Upshot:* You must file Form 941-X for all the calendar quarters affected by the revocation.

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