



# KPMG report: Employee retention credit— additional guidance ties up many loose ends

August 24, 2021

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## Introduction

More than a year after the enactment of the *Coronavirus Aid, Relief, and Economic Security Act*, Pub. L. No. 116-136 (“CARES Act”), additional information from the U.S. Department of the Treasury (“Treasury Department”) and the Internal Revenue Service (“IRS”) regarding the employee retention credit (“ERC”) was released in August 2021.

In particular, Notice 2021-49 generally provides guidance on the ERC under section 3134 of the Internal Revenue Code of 1986, as amended (the “Code”), which provides a credit for certain wages paid after June 30, 2021, and prior to January 1, 2022.<sup>1</sup> Additionally, Notice 2021-49 amplifies guidance previously provided by the Treasury Department and the IRS in Notice 2021-20 and Notice 2021-23.

Separately, the Treasury Department and IRS also released Revenue Procedure 2021-33 that provides a safe harbor that may be used to compute gross receipts to determine eligibility to claim the ERC.

Both Notice 2021-49 and Rev. Proc. 2021-33 are discussed in this report and address several open questions regarding not only the application of the ERC in the third and fourth quarter on 2021 (which includes a few revised definitions to ERC provisions), coordination among the ERC and other assistance programs (PPP, shuttered venue operator grants, restaurant revitalization grants, etc.), and clarification to existing ERC terms (such as the impact of section 280C add back to wage deductions in prior tax years).

- Read [Notice 2021-49](#) [PDF 189 KB] (34 pages)
- Read [Rev. Proc. 2021-33](#) [PDF 129 KB] (12 pages)

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<sup>1</sup> References to “ERC” in this report are to the ERC under section 2301 of the CARES Act or section 3134 of the Code, as applicable to the relevant calendar quarter. Unless otherwise indicated, references to “section” are to the Code.

## Background

As originally enacted under section 2301 of the CARES Act, the ERC provides a refundable payroll tax credit for eligible employers, including tax-exempt organizations, whose business has been affected by the coronavirus disease 19 (“COVID-19”), for qualified wages paid after March 12, 2020, and before January 1, 2021.<sup>2</sup> To be eligible to claim the ERC, an employer is generally considered to be an eligible employer with respect to any calendar quarter (1) for which the operation of the trade or business carried on during such quarter is fully or partially suspended due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19 (the “full or partial suspension test”), or (2) there is a significant decline in gross receipts for such quarter (the “gross receipts test”).

Amendments to the CARES Act were made by sections 206 and 207 of the *Taxpayer Certainty and Disaster Tax Relief Act of 2020*, which was enacted as Division EE of the *Consolidated Appropriations Act, 2021*, Pub. L. 116-260 (“Relief Act”), including extending the ERC to qualified wages paid during the first two calendar quarters of 2021.<sup>3</sup> The Treasury Department and IRS issued Notice 2021-20 to formalize and clarify previously released information contained in the frequently asked questions (“FAQs”) available on the IRS website with respect to the ERC for the 2020 calendar year.<sup>4</sup> The Treasury Department and IRS issued Notice 2021-23, which amplifies Notice 2021-20, to provide guidance regarding the ERC for the first two calendar quarters of 2021.<sup>5</sup>

Additional changes to the ERC were made under section 9651 of the *American Rescue Plan Act of 2021* (“ARP Act”), Pub. L. 117-2 (March 11, 2021). In particular, section 3134 of the Code was enacted, which allows certain eligible employers to claim the ERC for qualified wages paid after June 30, 2021, and before January 1, 2022.

## Notice 2021-49: Guidance for the third and fourth calendar quarters of 2021

The following portion of this report summarizes the guidance contained in Notice 2021-49 as it relates to the ERC for the third and fourth calendar quarters of 2021.

