

Current Federal Tax Developments

Week of March 8, 2021

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ACCOUNTING
CONTINUING EDUCATION

CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF MARCH 8, 2021
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IRS UPDATES FAQ ON VIRTUAL CURRENCY REGARDING TAXPAYERS WHO ONLY PURCHASED VIRTUAL CURRENCY FOR CASH IN 2020

Citation: “Frequently Asked Questions on Virtual Currency Transactions,” IRS webpage, March 2, 2021

The IRS has continued with their system of guidance by FAQ, this time effectively overriding the plain language of a question on page one of Form 1040 by adding a new question to the frequently asked questions (FAQ) page on the IRS website dealing with virtual currencies.¹

The IRS added a question to the front page of Form 1040 that asked “At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?” The initial draft of the instructions for Form 1040 indicated that a purchase of a virtual currency during the year would require a yes answer—which seems like the correct answer given that trading cash for a virtual currency would seem to be the textbook case for obtaining a financial interest in the virtual currency.

But, as was noted in an article we posted in February on the issue,² the IRS a week later published the final instructions for Form 1040, and those instructions removed the examples that showed purchasing such currency would require a yes answer. However, the final version of Form 1040 was not changed, and the question remained worded just as it did before.

The IRS informally indicated that the change meant that taxpayers should answer “no” to the question if all they did was purchase such currency³ but until March 2 nowhere did the IRS have that advice in writing.

Now the IRS has updated its virtual currency FAQ web page to specifically address this issue, adding question and answer 5 which provides the following:

Q5. The 2020 Form 1040 asks whether at any time during 2020, I received, sold, sent, exchanged, or otherwise acquired any financial

¹ “Frequently Asked Questions on Virtual Currency Transactions,” IRS webpage, March 2, 2021, <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions> (retrieved March 4, 2021)

² Edward Zollars, “IRS Revises Instructions to Virtual Currency Question, but Not Actual Question, Creating Uncertainty on What Answer is Appropriate in Some Cases,” *Current Federal Tax Developments* website, February 6, 2021, <https://www.currentfederaltaxdevelopments.com/blog/2021/2/6/irs-revises-instructions-to-virtual-currency-question-but-not-actual-question-creating-uncertainty-on-what-answer-is-appropriate-in-some-cases> (retrieved March 4, 2021)

³ Kristen A. Parillo, “Final Crypto Instructions May Send Mixed Signals,” *Tax Notes Today Federal*, February 8, 2021, 2021 TNTF 25-5, <https://www.taxnotes.com/tax-notes-today-federal/cryptocurrency/final-crypto-instructions-may-send-mixed-signals/2021/02/08/2r46r> (retrieved March 4, 2021, subscription required)

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interest in any virtual currency. During 2020, I purchased virtual currency with real currency and had no other virtual currency transactions during the year. Must I answer yes to the Form 1040 question? (3/2/2021)

A5. No. If your only transactions involving virtual currency during 2020 were purchases of virtual currency with real currency, you are not required to answer yes to the Form 1040 question.⁴

While helpful, the FAQ pages can be changed by the IRS (including being taken down) at any time, so it would be more helpful if the IRS issued more formal guidance (such as an Announcement or Notice) or even a revised set of instructions that specifically contained the guidance found in the FAQ.

Otherwise a taxpayer may find him/herself dealing with a question later if the IRS or, more likely, another party (say counsel trying to argue the individual is hiding assets in a civil case) asks the individual why they “lied” in responding to the question, since they clearly had acquired a financial interest in a virtual currency.

SECTION: ERC IRS NOTICE INDICATES HOW TO DETERMINE ERC ELIGIBLE WAGES DEEMED USED TO OBTAIN PPP LOAN FORGIVENESS IN 2020

Citation: Notice 2021-20, 3/1/21

The IRS issued updated guidance for the 2020 version of the employee retention credit in Notice 2021-20,⁵ taking into account modifications made to the program by the Taxpayer Certainty and Disaster Tax Relief Act of 2020 signed into law on December 27, 2020.

