

# The Employee Retention Credit – A Potential Source of Sizable Federal Aid for Qualifying Nonprofits

Original Publication Date: May 5, 2021

Revision Dates: May 21, July 14, and August 10, 2021

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## Quick Overview

If your nonprofit organization either:

- experienced a significant decline in gross receipts, or  
fully or partially suspended or reduced any significant part of its operations due to a federal, state, or local government mandate

during any calendar quarter since the COVID-19 pandemic was first recognized in the U.S.,

your organization may be eligible for a special payment from the federal government, which is provided via a credit against your payroll taxes. This special credit is labeled the **Employee Retention Credit**.

The credit amount could be **very significant** for your organization if:

- your organization experienced either of the adverse events described above in **2020**, and had **100** or fewer full-time employees in **2019**, or
- your organization experienced either of the adverse events described above in **2021** and had **500** or fewer full-time employees in **2019**.

## Background and Context

The Employee Retention Credit (ERC) is a relief provision originally contained in the CARES Act passed into law on March 27, 2020. The Relief Act of 2020, enacted as a part of the Consolidated Appropriations Act, 2021 (CAA) and passed in late December 2020, made significant changes to the ERC. The most significant change from the CAA was that the ERC became **available to Paycheck Protection Program (PPP) borrowers, subject to other eligibility requirements, and with the proviso that wages funded by forgiven PPP loan proceeds cannot be used as a basis for the ERC.**

Eligible employers claim the ERC as a credit against certain *employer* payroll taxes on their Form 941 for the applicable calendar quarter(s). The credit is refundable...meaning that if the employer qualifies for a credit that exceeds the applicable employer payroll taxes against which it is claimed for the applicable quarter, the excess credit is first used to reduce the employer's required payroll tax deposits for all *other* federal payroll taxes. Any excess beyond required federal payroll tax deposits is refunded to the employer in cash. The ERC

is essentially relief/stimulus money paid by the government to eligible employers. The credit has no actual relationship to the employer-paid payroll taxes against which it is claimed. Claiming the credit against these employer payroll taxes on Form 941 is simply the government's delivery method for transferring funds to eligible employers.

To claim the ERC for a prior quarter for which the employer has already filed Form 941, the employer must file a Form 941-X (amended Form 941) for the applicable quarter(s). Special rules provide that the ERC for the *first* quarter of 2020 is claimed on the Form 941 or Form 941-X for the *second* quarter of 2020. In anticipation of an ERC (i.e., before a Form 941 is filed for an applicable quarter), an employer can reduce its federal employment tax deposits, including deposits of employee taxes withheld, up to the amount of the anticipated credit. If the anticipated credit amount exceeds the employer's otherwise required payroll tax deposits, the employer can reduce its payroll tax deposits to zero...and may generally request an advance of the amount of the anticipated credit that exceeds the required federal employment tax deposits by filing Form 7200. Reductions in deposits and advance ERC payments are accounted for on the employer's applicable Form 941.

In March and April 2021, the IRS released IRS [Notice 2021-20](#) and IRS [Notice 2021-23](#), providing guidance regarding the ERC that applies from March 13, 2020, through December 31, 2020, and from January 1, 2021, through June 30, 2021, respectively. On March 11, 2021, The American Rescue Plan Act of 2021 (ARPA) was signed into law, extending the ERC from July 1 through December 31, 2021. In August 2021, the IRS released IRS [Notice 2021-49](#), providing guidance regarding the ERC that applies from July 1 through December 31, 2021.

*We note here that the general Employee Retention Credit (which is the primary subject of this article) is distinguished from the Employee Retention Credit for "qualified disasters." The Employee Retention Credit for qualified disasters is addressed at the end of this article.*

Following is a summary of the Employee Retention Credit requirements and rules, as modified and interpreted by the CAA, ARPA, and IRS Notices as we understand them. *(Note that entities that are part of a controlled group of entities are generally aggregated in making all determinations and calculations. Also, note that additional guidance is expected from the IRS, further clarifying the rules for applying the credit. Additional guidance may render portions of the information provided herein incomplete and/or inaccurate.)*

