PacificCPE

COURSE

21902A

Applying GAAP Income Tax Accounting Concepts

Building on the foundational framework introduced earlier, this section moves deeper into the application of GAAP principles for accounting and reporting income taxes. Designed for CPAs and tax professionals who need to stay current with evolving standards and legislative changes, including those introduced by the OBBBA, this section reinforces technical concepts and prepares you to handle complex income tax accounting scenarios you're likely to encounter in practice.

CREDIT HOURS 2 | FIELD OF STUDY ACCOUNTING | EXAM QUESTIONS 10

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Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recall how an entity should account for the PTE tax on its financial statements.
- Review the rule as to whether a company is required to allocate consolidated income tax expense to its single-member LLCs that do not pay taxes.

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Section 1: GAAP INCOME TAX ISSUES – 2025 AND 2026

Chapter Objective

After completing this chapter, you should be able to:

- Recall how an entity should account for the PTE tax on its financial statements.

K. Accounting and Disclosures for the ERC: 2025

Overview

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) as part of the overall plan to mitigate the economic effects of COVID-19.

A key element of the CARES Act was the issuance of the Employee Retention Credit (ERC), which is found in Section 2301. The basic goal of the ERC is to encourage employers to retain employees during the COVID-19 pandemic. In doing so, the ERC represents a payroll subsidy for qualified employers who have experienced a significant decline in revenue or a full or partial shutdown of operations due to COVID-19.

Subsequent to the issuance of the CARES Act, the provisions of the ERC were amended by the Consolidated Appropriations Act of 2021 (CAA), followed by further amendments in the American Rescue Plan (ARP) and, finally, by the Infrastructure Investment and Jobs Act.

A few facts related to the ERC:

- Thousands of companies filed for the ERC from 2020 through 2022, with more filing by the April 2025 deadline.
- Some companies have repaid some of the ERC under the IRS's Voluntary Disclosure Programs (VDP), which were in effect in 2024.
- Accounting and disclosure issues related to the ERC are still relevant for 2024 and 2025 financial statements.

Summary of the ERC Rules

After reflecting all changes made from its original issuance as part of the CARES Act, to subsequent amendments made through the Infrastructure Investment and Jobs Act, the ERC does the following:

1. The ERC provides a refundable tax credit for qualified wages (including qualified health plan expenses) and is claimed quarterly, either as a reduction in payroll tax payments or as a cash refund.

2. The ERC applies to qualified wages from March 12, 2020, through September 30, 2021 (third-quarter wages).
   a) The Infrastructure Investment and Jobs Act retroactively eliminates the ERC for fourth quarter 2021 wages.
3. The ERC is available to both eligible for-profit and not-for-profit employers, but not to federal, state, or local government entities.[16]
4. An employer can receive an ERC and a PPP loan, provided that the same qualified wages are not used to claim both the ERC and the PPP loan.
5. An employer qualifies for the ERC if:
   a) The employer carries on a trade or business during 2020 and has employees.
   b) There is a significant decline in gross receipts or a full or partial business shutdown due to a government order.
   c) A significant decline in gross receipts is defined as:
      - A 50% decline in 2020 gross receipts as compared with 2019 gross receipts
      - A 20% decline in 2021 gross receipts as compared with 2019 gross receipts

IRS ERC Voluntary Disclosure Programs (VDP)

In 2023 and 2024, the IRS offered two voluntary disclosure programs (VDPs) that allowed entities that had previously received ERC refunds to repay 80% to 85% of the ERC they had received. The programs apply to entities that received ERC refunds but recognize that the actual ERC should have been zero.

By voluntarily enrolling in either VDP, entities avoid IRS audits, interest and penalties, and criminal prosecution.

Accounting for enrollment in the VDPs is discussed further on in this chapter.

Statute of limitations to file the ERC for 2020 and 2021

Many companies still have not filed for the ERC for 2020 and 2021. One key reason is that they are unaware of some loopholes in the ERC legislation, such as the partial shutdown rules. For example, companies that experienced revenue increases in 2020 and 2021 may still qualify for the ERC if they experienced a partial shutdown of their operations during that time due to a state, local, or federal government mandate.

In general, the statute of limitations to file claims for the ERC is:

- April 15, 2024, for the 2020 tax filing year, and
- April 15, 2025, for the 2021 tax filing year.

Typically, the claims are made by filing amended payroll tax returns.

GAAP Accounting for the ERC

Because ERC filings can be made through April 2025, the accounting and disclosure requirements for ERCs are still relevant in 2024 and 2025.

There is no specific GAAP accounting and disclosure authority for the ERC. Certainly, the FASB did not anticipate the COVID-19 pandemic or the extent of financial stimulus that Congress would institute to mitigate the adverse economic effects of COVID-19. Thus, nowhere in GAAP is there any specific guidance that addresses payroll credits (such as the ERC) received by a company in response to the economic impact of the pandemic.

Although U.S. GAAP does not offer a formal definition of a grant, international standards do.