This guidance is limited to the 2020 version of the ERC, and does not take into account changes that took effect on January 1, 2021. The Notice provides:

The guidance provided in this notice addresses the employee retention credit as it applies to qualified wages paid after March 12, 2020, and before January 1, 2021. This notice does not address the changes made by section 207 of the Relief Act that apply to the employee retention credit for qualified wages paid after December 31, 2020. The Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) will address the modifications made by section 207 of the Relief Act applicable to calendar quarters in 2021 in future guidance.⁶

⁴ “Frequently Asked Questions on Virtual Currency Transactions,” IRS webpage, March 2, 2021, Question 5

⁵ Notice 2021-20, March 1, 2021, <https://www.irs.gov/pub/irs-drop/n-21-20.pdf> (retrieved March 1, 2021)

⁶ Notice 2021-20, Section I

In a footnote the IRS summarizes these 2021 changes that will be dealt with in future guidance:

Section 207 of the Relief Act makes substantial changes to the employee retention credit that apply to qualified wages paid during the first and second quarter of 2021. Among other changes, section 207 of the Relief Act (1) makes the employee retention credit available for eligible employers paying qualified wages that are paid after December 31, 2020, and before July 1, 2021; (2) increases the maximum credit amount that may be claimed per employee (making it equal to 70 percent of \$10,000 of qualified wages paid to an employee per calendar quarter); (3) expands the category of employers that may be entitled to claim the credit; (4) modifies the gross receipts test; (5) modifies the definition of qualified wages; (6) broadens the denial of double benefit rule and applies it to sections 41, 45A, 45P, 51, and 1396 of the Code; and (7) changes the eligibility to receive advance payments and limits the amount of the advances.⁷

Update of Original FAQ

The Notice updates the IRS's FAQ originally published on the ERC, incorporating the information in that FAQ into this Notice.

Following the enactment of the CARES Act, the IRS posted Frequently Asked Questions (FAQs) on IRS.gov to aid taxpayers in calculating and claiming the employee retention credit. As of the publication date of this notice, the FAQs have not been updated to reflect the changes made by the Relief Act. This notice incorporates the information provided in the FAQs and addresses additional issues, including the amendments to section 2301 of the CARES Act made by section 206 of the Relief Act. This notice also identifies instances in which section 206 of the Relief Act made changes to section 2301 of the CARES Act that resulted in rules that are substantially similar to the interpretation provided in the FAQs.⁸

The IRS Notice, continuing the format of the original online FAQ, uses a question and answer format for the guidance. The topics covered and subsections where the specific topic's discussion is found in Section III are:

- A. Eligible Employers
- B. Aggregation Rules
- C. Governmental Orders
- D. Full or Partial Suspension of Trade or Business Operations
- E. Significant Decline in Gross Receipts

⁷ Notice 2021-20, Section I, Footnote 2

⁸ Notice 2021-20, Section I

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- F. Maximum Amount of Employer’s Employee Retention Credit
- G. Qualified Wages
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- L. Special Issues for Employers: Income and Deduction
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- N. Substantiation Requirements

In this article we’ll look at the most anticipated part of the guidance—how to deal with PPP loans taken out in 2020.

Interaction with Paycheck Protection Program (PPP) Loans

The key change made by the Taxpayer Certainty and Disaster Tax Relief Act of 2020 to the ERC program for 2020 was removing the prohibition on taxpayers claiming the ERC if the taxpayer had obtained a PPP loan, even if none of that loan was forgiven.

Under the modifications found in Section 206 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, taxpayers could claim the ERC even if they took out a PPP loan, but the same wages could not be used to obtain PPP loan forgiveness and claim the ERC credit. A key unanswered question was how borrowers that had already obtained forgiveness would be able to determine wages that were used for forgiveness.

Under the law a taxpayer frees up wages to be used for forgiveness by electing not to use such wages on its employment tax return to obtain the ERC:

Section 2301(g)(1) of the CARES Act, as amended by the Relief Act, permits an eligible employer to elect not to take into account certain qualified wages for purposes of the employee retention credit. An eligible employer generally makes the election by not claiming the employee retention credit for those qualified wages on its federal employment tax return.⁹

However, since employers in 2020 were initially not allowed to claim the credit at all if they obtained a PPP loan, such employers did not claim the credit on any wages. So the

⁹ Notice 2021-20, Section III.I, Question 49

IRS, recognizing that fact, has modified the election so it was made when wages were reported as payroll costs on a PPP forgiveness application:

However, an eligible employer that received a PPP loan is deemed to have made the election under section 2301(g)(1) of the CARES Act for those qualified wages included in the amount reported as payroll costs on a Paycheck Protection Program Loan Forgiveness Application (PPP Loan Forgiveness Application).¹⁰

The IRS does recognize that borrowers may very well have listed wages on the application beyond the minimum needed to gain forgiveness of the entire loan, so the agency allows the taxpayer to limit the amount of wages for which the ERC “opt-out” election is made to the minimum necessary to obtain forgiveness based on the *expenses listed on the application filed*:

Specifically, the amount for which the eligible employer is deemed to have made the election is the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. The employee retention credit does not apply to the qualified wages for which the election or deemed election is made.¹¹

Similarly, any wages not listed on the PPP forgiveness application are treated as if no election was made to exclude those wages. This would include wages paid outside the covered period for the PPP loan, as well as wages paid in the covered period that are intentionally left off the application.

An eligible employer is not deemed to have made an election for any qualified wages paid by the eligible employer that are not included in the payroll costs reported on the PPP Loan Forgiveness Application.¹²

As well, the Notice provides that if the borrower is only granted partial forgiveness of the PPP loan, the wages for which the deemed election is made is limited to the minimum amount of wages listed on the application necessary to obtain the requested forgiveness:

Notwithstanding a deemed election, if an eligible employer reports any qualified wages as payroll costs on a PPP Loan Forgiveness Application to obtain forgiveness of the PPP loan amount, but the loan amount is not forgiven by reason of a decision under section 7A(g) of the Small Business Act, those qualified wages may subsequently be treated as subject to section 2301 of the CARES Act and may be taken into account for purposes of the employee retention credit. If an eligible employer obtains forgiveness of only

¹⁰ Notice 2021-20, Section III.I, Question 49

¹¹ Notice 2021-20, Section III.I, Question 49

¹² Notice 2021-20, Section III.I, Question 49

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a portion of the PPP loan amount, then the employer is deemed to have made an election for the minimum amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application necessary to obtain the forgiveness of that amount of the PPP loan.¹³

A number of borrowers who applied for forgiveness in 2020 may have opted to only provide payroll costs on the application form when applying for forgiveness. They may (and likely did) incur non-payroll costs that would have also counted towards forgiveness, but decided there was no reason to provide those costs when the borrower incurred more than enough payroll costs to obtain full forgiveness. The time and effort to determine and document those expenses for the forgiveness application appeared to offer no benefit, so many borrowers made the reasonable decision to not do the work to provide that additional information with the application.

While an understandable conclusion given the then existing law, that decision now may not work out well as the Notice looks only to what was provided on the application to determine the amount of ERC eligible wages that were used to obtain forgiveness—not what *could* have been provided in lieu of such expenses to allow a larger ERC to be claimed. Generally, a borrower only needed to spend 60% of the loan proceeds on payroll costs, a category which is made up of certain costs not eligible for the ERC (such as employer contributions to retirement plans), as well as including wages that, themselves, may not have been ERC eligible.

Thus, a borrower with enough non-payroll costs paid during the covered period could, at worst, limit the deemed election wages to 60% of the loan proceeds and, quite often, lower the amount even more by selecting payroll costs that simply aren't ERC eligible at all (retirement plan contributions) and wages that aren't ERC qualified wages to make up as much of that 60% as possible.

But if such costs were not listed on the application, the taxpayer cannot now go back and demonstrate they had incurred such expenses that could have been listed. The IRS looks only to what was listed on the actual application.

EXAMPLE 1, QUESTION 49, NOTICE 2021-20

Employer A received a PPP loan of \$100,000. Employer A is an eligible employer and paid \$100,000 in qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. In order to receive forgiveness of the PPP loan in its entirety, Employer A was required, under the Small Business Administration (SBA) rules, to report a total of \$100,000 of payroll costs and other eligible expenses (and a minimum of \$60,000 of payroll costs). Employer A submitted a PPP Loan Forgiveness Application and reported the \$100,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan. Employer A received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$100,000.

Employer A is deemed to have made an election not to take into account \$100,000 of the qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with

¹³ Notice 2021-20, Section III.I, Question 49

any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. It may not treat that amount as qualified wages for purposes of the employee retention credit.

But the IRS does allow that if the borrower listed more in wages on the form than were necessary to obtain forgiveness that the borrower can reduce the deemed election to that minimum necessary. In Example 2 the IRS gives an example of an employer that only listed qualified wages as items to justify forgiveness, but listed all wages paid in the covered period, not just the minimum necessary to obtain forgiveness.