### **For the Period March 13, 2020, through December 31, 2020**

1. Provides eligible employers – including tax-exempt organizations – a refundable credit against the employer's share of Social Security tax [the 6.2% portion – not the 1.45% Medicare tax]. (As described below, the fact that it is a refundable credit means that it is simply money from the government – if the amount of the credit exceeds the employer's share of Social Security tax against which it is a credit, the organization can reduce the amount that it deposits to cover other payroll tax obligations. If the credit exceeds all such taxes owed by the employer, the employer receives a refund of the excess credit amount.) [The IRS has published [special guidance](#) to address coordination of the ERC with the employer Social Security tax payment deferral also available during 2020 pursuant to the CARES Act. The deferral of employer Social Security tax payments does not impact the calculation of the ERC.]
  - a. Eligible employers must have carried on a trade or business during 2020 and satisfy one of two economic hardship tests (for tax-exempt organizations described in Section 501(c) of the Internal Revenue Code, all operations of the organization are considered a trade or business for this purpose):

- i. Had fully or partially suspended business operations during any calendar quarter of 2020 due to **orders** from a governmental entity limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes). The guidance clarifies that a business is considered partially suspended if, under the facts and circumstances, the operations that are closed or modified are “more than a nominal portion of its business operations and cannot be performed remotely in a comparable manner.” Selections from IRS Notice 2021-20 Q&A Items 10 – 22, which provide additional information regarding the full or partially suspended business operations economic hardship test, are outlined below - see the Notice for full details.
1. IRS Notice 2021-20, Q&A Item 10 clarifies that orders, proclamations, or decrees from the federal government or any state or local government may be taken into account by an employer as “orders from an appropriate governmental authority” for this purpose.
  2. IRS Notice 2021-20, Q&A Item 11 provides a safe harbor threshold that may be used by an organization to support a position that suspended operations were a more than nominal portion of the organization’s business operations. The guidance indicates that business operations will be deemed to constitute more than a nominal portion of an employer’s business operations if either:
    - The gross receipts from that portion of the business operations is not less than 10% of the total gross receipts (using the gross receipts of the same quarter in 2019)
    - or
    - The hours of service performed by employees in that portion of the business is not less than 10% of the total number of hours of service performed by all employees in the employer’s business (using number of hours of service performed by employees in the same quarter in 2019)
  3. IRS Notice 2021-20, Q&A Item 18 indicates that modifications of a business operation due to orders from a governmental entity may be considered a full or partial suspension of business operations if such modifications had more than a nominal effect on the business operations. Whether or not business operations were more than nominally affected is a facts and circumstances determination. Examples of modifications that should be considered include limiting occupancy to provide for social distancing, requiring services to be performed only on an appointment basis (for businesses that previously offered walk-in service), changing the format of service, etc.
  4. IRS Notice 2021-20, Q&A Item 21 indicates that all members of an aggregated group are considered to have their operations partially suspended for purposes of the employee retention credit if the operations of one member of the aggregated group are suspended due to a governmental order. If one member’s business operations are partially suspended, it is unclear how the safe harbor calculation is made (i.e., whether the safe harbor thresholds based on 10% of the aggregated group or based on the member itself).

