

## The “New” Employee Retention Credit – Expanding Opportunities for Independent Schools

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Schools have spent 2020 adapting to an ever-changing set of restrictions – the move to online learning followed by the return to classrooms with significant restrictions and costs to create a safe environment for students. Economic crisis has led to a decline in net tuition for many schools, as well as a decline in donations and other auxiliary revenues. In terms of government assistance, the key tool in 2020 was the Paycheck Protection Program (PPP) loan program. But in 2021, the strongest program for independent schools may be the Employee Retention Credit (ERC).

Initially implemented as part of the CARES Act, the ERC had limited utility in 2020 because it was only available to businesses who did not receive PPP loans. The Consolidated Appropriations Act (Act), approved in late December 2020, retroactively removed the restriction on claiming the ERC for PPP loan borrowers. While initial discussions have been around this retroactive availability of the credit in 2020, the Act also extends the credit into 2021, while providing for wider eligibility and a far larger maximum credit in 2021. The details of that expansion could be a large boon to independent schools in particular.

### ERC Basics

The ERC is a credit against Social Security taxes owed by an employer on “qualified wages.” To the extent the credit amount exceeds the amount of Social Security tax due on the wages paid, it is refundable. Businesses are eligible if they are closed (fully or partially) because of a government order related to COVID-19 or have experienced a significant decline in gross receipts.

Retroactive availability is unlikely to create a large benefit for many independent schools, even if they did qualify last year. In 2020, for taxpayers with more than 100 employees, the ERC could only be claimed for wages paid to employees not providing services. However, in 2021, taxpayers under **500** employees can claim the credit for wages paid to **all** employees. As a result, qualification in 2021 creates a much more powerful benefit.

For schools under 100 employees, retroactive qualification in 2020 could provide a benefit. While wages cannot be used for both PPP loan forgiveness and the ERC, schools are likely to have a period in which they qualify for the ERC because of a government shutdown before they received PPP funds, and if they can count wages for all employees, the benefit could be substantial.

For 2020, the ERC equals 50% of each employee’s qualified wages, up to a maximum of \$10,000 of wages. As such, the credit was capped at \$5,000 per employee.

In 2021, the ERC equals 70% of each employee’s qualified wages, up to a maximum of \$10,000 of wages **per quarter**. Thus, since the ERC is available for the first two quarters of 2021, the cap per employee is a \$14,000 credit.

### ERC Eligibility

The two qualification tests have different timeframes regarding employer eligibility for the credit.

- **Operations were fully or partially suspended on orders from a governmental authority due to COVID-19 (COVID-19 Shutdown)** – Independent schools likely qualified under this test in 2020 because campuses were initially closed in full, limiting the schools’ ability to charge for programs such as food service and after-school activities. In addition, day-care services were forced to be closed for an extended period as well. However, in 2021, although schools may be putting

restrictions in place, many states have no official restrictions on capacity. As a result, most schools will need to meet the gross receipts test in order to qualify.

- **For 2021, the reduction in gross receipts required is 20% in the quarter, compared to the same calendar quarter in 2019.** For 2021, businesses may also choose to compare gross receipts in the immediately preceding quarter (i.e., for Q1 2021, qualification can be determined based on comparing Q4 2020 to Q4 2019). (In 2020, a reduction of 50% in a quarter was required to begin qualification under this test.)

Gross receipts are specifically defined for nonprofit businesses, using the standard in the Internal Revenue Code that dictates the amounts reported on Form 990. Specifically, gross receipts for a nonprofit business are:

- Gross receipts from all operations, not only from activities that constitute unrelated trades or businesses
  - Net tuition and other school revenue (auxiliary, afterschool, camp, food service, etc.)
- Investment income, including dividends, rents, and royalties
- Gross proceeds from sales of assets, including investments and real property, with no reduction for cost basis
- The gross amount received/pledged as contributions, gifts, grants, and similar amounts

### How Is the ERC Claimed?

The ERC can be claimed on a taxpayer's quarterly employment tax return (Form 941). Unlike the PPP, the credit is not applied for, but merely claimed by the business. However, we recommend having robust documentation of qualification on file, as a guard against a potential future IRS audit. This is particularly true if the ERC ends up being a significant amount. Building documentation now will be easier than trying to do so retrospectively at the end of a quarter.

### What Should I Do Now?

The ERC may be a lucrative program for your school. We recommend that schools focus on determining program eligibility for both 2021 and 2020. The Independent School team at PKF O'Connor Davies can provide individualized guidance on determining eligibility, calculating your school's maximum credit, and developing documentation with an eye toward presenting to school leadership.

### Contact Us

If you have questions about the employee retention credit, contact your client service partner or:

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