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Tax Notes

The "New" Employee Retention Credit – Don't Miss this Valuable Opportunity for Exempt Organizations

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Many exempt organizations spent 2020 and 2021 adapting to an ever-changing set of restrictions – the move to online programming and a virtual workforce, followed by a return to in-person activities with significant restrictions. The pandemic led to economic hardship for many not-for-profit organizations, including those that rely on government funding. The Paycheck Protection Program (PPP) loan was the most popular form of government assistance in 2020 and 2021. But in addition to the PPP, another important, and perhaps lesser known, source of government funding for non-profits still remains available: 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 organizations that did not receive PPP loans. The Consolidated Appropriations Act (Act), approved in late December 2020, retroactively repealed this restriction. Moreover, qualifying for the ERC became easier and the provisions became more generous in 2021 (discussed further below). After a series of extensions and retractions, the ERC is available for wages paid through the third quarter of 2021, and can still be accessed by eligible organizations.

ERC Basics

The ERC is a credit against payroll taxes owed by an employer on "qualified wages." To the extent the credit amount exceeds the amount of Social Security tax (Medicare tax for third quarter 2021) 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.

The credit for quarters in 2020 is unlikely to create a large benefit for larger not-for-profit organizations, even if they did qualify. That's because in 2020, the ERC was limited to organizations with more than 100 full-time employees in 2019 – it could only be claimed for wages paid to employees not providing services (i.e., not working). However, in 2021, organizations having less than **500** employees can claim the credit for wages paid to **all** employees. As a result, qualification in 2021 creates a much more powerful benefit.

Organizations with less than 100 employees with qualification in 2020 could receive a substantial benefit. While wages cannot be used for both PPP loan forgiveness and the ERC, organizations may have one or more quarters in which they qualify for the ERC because of a government shutdown, likely before they received PPP funds. If wages for all employees qualify, the amount could be significant.

For 2020, the ERC equals 50% of each employee's qualified wages, up to a maximum of $10,000 of wages for the year. As such, the credit is 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 three quarters of 2021, the credit can be as much as $21,000 per employee.

ERC Eligibility

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

1. **Operations were fully or partially suspended on orders from a governmental authority due to COVID-19 (COVID-19 Shutdown)**. Certain not-for-profit organizations may have qualified under this test in 2020, if the governmental shutdown had a more than nominal impact on the organization's ability to provide services. However, in 2021, governmental shutdown orders and restrictions would

likely have been lifted (although some organizations still faced restrictions in the early part of 2021). Once the shutdown orders were lifted, organizations had to meet the gross receipts test in order to qualify.

2. **For 2021, the reduction in gross receipts required is 20% in the quarter, compared to the same calendar quarter in 2019.** For 2021, organizations 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 not-for-profit organizations using the standard in the Internal Revenue Code that dictates the amounts reported on Form 990. Specifically, gross receipts for a not-for profit are:

- Gross receipts from all operations
- Investment income, including dividends, rents, and royalties
- Gross proceeds from sales of assets, including investments and real property, with no reduction for cost basis (note – this is sales proceeds, not realized gains)
- Gross amount received/pledged as contributions, gifts, grants, and similar amounts
- PPP forgiveness income is NOT included

PKFOD Observation: For not-for-profits, the gross receipts test can sometimes produce surprising results, particularly based on the timing of large donations or sales of securities. We strongly recommend running the numbers for your organization even if your initial impression is that gross receipts have not significantly declined.

How Is the ERC Claimed?

Eligible employers report their ERC eligible wages and claim the related tax credits on their federal payroll tax returns (Form 941). Since the ERC no longer applies after the 3rd quarter of 2021 and 3rd quarter payroll tax returns were due at the end of October, the sole means of claiming the credit now is an amended payroll tax return (Form 941-X).

Importantly, although the ERC ends with the third quarter of 2021, amended payroll tax returns can be filed three years after the original return filing date; that means there's plenty of time to do so.

What Should I Do Now?

The ERC may be a lucrative program for your not-for-profit organization. We recommend that organizations first focus on determining eligibility for both 2021 and 2020. The Employee Retention Credit team at PKF O'Connor Davies can provide individualized guidance on determining eligibility, calculating your organization's maximum credit, and developing appropriate supporting documentation.

Contact Us

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

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