or

- ii. Experienced a reduction in **gross receipts** of more than 50% in any calendar quarter of 2020 as compared to the same calendar quarter of 2019. If an organization meets this test for any calendar quarter in 2020, it is deemed to continue meeting this test through the end of the first *subsequent* calendar quarter of 2020 in which gross receipts exceed 80% of the amount for the corresponding quarter of 2019. (If, after declining by more than 50% in a quarter, gross receipts do not increase for any subsequent quarter in 2020 to more than 80% of the amount for the corresponding quarter in 2019, the credit continues through the end of 2020.) For nonprofit organizations, the IRS guidance indicates that the term *gross receipts* is defined in the same manner as described in Internal Revenue Code Section 6033, which is interpreted by Treasury Regulations (Reg. §1.6033-2(g)(4)), further described below.
1. The term “gross receipts” means the gross amount received by the organization during its annual accounting period from all sources without reduction for any costs or expenses including, for example, cost of goods or assets sold, cost of operations, or expenses of earning, raising, or collecting such amounts. Thus “gross receipts” includes, but is not limited to, (i) the gross amount received as contributions, gifts, grants, and similar amounts without reduction for the expenses of raising and collecting such amounts, (ii) the gross amount received as dues or assessments from members or affiliated organizations without reduction for expenses attributable to the receipt of such amounts, (iii) gross sales or receipts from business activities (including business activities unrelated to the purpose for which the organization qualifies for exemption, the net income or loss from which may be required to be reported on Form 990-T), (iv) the gross amount received from the sale of assets without reduction for cost or other basis and expenses of sale, and (v) the gross amount received as investment income, such as interest, dividends, rents, and royalties.
  2. *The rules do not appear to make a distinction between restricted and unrestricted contributions with respect to nonprofit organizations.*
  3. In [Notice 2021-33](#) the IRS confirmed that an employer can elect to exclude forgiveness of a PPP loan from gross receipts for purposes of this evaluation. An employer makes this election by simply excluding the amount of forgiveness of the PPP loan from its gross receipts.
  4. Unrealized gains/losses are not included in the definition of gross receipts.
  5. IRS Notice 2021-20, Q&A items 23 – 28 provide additional information regarding the determination of whether an organization experienced a significant reduction in gross receipts for purposes of ERC eligibility.

**Example:** Employer A’s gross receipts were \$100,000, \$190,000, \$230,000, and \$250,000 in the first, second, third, and fourth calendar quarters of 2020, respectively. Its gross receipts were \$210,000, \$230,000, \$250,000, and \$250,000 in the corresponding calendar quarters of 2019. Thus, Employer A’s 2020 first, second, third, and fourth quarter gross receipts were approximately 48%, 83%, 92%, and 100% of its 2019 corresponding quarterly gross receipts. Accordingly, Employer A had a significant decline in gross receipts commencing on the first day of the first calendar quarter of 2020 (the calendar quarter in which gross receipts were less than 50% of the same quarter in 2019) and ending on the last day of the second calendar quarter of 2020 (the first subsequent quarter in 2020 for which the gross receipts were more than

80% of the amount in the same quarter in 2019). Thus, Employer A is eligible for a retention credit with respect to the first and second calendar quarters of 2020.

2. The credit is 50% of the first \$10,000 in qualified wages per employee (including the value of qualified group health plan benefits as further described in IRS Notice 2021-20, Q&A items 40 - 48). IRS Notice 2021-49 clarifies that an employee's status as a full-time or part-time employee is irrelevant in determining qualified wages (i.e., qualified wages paid to both full-time and part-time employees are counted in calculating the ERC). [Note, however, that wages paid with forgiven PPP loan proceeds may not be used as a basis for the ERC.] *Qualified wages are further defined in IRS Notice 2021-20, Q&A items 30 - 48 and the ERC's interaction with PPP loans is further described in IRS Notice 2021-20, Q&A item 49. Additionally, Q&A item 58 describes a special rule for claiming an ERC for wages funded by a PPP loan that was not forgiven.*

**Note** – Wages for purposes of the ERC are generally FICA wages...clergy compensation is not ordinarily considered FICA wages.

3. The credit is reduced by any credits claimed for emergency sick pay or emergency family leave pay under the Families First Coronavirus Response Act (FFCRA) or for other credits applicable to the same wages.
4. To the extent the credit exceeds the employer's Social Security tax due, the excess is considered a refundable overpayment.
5. For employers with an average of more than 100 full-time employees in 2019, only wages paid to employees for periods during which they were not providing services due to an economic hardship (either (1) a full or partial suspension of operations by order of a governmental authority due to COVID-19 or (2) a significant decline in gross receipts) are eligible for the credit. For eligible employers with an average of 100 or fewer full-time employees in 2019, **wages** paid to **all employees** (regardless of whether they were providing services) during a period of economic hardship (as defined above) are eligible for the credit.
  - a. Aggregation of employee counts of affiliated entities may be required. *Q&A items 7, 8, 9, 32, and 55 within Notice 2021-20 provide additional information regarding the aggregation rules applicable to the ERC.*
  - b. Employee counts are made using the [methods applicable under the Affordable Care Act](#) in determining whether an employer is an "applicable large employer." IRS Notice 2021-49 clarifies that employers are not required to include full-time equivalents when determining the average number of full-time employees – just full-time employees. (Note that only the counting method is applicable...the employee count thresholds for the Employee Retention Credit are unrelated to the thresholds for the Affordable Care Act.) *Q&A item 31 within Notice 2021-20 provides additional information regarding the calculation of employee counts for purposes of the ERC.*
6. IRS Notice 2021-20, Q&A items 70 and 71 provide information regarding documentation that should be kept in an employer's records as support for the ERC.
7. The Employee Retention Credit, as described in this section of this article, is effective for wages paid after March 12, 2020, and before January 1, 2021.

The Internal Revenue Service provides a [list of FAQs](#) related to the Employee Retention Credit. (As of the date this article was written, the IRS's FAQs did not reflect changes to the ERC made by the CAA or the ARPA.) As

referenced above, Notice 2021-20 includes a list of Q&A items related to the ERC for the period March 13, 2020, through December 31, 2020.

### **Observations for Churches, Schools, and Other Organizations Subject to Mandatory Suspension of Group Meetings**

Thankfully, few churches, schools, and charities have experienced revenue declines in a calendar quarter of 2020 in excess of 50% as compared to 2019 – so that aspect of ERC eligibility has limited application. We note, however, that churches, schools, and other organizations that were subject to **mandatory** government orders that resulted in the full or partial suspension of operations or group meetings (including mandatory government orders that required or resulted in capacity limitations in connection with such operations or group meetings, assuming the capacity limitations had more than a nominal effect on the operations) seem to be eligible for the Employee Retention Credit regardless of whether they were able to continue carrying on certain of their activities via remote participation.

Applying this interpretation would require the organization to evaluate whether it had “operations that were **fully or partially suspended** during any calendar quarter in 2020 due to **orders** from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19.” Such a determination may not be easy to make in every instance, since certain safety protocol communications made by government officials or agencies may not have reached the level of authority of “**orders**.” (See Notice 2021-20, Q&A Item 10 for additional information on what qualifies as a governmental order for this purpose.) Additionally, language in the IRS Notice 2021-20, Q&A Item 15 states that if the “employer is able to continue operations comparable to its operations prior to the closure by requiring its employees to telework, the employer’s operations are not considered to have been fully or partially suspended as a consequence of a governmental order.”

While it may be tempting to assume that such language means that churches that offered virtual worship services were able to “continue operations comparable to its operation prior to the closure,” we would argue that such is not the case. Not only are virtual worship services not comparable to regular in-person worship meetings, most churches stopped or limited other significant aspects of their operations in addition to in-person worship services...such as children’s ministries, Sunday Schools, fellowship events, and more. Similarly, even though schools may have continued conducting classes online, many other school functions were stopped or limited...including athletics and other extracurricular activities. Our firm believes that, until and unless additional official contrary guidance is published, the position we have described herein with respect to churches and schools is reasonable, assuming that the suspended operations are more than a nominal portion of the church or school’s business operations as defined in IRS Notice 2021-20.

**Assuming the IRS agrees with the interpretation described in the preceding paragraph, the Employee Retention Credit could represent a significant financial benefit to churches, schools, and other entities required to suspend or limit group meetings – particularly those with 100 or fewer full-time employees in 2019.** The reason is that for such organizations, the credit is half of the first \$10,000 in wages paid to **all** employees during the applicable period, regardless of whether such employees are providing services for the organization or not. That treatment contrasts dramatically with the treatment of organizations with more than 100 full-time employees in 2019. For those organizations, the credit is half of the first \$10,000 in wages paid during the applicable period **only to employees while they are not currently providing services to the organization.**

#### **Example – Church with 85 Full-Time Employees in 2019 and 2020**

*Note – The IRS has published guidance on the interaction between the ERC and PPP loan rules as they relate to identifying the wages applicable to each – see IRS Notice 2021-20, Q&A items 49 and 58. The ERC cannot be claimed with respect to wages paid with PPP loan funds that are forgiven. This example*

*specifically notes that the employer ignored wages paid with PPP loan funds in calculating wages paid by the employer for purposes of the ERC.*

Oak Church obtained a PPP1 loan that was fully forgiven in 2020. It does not qualify for any wage-related credits other than the ERC. Oak Church had 85 full-time non-clergy employees in 2019 and 2020 and no part-time employees. On March 15, 2020, Oak Church was ordered by government officials to stop holding in-person worship services. That mandate continued through May 31, 2020, at which time government officials permitted the church to hold limited-capacity worship services. The mandate for limited capacity worship services continued through December 31, 2020, and included a prohibition against conducting certain of the church's other activities involving gatherings. Oak Church continued to pay all of its employees for the entire time during which in-person worship services were prohibited or limited. The operations that ceased as a result of government orders met IRS criteria for being more than nominal.

Ten of its employees (other than clergy) performed no services for Oak Church during the period from March 15 through May 31, 2020 (due to government orders to cease holding worship services), but were paid, nonetheless. During the period from March 15, 2020, through December 31, 2020, Oak Church paid its 85 non-clergy employees \$42,000 each in wages (including qualified health plan benefits). Oak Church ignored the wages it paid employees with PPP loan funds. Half of the first \$10,000 of non-PPP wages paid to each of its employees during the applicable period is \$5,000 per employee. Oak Church is entitled to an Employee Retention Credit of \$425,000 (85 x \$5,000). The credit is refundable. To the extent that the credit exceeds Oak Church's employer Social Security tax due on its Form 941s for the applicable quarters of 2020, Oak Church may reduce its federal employer payroll tax deposits for the applicable periods to zero and receive a refund of the credit amount in excess of the otherwise required deposits.

*[Note that if Oak Church had an average of more than 100 full-time employees in 2019, the credit would apply only with respect to the wages paid to the 10 employees who did not provide services and only during the period in which they were paid while not providing services.]*

## **For the Period January 1, 2021, through June 30, 2021**

*IRS Notice 2021-23 amplifies IRS Notice 2021-20 and specifically addresses the ERC for the period January 1, 2021, through January 30, 2021. Unless otherwise noted below, information included in IRS Notice 2021-20 (applicable to the ERC for March 13, 2020 – December 31, 2020), including the Q&A references above, continues to apply to the ERC for the period January 1, 2021, through June 30, 2021.*

1. Provides eligible employers – including tax-exempt organizations – a refundable credit against the employer's share of Social Security tax [the 6.2% portion – not the 1.45% Medicare tax]. (As described below, the fact that it is a refundable credit means that it is simply money from the government – if the amount of the credit exceeds the employer's share of Social Security tax against which it is a credit, the organization can reduce the amount that it deposits to cover other payroll tax obligations. If the credit exceeds all such taxes owed by the employer, the employer receives a refund of the excess credit amount.)
  - a. Eligible employers must have carried on a trade or business during 2021 and satisfy one of two economic hardship tests (for tax-exempt organizations described in Section 501(c) of the Internal Revenue Code, all operations of the organization are considered a trade or business for this purpose):

- i. Have fully or partially suspended business operations during either the **first or second quarter of 2021** due to **orders** from a governmental entity limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes)

or

- ii. Experience a reduction in **gross receipts** of more than **20%** in either the **first or second quarter of 2021** as compared to the same calendar quarter of **2019**. (Special rules apply for organizations not in operation during the applicable quarter of 2019 and for seasonal employers.) For quarters in 2021, a special rule allows organizations to elect to use the immediately preceding quarter to compare to 2019. For example, in measuring a decline in gross receipts for the second quarter of 2021, an organization can elect to use the first quarter of 2021 to compare to the first quarter of 2019. IRS Notice 2021-49 confirms that the IRS does not require consistency from quarter to quarter in making such an election. Gross receipts are defined in the same manner as for the 2020 ERC described above. *See notes above for special considerations in the definition of gross receipts for purposes of the ERC.*

**Example:** Employer A's gross receipts were \$150,000 and \$190,000 in the first and second calendar quarters of 2021, respectively. Its gross receipts were \$210,000 and \$230,000 in the first and second calendar quarters of 2019, respectively. Thus, Employer A's 2021 first and second quarter gross receipts were approximately 71% and 83% of its 2019 first and second quarter gross receipts, respectively. Accordingly, Employer A had a qualifying decline in gross receipts for the first calendar quarter of 2021 (the calendar quarter in which gross receipts were less than 80% of the amount in the same quarter in 2019) but not for the second quarter of 2021 (because gross receipts for that quarter were not less than 80% of the amount in the same quarter of 2019). Thus, Employer A is eligible for an Employer Retention Credit with respect to the first quarter of 2021. However, if Employer A elected (with respect to the second quarter) to use the immediately preceding quarter as a basis for comparison to 2019, it would have a qualifying decline in gross receipts for the second quarter as well.

2. The credit is 70% of the first \$10,000 in wages per employee (including the value of qualified health plan benefits) paid during **each of the first two calendar quarters of 2021**, during which the employer qualifies. Thus, the maximum credit per employee is \$7,000 per quarter for the first two quarters of 2021 (for a total of \$14,000).

**Note** – Wages for purposes of the ERC are generally FICA wages...clergy compensation is not ordinarily considered FICA wages.

3. The credit is reduced by any credits claimed for emergency sick pay or emergency family leave pay under the Families First Coronavirus Response Act (FFCRA) or for other credits applicable to the same wages.
4. To the extent the credit exceeds the employer's Social Security tax due, the excess is considered a refundable overpayment.
5. For employers with an average of more than **500** full-time employees in 2019, only wages paid to employees for periods during which they are not currently providing services due to an economic hardship (either (1) a full or partial suspension of operations by order of a governmental authority due to COVID-19 or (2) a significant decline in gross receipts) are eligible for the credit. For eligible employers with an average of 500 or fewer full-time employees in 2019, **wages** paid to **all employees**

(regardless of whether they were providing services) during a period of economic hardship (as defined above) are eligible for the credit.

- a. Aggregation of employee counts of affiliated entities may be required.
- b. Employee counts are made using the [methods applicable under the Affordable Care Act](#) in determining whether an employer is an “applicable large employer.” (Note that only the counting method is applicable...the employee count thresholds for the Employee Retention Credit are unrelated to the thresholds for the Affordable Care Act.)

In addition to IRS Notice 2021-20, IRS Notice 2021-23, and IRS Notice 2021-49 the Internal Revenue Service provides a [list of FAQs](#) related to the Employee Retention Credit. (As of the date this article was written, the IRS’s FAQs did not reflect changes to the ERC made by the CAA or the ARPA.)

### **Observations for Churches, Schools, and Other Organizations Subject to Mandatory Suspension of Group Meetings**

Some churches, schools, and charities may experience revenue declines in the first or second calendar quarter of 2021 in excess of 20% as compared to the same quarter of 2019 and may qualify for the credit accordingly. Additionally, churches, schools, and other organizations that were subject to **mandatory** government orders that resulted in the full or partial suspension of operations or group meetings (including mandatory government orders that required or resulted in capacity limitations in connection with such operations or group meetings, assuming the capacity limitations had more than a nominal effect on the operations) seem to be eligible for the Employee Retention Credit regardless of whether they were able to continue carrying on certain of their activities via remote participation.

Applying this interpretation would require the organization to evaluate whether it had “operations that were **fully or partially suspended** during any applicable calendar quarter due to **orders** from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19.” Such a determination may not be easy to make in every instance, since certain safety protocol communications made by government officials or agencies may not have reached the level of authority of “**orders**.” (See Notice 2021-20, Q&A Item 10 for additional information on what qualifies as a governmental order for this purpose.) Additionally, language in the IRS Notice 2021-20, Q&A Item 15 states that if the “employer is able to continue operations comparable to its operations prior to the closure by requiring its employees to telework, the employer’s operations are not considered to have been fully or partially suspended as a consequence of a governmental order.”