EXAMPLE 2, QUESTION 49, NOTICE 2021-20

Employer B received a PPP loan of \$200,000. Employer B is an eligible employer and paid \$250,000 of qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. In order to receive forgiveness of the PPP loan in its entirety, Employer B was required, under the SBA rules, to report a total of \$200,000 of payroll costs and other eligible expenses (and a minimum of \$120,000 of payroll costs). Employer B submitted a PPP Loan Forgiveness Application and reported the \$250,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan. Employer B received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000.

Employer B is deemed to have made an election not to take into account \$200,000 of the qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. It may not treat that amount as qualified wages for purposes of the employee retention credit. Employer B is not treated as making a deemed election with respect to \$50,000 of the qualified wages (\$250,000 reported on the PPP Loan Forgiveness Application, minus \$200,000 reported on the PPP Loan Forgiveness Application up to the amount of the loan that is forgiven), and it may treat that amount as qualified wages for purposes of the employee retention credit.

The third example specifically rejects allowing the borrower who had incurred other expenses qualifying for forgiveness but did not list them on the application from being able to use those expenses *not on the PPP loan forgiveness application* from being used to reduce the deemed election to exclude wages from the ERC credit:

EXAMPLE 3, QUESTION 49, NOTICE 2021-20

Employer C received a PPP loan of \$200,000. Employer C is an eligible employer and paid \$200,000 of qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. Employer C also paid other eligible expenses of \$70,000. In order to receive forgiveness of the PPP loan in its entirety, Employer C was required, under the SBA rules, to report a total of \$200,000 of payroll costs and other eligible expenses (and a minimum of \$120,000 of payroll costs). Employer C submitted a PPP Loan Forgiveness Application and reported the \$200,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan, but did not report the other eligible expenses of \$70,000.

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Employer C received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000.

Employer C is deemed to have made an election not to take into account \$200,000 of qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. Although Employer C could have reported \$70,000 of eligible expenses (other than payroll costs) and \$130,000 of payroll costs, Employer C reported \$200,000 of qualified wages as payroll costs on the PPP Loan Forgiveness Application. As a result, no portion of those qualified wages reported as payroll costs may be treated as qualified wages for purposes of the employee retention credit. Employer C cannot reduce the deemed election by the amount of the other eligible expenses that it could have reported on its PPP Loan Forgiveness Application.

But Example 4 provides that if those non-payroll expenses were listed on the application, even though not required to obtain the full forgiveness, the taxpayer now is able to get credit for those expenses to maximize the ERC eligible wages:

EXAMPLE 4, QUESTION 49, NOTICE 2021-20

Same facts as Example 3, except Employer C submitted a PPP Loan Forgiveness Application and reported the \$200,000 of qualified wages as payroll costs, as well as the \$70,000 of other eligible expenses, in support of forgiveness of the PPP loan. Employer C received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000. In this case, Employer C is deemed to have made an election not to take into account \$130,000 of qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with the \$70,000 of other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that was forgiven. As a result, \$70,000 of the qualified wages reported as payroll costs may be treated as qualified wages for purposes of the employee retention credit.

Example 5 illustrates that you cannot use those other non-payroll costs to reduce necessary payroll costs below the 60% of the loan usage requirement for payroll costs—in this case, despite having paid \$90,000 of such costs, the benefit is limited to \$80,000 of freed payroll costs since the borrower must have used 60% of the \$200,000 loan (\$120,000) for payroll costs.

EXAMPLE 5, QUESTION 49, NOTICE 2021-20

Same facts as Example 4, except Employer C paid \$90,000 of other eligible expenses, and reported the \$200,000 of qualified wages as payroll costs, as well as the \$90,000 of other eligible expenses, in support of forgiveness of the entire PPP loan. In this case, Employer C is deemed to have made an election not to take into account \$120,000 of qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with the \$90,000 of other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that was forgiven. As a result, \$80,000 of the qualified wages

reported as payroll costs may be treated as qualified wages for purposes of the employee retention credit.