### Applicable employment taxes

Prior to the ARP Act, the ERC could be claimed against the employer’s share of social security tax (or the equivalent portion of the Tier 1 tax due under the *Railroad Retirement Tax Act* (“RRTA”)), after the taxes are reduced for certain other credits claimed. Under section 3134 of the Code, however, eligible employers may claim the ERC for the third and fourth calendar quarters of 2021 against the employer’s share of Medicare tax, or the portion of Tier 1 tax under RRTA that is equivalent to the employer’s share of Medicare tax, after these taxes are reduced by any credits allowed under sections 3131 and 3132 of the Code (i.e., qualified sick leave and qualified family leave). In both scenarios, any excess ERC amounts

<sup>2</sup> Read [TaxNewsFlash](#) (April 23, 2020)

<sup>3</sup> Read [TaxNewsFlash](#) (January 25, 2021)

<sup>4</sup> Read [TaxNewsFlash](#) (March 5, 2021)

<sup>5</sup> Read [TaxNewsFlash](#) (April 6, 2021)

are treated as an overpayment that may be refunded.

## Maximum amount of the ERC

The maximum amount of the ERC for the first two calendar quarters in 2021 was 70% of up to \$10,000 of an employee's qualified wages per calendar quarter (i.e., a \$7,000 credit per employee per quarter). This limit continues to apply under section 3134 of the Code for the third and fourth calendar quarters of 2021. There is a separate limit of \$50,000 for each of the third and fourth calendar quarters for a recovery startup business which is discussed in more detail in the next portion of this report.

## Recovery startup businesses

As under section 2301(c) of the CARES Act, section 3134 of the Code provides that an eligible employer for third and fourth calendar quarters includes an employer who satisfies the full or partial suspension test or the gross receipts test. Additionally, under section 3134 of the Code, a recovery startup business may also be an eligible employer for such calendar quarters.

Generally, a recovery startup business is an employer:

- That began carrying on any trade or business after February 15, 2020 (determined in the same manner as under section 162 of the Code);
- For which the average annual gross receipts of the employer (as determined under rules similar to the rules under section 448(c)(3) of the Code) for the three-tax-year period ending with the tax year that precedes the calendar quarter for which the credit is determined does not exceed \$1 million; and
- That is not otherwise an eligible employer due to the full or partial suspension test or the gross receipts test.

Although the statutory language of section 3134(c)(2)(C) of the Code does not specifically provide that a tax-exempt organization under section 501(c) of the Code may qualify as an eligible employer due to being a recovery startup business, based on the statutory language, the Treasury Department and IRS determined that such organizations may be considered an eligible employer due to being a recovery startup business based on all of its operations and average annual gross receipts determined under section 6033 of the Code.

The Treasury Department and the IRS highlight that the statutory language does not include a definition of qualified wages applicable to a recovery startup business. To carry out legislative intent in allowing a recover startup business to claim the ERC, the Treasury Department and the IRS determined that qualified wages include wages paid by a recovery startup business. Further, although section 3134 of the Code does not specifically include a reference to the small eligible employer rule applicable to a recovery startup business, the Treasury Department and IRS concluded that it was appropriate to read the small eligible employer rule in section 3134(c)(3)(A)(ii)(III) of the Code as if a reference to recovery startup businesses were included to carry out legislative intent. Thus, in the third and fourth calendar quarters of 2021, a recovery startup business that is a small eligible employer may treat all wages paid with respect to an employee during the quarter as qualified wages.

The determination of whether an employer is a recovery startup business is made separately for each calendar quarter.

The aggregation rules described in section III.B. of Notice 2021-20 are applicable in determining if an employer is a recovery startup business and with respect to the \$50,000 per quarter limitation on the ERC.