While it may be tempting to assume that such language means that churches that offered virtual worship services were able to “continue operations comparable to its operation prior to the closure,” we would argue that such is not the case. Not only are virtual worship services not comparable to regular in-person worship meetings, most churches stopped or limited other significant aspects of their operations in addition to in-person worship services...such as children’s ministries, Sunday Schools, fellowship events, and more. Similarly, even though schools may have continued conducting classes online, many other school functions were stopped or limited...including athletics and other extracurricular activities. Our firm believes that, until and unless additional official contrary guidance is published, the position we have described herein with respect to churches and schools is reasonable, assuming that the suspended operations are more than a nominal portion of the church or school’s business operations as defined in IRS Notice 2021-20.

**Assuming the IRS agrees with the interpretation described in the preceding paragraph, the Employee Retention Credit could represent a significant financial benefit to churches, schools, and other entities required to suspend or limit group meetings – particularly those with 500 or fewer full-time employees in 2019.** The reason is that for such organizations, the credit is 70% of the first \$10,000 in wages

paid to **all** employees during the applicable quarter, regardless of whether such employees are providing services for the organization or not. That treatment contrasts dramatically with the treatment of organizations with more than 500 full-time employees in 2019. For those organizations, the credit is 70% of the first \$10,000 in wages paid during the applicable quarter **only to employees while they are not currently providing services to the organization.**

### **Example – Church with 285 Full-Time Employees in 2019 and 2021**

Oak Church obtained and fully spent a PPP1 loan in 2020. It did not obtain a PPP2 loan. It does not qualify for any wage-related credits other than the ERC. Oak Church had 285 full-time non-clergy employees in 2019, 2020, and 2021 and no part-time employees. On March 15, 2020, Oak Church was ordered by government officials to stop holding in-person worship services. That mandate continued through May 31, 2020, at which time government officials permitted the church to hold limited-capacity worship services. The mandate for limited capacity worship services continued through March 31, 2021, and included a prohibition against conducting certain of the church's other activities involving gatherings. Oak Church continued to pay all of its employees for the entire time during which in-person worship services were prohibited or limited. The operations that ceased as a result of government orders met IRS criteria for being more than nominal.

80 of its employees (other than clergy) performed no services for Oak Church during the period from March 15 through May 31, 2020 (due to government orders to cease holding worship services), but were paid, nonetheless. During the period from January 1, 2021, through March 31, 2021, Oak Church paid its 285 non-clergy employees \$12,000 each in wages (including qualified health plan benefits). 70% of the first \$10,000 of wages paid to each of its employees during the first quarter of 2021 is \$7,000 per employee. Oak Church is entitled to an Employee Retention Credit of \$1,995,000 (285 x \$7,000). The credit is refundable. To the extent that the credit exceeds Oak Church's employer Social Security tax due on its Form 941s for the first quarter of 2021, Oak Church may reduce its federal employer payroll tax deposits for that quarter to zero and receive a refund of the credit amount in excess of the otherwise required deposits.

*[Note that if Oak Church had an average of more than 500 full-time employees in 2019, the credit would not apply. For employers of that size, the credit would apply only with respect to the wages paid to employees who did not provide services and only during the period in which they were paid while not providing services. Oak Church did not have employees who were paid while not providing services during the first quarter of 2021.]*

## **For the Period July 1, 2021, through December 31, 2021**

The American Rescue Plan Act of 2021 (ARPA), enacted on March 11, 2021, created Internal Revenue Code Section 3134, which provides an employee retention credit for wages paid from July 1, 2021, through December 31, 2021. The ERC for the third and fourth quarter 2021 generally follows the same rules for the first and second quarter 2021 (described in the immediately preceding section), with specific changes noted below. The IRS released [IRS Notice 2021-49](#) that provides additional guidance regarding the ERC for this time period.

1. The ERC for this period is a refundable credit against the employer's share of **Medicare** tax [the 1.45% portion – not the 6.2% Social Security tax as in prior quarters]. (To reiterate, the fact that the ERC is a refundable credit means that it is simply money from the government – if the amount of the credit exceeds the employer's share of Medicare tax against which it is a credit, the organization can reduce the amount that it deposits to cover other payroll tax obligations. If the credit exceeds all such taxes owed by the employer, the employer receives a refund of the excess credit amount.)