Example 6 raises the issue that not all payroll costs are ERC eligible even if not used for PPP loan forgiveness. In a footnote, the IRS provides the following discussion of such expenses:

Employer D may have payroll costs that are not qualified wages for various reasons. For example, Employer D may be a large eligible employer that paid wages to employees who continued to provide services during the period of a partial suspension of business operations.¹⁴

The example illustrates how these ineligible expenses can be deemed to be used to obtain forgiveness, again increasing wages eligible for use in computing the employee retention credit:

EXAMPLE 6, QUESTION 49, NOTICE 2021-20

Employer D received a PPP loan of \$200,000. Employer D is an eligible employer and paid \$150,000 of qualified wages that would qualify for the employee retention credit during the second and third quarters of 2020. In addition to the qualified wages, Employer D had \$100,000 of other payroll costs that are not qualified wages and \$70,000 of other eligible expenses. In order to receive forgiveness of the PPP loan in its entirety, Employer D was required, under the SBA rules, to report \$200,000 of payroll costs and other eligible expenses (and a minimum of \$120,000 of payroll costs).

Employer D submitted a PPP Loan Forgiveness Application and reported \$130,000 of payroll costs and \$70,000 of other eligible expenses, in support of forgiveness of the entire PPP loan. Employer D can demonstrate that the payroll costs reported on the PPP Loan Forgiveness Application consist of \$100,000 of payroll costs that are not qualified wages and \$30,000 of payroll costs that are qualified wages. Employer D received a decision under section 7A(g) of the Small Business Act in the first quarter of 2021 for forgiveness of the entire PPP loan amount of \$200,000.

Employer D is deemed to have made an election not to take into account \$30,000 of qualified wages for purposes of the employee retention credit, which was the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven. It may not treat that amount as qualified wages for purposes of the employee retention credit. Employer D is not deemed to have made an election with respect to the \$120,000 of qualified wages that are not included in the payroll costs reported on the PPP Loan Forgiveness Application. Accordingly, Employer D may take into account the \$120,000 of qualified wages (\$150,000 of qualified wages paid minus

¹⁴ Notice 2021-20, SECTION III, Footnote 17

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\$30,000 of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application) for purposes of the employee retention credit.

Example 7 deals with a case where the borrower is denied forgiveness of the loan. In such a case, no deemed election to exclude wages from the ERC is made even though the wages were listed on the application form.

EXAMPLE 7, QUESTION 49, NOTICE 2021-20

Same facts as Example 6 except Employer D's PPP loan is not forgiven by reason of a decision under section 7A(g) of the Small Business Act. Employer D may treat the full \$150,000 as qualified wages (the \$30,000 of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application, plus the additional \$120,000 of qualified wages not included in the payroll costs) as qualified wages for purposes of the employee retention credit.

Steps to Be Taken Now

The guidance provides information both for borrowers who have already applied for and received forgiveness as well as those who have yet to apply. In both cases advisers must carefully consider how to maximize the ERC credit available to the employer.

Borrowers who have already applied for and received forgiveness have less flexibility, but that doesn't mean that care shouldn't be taken to maximize the credit based on what was listed on the forgiveness application.

- A borrower should first determine the minimum wage amount necessary to support the forgiveness obtained. The 60% calculation is a starting point here, since forgiveness can be no more than payroll costs divided by 0.60. Looked at from the other direction, payroll costs used in forgiveness will have to be at least 60% of the forgiveness obtained.
- Consider how many payroll costs listed on the forgiveness application would not be qualified wages for ERC purposes and use those first to meet the required minimum. That includes, among other things:
 - Wages paid by a large employer to employees performing services
 - Wages paid to employees not eligible to be used for ERC purposes due to the related party rules found at IRC §51(i)(1)
 - Payroll costs such as retirement plan costs and payroll taxes paid to state and local governments
 - Wages paid to an employee in excess of the \$10,000 cap on ERC qualified wages for 2020
- After minimizing the ERC qualified wages used to meet the 60% test, determine if the borrower reported sufficient non-payroll costs to have obtained forgiveness if only this minimum amount of ERC qualified wages listed on the PPP application are included as leading to forgiveness

- If the non-payroll expenses are not sufficient, determine the minimum amount of qualified wage costs that need to be treated as expenses leading to forgiveness to obtain the forgiveness granted.

For borrowers who have not yet applied for forgiveness, care should be taken in filling out the PPP forgiveness application to be certain enough in non-ERC costs are included on the application so that only the very minimum amount of ERC wages are deemed used to obtain forgiveness. Thus, borrowers will want to make sure they maximize the use of non-payroll costs in obtaining forgiveness, as well as maximizing the use of non-ERC qualified payroll costs for the minimum payroll costs that must be included in the forgiveness application.