## Qualified wages

The rules described in Notice 2021-20 and Notice 2021-23 generally remain the same for purposes of section 3134 of the Code, with the relevant exceptions discussed below:

- If an employer was not in existence in 2019, the employer determines the average number of full-time employees in 2020.
- Special rules apply to determine qualified wages for a severely financially distressed employer:
  - An eligible employer with gross receipts that are less than 10% of the gross receipts for the same calendar quarter in 2019 (or 2020 if the employer was not in existence in 2019) is a severely financially distressed employer.
  - An employer is to first determine whether the gross receipts test has been satisfied, based on the rules described in section III.C. of Notice 2021-23, before determining whether it is a severely financially distressed employer. For example, an eligible employer with gross receipts of 5% in the second calendar quarter of 2021 compared to gross receipts in the second calendar quarter of 2019 is a severely financially distressed employer for the third calendar quarter of 2021 based on the alternative quarter election.
  - If an employer is a severely financially distressed employer for the third or fourth calendar quarter of 2021, then **all wages paid** to its employees during the quarter in which it is determined to be a severely financially distressed employer regardless of whether it is a large or small eligible employer **may be treated as qualified wages**.
- Similar to the ERC for the first two calendar quarters of 2021, qualified wages do not include any wages taken into account under sections 41, 45A, 45P, 45S, 51, or 1396, as well as 3131, or 3132 of the Code.

## Coordination with certain programs

**PPP loans:** The determination of whether section 3134 of the Code applies to amounts of qualified wages taken into account as payroll costs for PPP loans for purposes of the ERC is made in the same manner and under the same principles described in section III.I. of Notice 2021-20. Generally, under Notice 2021-20, the ERC does not apply to qualified wages for which an election or deemed election to not take the wages into account for purposes of the ERC is made.

**Shuttered venue operators and restaurant revitalization:** Coordination between the shuttered venue operators grant, which was established under the *Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act*, and the restaurant revitalization grant, which was established under the ARP Act, was not required under the CARES Act for the first two calendar quarters of 2021. However, under section 3134 of the Code, an eligible employer receiving a shuttered venue operators grant or restaurant revitalization grant may not treat any amounts reported to the Small Business Administration (“SBA”) or otherwise taken into account as payroll costs in connection with either program as qualified wages for purposes of the ERC for the third or fourth calendar quarters of 2021. An eligible employer who receives

a shuttered venue operators grant or restaurant revitalization grant must retain support for the ERC claimed in its records, including documentation supporting that it did not claim the ERC on amounts taken into account as payroll costs paid in the third or fourth calendar quarters of 2021 in connection with the shuttered venue operators grant or restaurant revitalization grant programs.

## Claiming the ERC

The rules described in Notice 2021-20 and Notice 2021-23 related to claiming an advance ERC and relevant limitations continue to apply for the third and fourth calendar quarters of 2021. Generally, if an employer receives an excess advance payment of the ERC, then the tax due for the quarter is increased by the excess amount.

The statute of limitations period is extended with respect to the ERC claimed for the third and fourth calendar quarters of 2021. In particular, the statute of limitations does not expire before the date that is five years after the later of (1) the date on which the original return that includes the calendar quarter with respect to which the ERC is determined is filed, or (2) the date on which the return is treated as filed under section 6501(b)(2) of the Code.

### **Notice 2021-49: Miscellaneous guidance applicable to the ERC for 2020 and 2021**

In addition to the above-described guidance on the ERC for the third and fourth calendar quarters of 2021, Notice 2021-49 provides additional guidance to clarify the application of the ERC under section 2301 of the CARES Act as amended by the Relief Act and section 3134 of the Code for 2020 and 2021. To the extent an employer files an adjusted or amended return to reflect these clarifications and consequently pays any additional tax, penalties for failure to timely pay or deposit tax will not apply if the taxpayer can show reasonable cause and not willful neglect. This additional guidance is summarized below:

## Full-time employees and full-time equivalents

For purposes of deciding whether an eligible employer is a large or small eligible employer, Notice 2021-49 clarifies that the eligible employer is not required to include full-time equivalents to determine the average number of full-time employees. Further, for purposes of identifying qualified wages, Notice 2021-49 indicates that an employee's status as a full-time employee is irrelevant and wages paid to an employee who is not full-time may be treated as qualified wages if the other requirements to treat such amounts as qualified wages are satisfied.

## Treatment of tips and section 45B credit

With respect to cash tips, Notice 2021-49 clarifies that any cash tips treated as wages within the definition of section 3121(a) of the Code or compensation within the definition of section 3231(e)(3) of the Code are treated as qualified wages if all other requirements to treat the amounts as qualified wages are satisfied. Further, based on section 2301 of the CARES Act and section 3134 of the Code, eligible employers are not prevented from receiving both the ERC and the section 45B credit for the same wages.

## Qualified wage deduction disallowance

Section 2301(e) of the CARES Act and section 3134 of the Code generally provide that an employer's

deduction for qualified wages, including qualified health plan expenses, is reduced by the amount of the ERC. If an employer claims the ERC because of retroactive amendments to the CARES Act (i.e., related to eligibility of PPP borrowers to claim the ERC) or otherwise files an adjusted employment tax return to claim the ERC, the taxpayer should file an amended federal income tax return or administrative adjustment request (“AAR”), if applicable, for the tax year in which the qualified wages were paid or incurred to correct any overstated deduction taken with respect to those same wages on the original federal tax return. According to Notice 2021-49, section 280C(a) requires tracing to the specific wages generating the applicable credit, and to satisfy this tracing requirement, the taxpayer must file an amended return or AAR, as applicable. This is an unfortunate result as taxpayers had held out hope that the rules “similar to” language of the CARES Act with respect to section 280C may provide some flexibility to provide guidance similar to the work opportunity tax credit where the impact of the add back is more flexible to the year of certain state certification in years after the payment of the actual wages. Unfortunately, Notice 2021-49 rigidly applies section 280C.

## Related individuals

With respect to whether wages paid to an employee who owns more than 50% (i.e., a majority owner) of the value of a corporation or the spouse of such majority owner may be treated as qualified wages, Notice 2021-49 provides a number of clarifications and illustrative examples. Applying the rules under sections 152(d) and 267(c) of the Code, Notice 2021-49 indicates that a majority owner of a corporation is a related individual for purposes of the ERC, whose wages are not qualified wages, if the majority owner has a brother or sister, ancestor, or lineal descendent. The spouse of the majority owner is a related individual for purposes of the ERC, whose wages are not qualified wages, if the majority owner has a family member who is a brother or sister, ancestor, or lineal descendant (and thus is deemed to own the majority owner’s shares under section 267(c) of the Code) and the spouse bears a relationship described in section 152(d)(2) to the family member. In the event, however, that the majority owner of a corporation has no brother or sister, ancestor, or lineal descendent described in section 267(c)(4) of the Code, then neither the majority owner nor the spouse is a related individual and the wages paid to the majority owner and/or spouse are qualified wages for purposes of the ERC, assuming the other requirements for qualified wages are satisfied.

For example, assume Corporation B is owned 100% by Individual G and Individual G is an employee of Corporation B. Individual H is the child of Individual G and is not an employee of Corporation B. Corporation B is an eligible employer for the first calendar quarter of 2021. Due to the attribution rules of section 267(c) of the Code, Individual H is attributed 100% of the ownership of Corporation B, and both Individual G and Individual H are treated as 100% owners. Individual G has the relationship to Individual H described in section 152(d)(2)(C) (i.e., the father or mother, or an ancestor of either). Thus, Corporation B may not treat any wages paid to Individual G as qualified wages because Individual G is a related individual for purposes of the ERC.

## Alternative quarter election for calendar quarters in 2021

Under section 2301 of the CARES Act and as described in Notice 2021-23, section III.C., for the first and second calendar quarters in 2021, the determination of whether an employer satisfies the gross receipts test may be made by using an alternative calendar quarter. The ability to use the alternative calendar quarter to determine whether the gross receipts test is satisfied is also available under section 3134 of the Code for the third and fourth calendar quarters of 2021. Notice 2021-49 clarifies that an employer is not required to use the alternative quarter election consistently. For example, an employer may be an eligible employer due to a decline in gross receipts for the second calendar quarter of 2021 if its gross receipts are equal to 75% of the gross receipts in the second calendar quarter of 2019 (i.e., not relying on the alternative quarter election) and the employer could then use the alternative quarter election to be an

eligible employer for the third calendar quarter of 2021.

## Gross receipts safe harbor

A safe harbor in Notice 2021-20 permits an employer that acquires a business in 2020 to include the gross receipts of the acquired business in its gross receipts for 2019 to determine whether the employer satisfies the gross receipts test. This rule continues to apply to employers that acquire businesses in 2021 for purposes of determining whether the gross receipts test is satisfied.

For an employer that came into existence in the middle of a calendar quarter in 2019, Notice 2021-20, section III.E., provides rules for determining gross receipts. These rules continue to apply for 2021.

## Rev. Proc. 2021-33: Gross receipts safe harbor

The Treasury Department and the IRS also recently released Rev. Proc. 2021-33 to provide a safe harbor that permits a taxpayer to exclude certain items from gross receipts under sections 448(c) and 6033 of the Code solely for purposes of determining eligibility to claim the ERC. Unless the employer uses the safe harbor, the employer must include the amount of the PPP loan forgiveness, the shuttered venue operator grant, and the restaurant revitalization grant in gross receipts to determine eligibility to claim the ERC with respect to the relevant calendar quarters in 2020 and 2021.

**Safe harbor:** Under the safe harbor, an employer may exclude the amount of the forgiveness of a PPP loan, the shuttered venue operator grant, and the restaurant revitalization grant from the definition of the gross receipts solely for purposes of determining eligibility to claim the ERC. An employer must consistently apply the safe harbor in determining eligibility to claim the ERC. An employer consistently applies the safe harbor by (i) excluding the amount of the forgiveness of any PPP loan, the shuttered venue operator grant, and the restaurant revitalization grant from its gross receipts for each calendar quarter in which gross receipts for that calendar quarter are relevant to determining eligibility for the ERC, and (ii) applying the safe harbor to all employers treated as a single employer under the ERC aggregation rules.

**Manner of election:** An employer elects to use the safe harbor by excluding the amount of PPP loan forgiveness, shuttered venue operator grant, or restaurant revitalization grant from its gross receipts when determining eligibility to claim the ERC on its employment tax return or adjusted employment tax return for that calendar quarter, or for employers filing on an annual basis, for the year including the calendar quarter.

**Revocation of safe harbor election:** The safe harbor election may be revoked by including the amount of PPP loan forgiveness, shuttered venue operator grant, or restaurant revitalization grant in its gross receipts when determining eligibility to claim the ERC on its employment tax return or adjusted employment tax return for that calendar quarter, or for employers filing on an annual basis, for the year including the calendar quarter. Due to the consistency rule, the employer must also adjust all employment tax returns that are affected by the revocation of the safe harbor election.

**Substantiation:** An employer must retain support for the ERC claimed in its records, including the use of the safe harbor.



## Conclusion

Notice 2021-49 provides anticipated assistance to employers that may be eligible to claim the ERC for the third and fourth calendar quarters of 2021, as well as addresses specific questions that have been raised regarding the application of prior guidance provided by the Treasury Department and the IRS in Notice 2021-20 and Notice 2021-23. Although the guidance provided in Notice 2021-49 generally follows previously provided information from the Treasury Department and the IRS, employers may want to consider how certain rules, such as the deduction disallowance under section 280C of the Code and the related individual rules, may apply to their particular circumstances.

The safe harbor provided in Rev. Proc. 2021-33 is generally helpful for certain employers to determine whether the gross receipts test has been satisfied. Thus, any employer who has received PPP loan forgiveness, shuttered venue operator grant, or restaurant revitalization grant may want to consider the impact of the safe harbor on the determination of whether they are an eligible employer.

Although the recently released guidance is helpful information for employers, given current legislative proposals, it is possible that further ERC guidance will be not released or that it may be pulled back. As indicated in Notice 2021-49, the Treasury Department and IRS will monitor legislative developments to the ERC that may impact the ERC rules. In the meantime, employers may continue to determine whether they may claim the ERC for the 2020 and/or 2021 calendar years by considering the guidance previously provided in Notices 2021-20, 2021-23, and 2021-49, as well as Rev. Proc. 2021-33.

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