2. An election may be made by the employer in evaluating its eligibility for the ERC in the third and fourth quarters of 2021 to calculate its gross receipts reduction threshold based on the immediately preceding calendar quarter as compared to the same quarter in 2019. For example, for purposes of determining whether the employer meets the gross receipts reduction threshold for ERC eligibility in Q3 2021, the employer may elect to compare its Q2 2021 gross receipts with its gross receipts in Q2 2019. IRS Notice 2021-49 confirms that the IRS does not require consistency from quarter to quarter in making such an election. (Special rules continue to apply for organizations not in operation during the applicable quarter of 2019 and for seasonal employers.)
3. A special rule was created for employers that have experienced a reduction in gross receipts in a quarter in excess of 90% of the gross receipts for the same quarter in 2019.

In addition to IRS Notice 2021-20, IRS Notice 2021-23, and IRS Notice 2021-49, the Internal Revenue Service provides a [list of FAQs](#) related to the Employee Retention Credit. (As of the date this article was written, the IRS's FAQs did not reflect changes to the ERC made by the CAA or the ARPA.)

## **Not-So-Obvious 2020 and 2021 ERC Eligibility Considerations**

Nuances within the ERC eligibility rules and definitions described above create opportunities for organizations to be eligible for the ERC that may not be obvious to an organization without careful consideration of an organization's particular facts. We have included some examples of "not-so-obvious" scenarios that may cause your organization to be eligible for the ERC. This is not an exhaustive list of possibilities but is intended to demonstrate that the definitions and rules described in the guidance above must be carefully considered and evaluated.

- In considering the gross receipts reduction thresholds for 2020 and 2021, did your organization engage in a special fundraising or capital campaign in 2019, such that the mechanical calculation of gross receipts in a particular quarter in 2020 or 2021 as compared to the same quarter in 2019 meets the ERC gross receipts reduction thresholds?
- In considering the gross receipts reduction thresholds for 2020 and 2021, did your organization liquidate a significant asset or assets in 2019, such that the mechanical calculation of gross receipts in a particular quarter in 2020 or 2021 as compared to the same quarter in 2019 meets the ERC gross receipts reduction thresholds?
- In considering the gross receipts reduction thresholds for 2020 and 2021, did your organization receive an unusual grant or gift in a particular quarter in 2019? If so, have you considered whether your organization's gross receipts in 2020 or 2021 for that same quarter may meet the ERC gross receipts reduction thresholds?
- In considering the full or partial suspension of business operations economic hardship test, have you considered capacity limitations that your organization imposed in its operations in order to adhere to a government mandate regarding social distancing – even if your organization was considered an "essential business?" Did such capacity limitations more than nominally affect your organization's operations?
- In considering the full or partial suspension of business operations economic hardship test, have you considered whether a key supplier or landlord's operations were suspended due to government orders, which impacted your organization in more than a nominal manner?

## **2020 ERC for Qualified Disasters**

The Taxpayer Certainty and Disaster Tax Relief Act of 2020, enacted as a part of the CAA in late 2020, created a separate ERC for wages paid or incurred by nonprofit employers located in qualified disaster zones after the nonprofit employer's business became inoperable because of damage from a 2020 qualified disaster. Qualified disaster zones are specifically designated for each federally-declared disaster. The qualified disaster ERC is equal to 40% of up to \$6,000 of wages for each qualifying employee for the 2020 tax year. Wages for this purpose are generally FICA wages and do not include any wages claimed in applying for the COVID-19 relief ERCs described above. Unlike the general COVID-19 relief ERC credit described above, the qualified disaster ERC is a **non**-refundable credit against the employer's share of Social Security tax [the 6.2% portion – not the 1.45% Medicare tax]. Nonprofits may claim the credit by filing [Form 5884-D](#). A list of 2020 federally-declared disasters will be included in the Form 5884-D instructions (the Coronavirus pandemic is not included in the list of 2020 federally-declared disasters for this purpose).

### **BMWL Can Help**

BMWL's COVID-19 Task Force is ready, willing, and able to help our clients navigate the Employee Retention Credit. Nonprofit organizations that would like the assistance of our Task Force in addressing the Program should contact us at [C19TaskForce@nonprofitcpa.com](mailto:C19TaskForce@nonprofitcpa.com).

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