Specifically, IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, uses a definition of a grant as:

> "a transfer of resources in return for past or future compliance with certain conditions relating to the operating activities of the company."

The ERC is a form of a grant in that an entity receives a payroll credit (through its Form 941) in return for retaining employees during the COVID-19 pandemic.

Once an entity concludes that the ERC is a form of government grant, the next step is to find GAAP guidance on grants.

Guidance for grants in GAAP and other standards is found in the following sections:

1. Conditional contribution rules in ASC 958-605, *Not-for Profit Entities- Revenue Recognition*, and
2. Government grant rules are found in IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance* (international standards).

Note

The gain contingency rules found in ASC 450-30, *Contingencies- Gain Contingencies*, might be considered a source of U.S. GAAP that is analogous to the ERC and could be used to account for the ERC. The author does not address gain contingency rules in this section.

OPTION 1: ASC 958-605 – Not-for-Profit Entities

In accordance with the ASC 958-605-25-11 contribution model:

1. A business entity treats the ERC as a "conditional contribution (promise to give)" received, subject to donor-imposed conditions that serve as barriers to releasing the obligation and recognizing the contribution (grant) as revenue.

2. The ERC is recognized as revenue when conditions required by the ERC are substantially met, and the promise (right to receive the ERC) is unconditional.
3. Conditions to earn the ERC are substantially met when:
   a) There is a significant decline in gross receipts or a full or partial shutdown of the entity's operations
   b) The entity has qualified wages for the ERC, and
   c) Other requirements of the ERC are satisfied, such as the entity has not used any of the qualified wages toward a PPP loan.
4. When the conditions for the ERC are substantially met, an entity should reflect the ERC as revenue or gain in the other income section of the statement of income.[17]
   a) Using the ASC 958 model, it is not appropriate to credit the ERC against payroll expense (or payroll tax expense).
5. If the conditions are not substantially met, the entity should record the ERC as an advanced credit liability on the balance sheet until the condition(s) are substantially met.

Following are the entries that are made using the ASC 958 contributions (grants) received model:

Entry:	dr	cr
Qualified wages expense	XX	
Cash/accrued wages/payables		XX
ERC receivable	XX	
Contribution/Grant income (other income)		XX

Company X

Statement of Income

For the Year Ended December 31, 20XX

Net sales	$XX
Cost of sales	XX
Gross profit	XX
Operating expenses	XX
Income from operations	XX
Other income:	
Grant income- Employee Retention Credit	XX
Net income before income taxes	XX
Income taxes	XX
Net income	$XX

Observation

Using the ASC 958 model, the ERC is recorded as revenue (income), not as a credit to payroll tax expense or payroll expense. The fact that the mechanism by which the ERC is distributed to an employer is through a reduction in payroll tax expense on the Form 941 has nothing to do with how it is presented in the statement of income. ASC 958 does not allow the ERC (contribution received) to be credited to the related expense, such as payroll or payroll tax expense. Instead, the ERC must be presented as revenue on a for-profit entity's statement of income, most logically shown in the other income section.

OPTION 2: IAS 20, Accounting for Government Grants and Disclosure of Government Assistance

In applying the IAS 20 accounting model to a business entity with an ERC, certain rules are followed:

1. IAS 20's scope includes for-profit entities that receive government grants.
2. IAS 20 provides that the ERC is recorded on the income statement when there is reasonable assurance (it is probable[18]) that:
   a) The entity will comply with the conditions attached to the grant (qualified wages are incurred, etc.), and
   b) The grant (ERC) will be received.

3. The reasonable assurance threshold is met when the entity has satisfied the conditions required to earn the ERC, such as:
   a) There is a significant decline in gross receipts or a full or partial shutdown of the entity's operations
   b) The entity has qualified wages for the ERC, and
   c) Other requirements of the ERC are satisfied, such as the entity has not used any of the qualified wages toward a PPP loan.
4. Once an entity achieves the "reasonable assurance" (probable) threshold, the grant is recognized in profit and loss on a systematic basis over the period in which the entity recognizes the expenses (qualified wages) for which the grant (ERC) is intended to compensate.
5. The grant is presented on the income statement in one of two ways:
   a) As a credit on the income statement, such as other income, or
   b) As a reduction of the related payroll expense.

Note

If the IAS 20 model is used, the ERC is credited to either other income or payroll expense, not payroll tax expense. The presentation of the ERC is credited to payroll expense (not payroll tax expense) because qualified wages (payroll) are the expense that gives rise to the ERC. The taxpayer receives the credit by reducing payroll tax payments on its Form 941 filings, but it is the payroll expense (qualified wages) that creates the ERC.

6. If the reasonable assurance (probable) threshold has not been met, the ERC is recorded as a deferred income liability on the balance sheet until the reasonable assurance (probable) threshold is met.
7. Not-for-profit organizations may not use the IAS 20 model; therefore, they should use only the ASC 958-605 model.

The following are examples illustrating the two income statement formats for presenting the ERC using the IAS 20 government grant model:

IAS 20: Presentation 1: Present the grant as other income: