ELAINE'S EXTRAS

THE EMPLOYEE RETENTION CREDIT

By: Elaine L. Sommerville, CPA

Provided by the Coronavirus Aid, Relief and Economic Security Act (CARES Act), the employee retention credit (ERC) assisted employers experiencing economic distress but who were endeavoring to maintain their employees. Originally intended to apply in 2020, the ERC has been modified and extended by the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (TCDTRA) passed in December of 2020 and the American Rescue Plan Act of 2021 (ARPA). The rules depend on the period for which an employer is claiming the credit. Rules for 2020 differ from rules for 2021. The credit is now available through December 31, 2021. Since the rules for 2020 changed at the very end of 2020, more employers might benefit from the credit for 2020 than initially allowed. Therefore, churches should review all the credit's current requirements for both 2020 and 2021 to determine its availability. Churches may still take advantage of the ERC for 2020 by amending the appropriate Form 941 to claim the credit.

THEREFORE, CHURCHES SHOULD REVIEW ALL THE CREDIT'S CURRENT REQUIREMENTS FOR BOTH 2020 AND 2021 TO DETERMINE ITS AVAILABILITY.

The Employee Retention Credit for 2020

For 2020, the maximum credit equals 50% of qualified wages not exceeding $10,000. This provides a $5,000 credit per employee for the entire period of March 13, 2020 to December 31, 2020. (This differs significantly from the 2021 rules, so review the information below for 2021 carefully.) The credit is applied against an employer's Old Age, Survivors & Disability Insurance (OASDI) portion of the Social Security tax but is refundable after the tax is eliminated.

Eligible Employer
Any employer actively carrying on a trade or business and either:

- fully or partially suspends operations in any calendar quarter in 2020 due to government orders affecting commerce, travel, size of gathering, etc.; or

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While the credit was originally limited to employers experiencing a significant reduction in operations and not available to those receiving PPP loans, the credit has been significantly expanded in all aspects of its operations and availability. All employers should review these rules to determine if the credit is available to them.

- the business experiences a significant decrease in revenues due to the current circumstances. A significant decrease is defined as the revenues for the quarter are 50% less than the revenues of the same quarter in 2019 and continues until revenues for a calendar quarter exceed 80% of the revenues for the same calendar quarter in 2019.

Governmental employers and self-employed individuals are not eligible, but nonprofit organizations are eligible employers. (Note: If a self-employed individual had other employees that were not family members, the credit might be available for those employees.) While there are limitations for certain employers based on the size of the employer's workforce, the credit is available to all other employers.

Qualified Wages

Qualified wages are defined under IRC Section 3121(a) for FICA taxes. While this code section works for most employers, it does not work well for religious organizations employing ministers. Wages paid to ministers are not wages for IRC Section 3121(a). Therefore, in calculating qualified wages, wages paid to a minister must be omitted. And churches who have elected not to participate in the FICA/Medicare program under IRC Section 3121(w) cannot include any of their employees' wages in the calculation.

Wages paid from March 13, 2020 through December 31, 2020 may be considered. For wages paid from March 13, 2020 to March 31, 2020, the credit was claimed on Form 941 for the second quarter of 2020 and not Form 941 for the first quarter of 2020.

Qualifying wages also include certain health care costs provided by the employer for the employee, provided the benefit to the employee was not included in the employee's taxable income. This would include both the costs directly paid by the church and the costs paid by an employee through pre-tax salary reduction contributions, such as contributions to a medical flexible spending account or a HAS through a Section 125 cafeteria plan.

Large Employer Caution – If an employer averaged more than 100 full-time employees during 2019, qualified wages (as defined above) are limited to wages associated with employees who did not perform any services for the employer because of one of the triggering events. Therefore, if an employee continues providing services, their wages do not qualify for the credit.

> Example: First Church had 150 full-time employees in 2019. In 2020, they experienced a partial closure when their state orders a shutdown, including all churches. While the church succeeds in moving its main service to a virtual format, it cannot continue its overall operations. The church continues to pay its' facilities team and general office staff even though they cannot perform their job. The church may claim the ERC related to these wages if the wages were not utilized to justify forgiveness of a PPP loan.

Wages not eligible include wages paid under the special sick leave and family leave provisions enacted by the Families First Coronavirus Response Act (FFCRA) and those utilized to justify forgiveness of PPP loan proceeds.

The ERC & the PPP Loan Program for 2020

Initially, the law provided that obtaining a PPP loan disqualified a church from utilizing the ERC. This has been eliminated and replaced with the provision that the same wages may not be utilized for both programs. Therefore, churches who initially believed the ERC was not available to them due to the PPP loan program should review the above rules to determine eligibility for the ERC for 2020. The credit may still be claimed by filing an amended Form 941 for the applicable quarter.

<u>The Employee Retention Credit for 2021</u>

For 2021, the credit is 70% of an employee's qualified wages not to exceed $10,000 per employee per calendar quarter. The potential credit of $7,000 per employee per calendar quarter creates a potential credit of $28,000 per employee for the calendar year 2021.

Eligible Employer
Any employer actively carrying on a trade or business and either:

- fully or partially suspends operations in any calendar quarter in 2021 due to government orders affecting commerce, travel, size of gathering, etc; or
- the business experiences a significant decrease in revenues due to the current circumstances. A significant decrease is defined as the revenues for the quarter are less than 80% than the revenues of the same quarter in 2019 and continues until revenues for a calendar quarter exceed 80% of the revenues for the same calendar quarter in 2019. (An election is available to utilize the immediately preceding calendar quarter for the calendar quarter in question and utilize the corresponding calendar quarter from 2019 for the comparison. For example, when reviewing the testing for the 1st quarter of 2021, a church may do the testing based on the 1st quarter of 2021 to the 1st quarter of 2019 or elect to utilize the prior quarter, i.e., the 4th quarter of 2020, and compare it to the 4th quarter of 2019.) If a church did not exist in 2019, it may use the comparable quarter for 2020.

Governmental employers and self-employed individuals are not eligible, but nonprofit organizations are eligible employers. (Note: If a self-employed individual had other employees that were not family members, the credit might be available for those employees.) While there are limitations for certain employers based on the size of the employer's workforce, the credit is available to all other employers.

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Qualifying wages also include certain health care costs provided by the employer for the employee provided the benefit to the employee was not included in the employee's taxable income. This would include both the costs directly paid by the church and the costs paid by an employee through pre-tax salary reduction contributions, such as contributions to a medical flexible spending account or a HAS through a Section 125 cafeteria plan.

Large Employer Caution -For employers of fewer than 500 full-time equivalent employees, the ERC will apply to all its employees even if they work in an area not generating the reason for the credit. However, for employers of over 500 full-time equivalent employees, the ERC will apply only to those employees directly affected by the triggering event creating a qualified employer and only for wages paid when services were not actually provided to the employer.

Wages not eligible include those paid under the special sick leave and family leave provisions enacted by the Families First Coronavirus Response Act of 2020 (FFCRA)and those utilized to justify forgiveness of PPP loan proceeds.

Claiming the Credit
The credit is claimed against the employer portion of the OASDI (FICA tax) for the 1st and 2nd quarters of 2021 but against the employer portion of Medicare taxes for the 3rd and 4th quarters of 2021. However, if the credit is larger than the employer's OASDI or Medicare tax for the applicable quarter, the excess credit is refundable. The credit is claimed on an employer's quarterly Form 941.

If an employer is entitled to the credit on the upcoming Form 941, the employer may reduce its payroll tax deposits, against the total taxes due, for the quarter claiming the credit. If an employer does not have enough federal payroll taxes to absorb the credit, it may apply for an advance payment of the credit by filing Form 7200. The Form 7200 may be located at https://www.irs.gov/pub/irs-pdf/f7200.pdf.

Caution in Qualification for the Credit

Suspension of Operations

The credits for 2020 and 2021 may be available if a church or business is adversely affected by government orders affecting commerce, travel, or size of gathering, resulting in a full or partial shutdown of a church's operations. Such orders must be issued by federal, state, or local authorities and must be more than "suggestions." An employer's independent decision to suspend part or all of its operations does not meet these criteria. In areas where churches were designated as essential businesses, the church may not be considered to have a full or partial suspension of operations if the government allows the church to remain open without gathering restrictions. If a government order still limits the activities and allows the church to remain open, but at a reduced capacity, then the provision may apply. In many states, churches have been deemed to be "essential" businesses. While gathering sizes may have been restricted, the decision not to convene services were often based on internal church decisions and not on governmental orders. For example, a church's decision to end Wednesday night "in-person" classes, might have been based on the church's decision on how to respond to the pandemic and not on a government decree.

> Example: A church is deemed an essential business, but the government orders it to limit its capacity to 50% of its worship facilities. This may meet the partial shutdown provision.

If a church may continue its operations via other means, then the existence of a governmental order to reduce the size of a gathering may not create eligibility for the credit. Where a church may continue operations comparable to its operations before the closure, the church may not be considered subject to the full or partial shutdown order.

> Example: First Church is deemed an essential business, but its gathering size is restricted to 50% of its sanctuary's capacity. To compensate, it initiates online services of its Sunday morning and Wednesday evening services. Between the service options, attendance remains steady, and First Church does not experience a decline in its revenue. First Church would have to argue it was not continuing its operations as it was before the closure to qualify for the credit. This may be difficult if the church is reaching the same number of people it reached before the pandemic and is not financially suffering.

Where the church may not qualify under the government order provision, it may be possible that a church may still qualify for the credit using this provision because it applies to activities of the church that constitute at least 10% of the overall activities of the church.

> Example: A church operates a daycare. It may remain open, but it may only accept children whose parents work in essential businesses, and it must reduce its classroom capacity to 50% of regular capacity. This creates a partial shutdown of the daycare operations.

Determining if governmental orders affect a church requires a specific analysis of both the orders and the church's response to the orders. Caution should be used before applying for the credit under this provision, especially if a church has not experienced a significant decline in participation or any decline in revenue.

Gross Receipts

The definition of gross receipts is defined by the definition utilized in IRC Section 6033 to define the filing requirements for an exempt organization's Form 990. Under this definition, gross receipts mean all contributions, investment income, sales of investments, royalties, rents, and fundraising income. No deductions are allowed for the cost of operations, cost of sales, rental expenses, fundraising expenses, or the basis of assets sold.

Churches should remember that designated funds or restricted funds accounted for through liability accounts or equity accounts on the balance sheet are receipts in the year received. Many churches account for these funds without reporting them on the church's profit and loss statements because the profit and loss statements only report budgeted revenue and expenses. However, this accounting treatment does not remove these funds from the definition of gross receipts for purposes of IRC Section 6033.

> Example: First Church reports its tithes and offerings and other budgeted revenue through its profit and loss statement each year. For the first quarter of 2021, the total revenue reported was $50,000. During this same quarter, the church received $75,000 in revenue in its designated accounts maintained through the equity portion of its balance sheet. Gross receipts for the first quarter of 2021 are $125,000, not $50,000.

Full-Time Equivalent

For the testing of the 100 full-time employees for 2020 and the 500 full-time employees for 2021, the requirements for a full-time equivalent employee for purposes of the Affordable Care Act are utilized.

Coordination of Related Organizations

Organizations that meet certain related entity tests must all be considered as one entity for applying the wage limit per employee per quarter. And all employees must be considered among related entities when determining if an employer has more or less than 500 full-time equivalent employees.

Extension of the Statute of Limitations

Forms 941 claiming the ERC will have an extended statute of limitations. These returns will all be treated as filed on April 15, 2022, and the statute of limitations will run for 5 years until April 15, 2027.

EMPLOYEE RETENTION CREDIT

Summary

All churches and nonprofits should review operations to determine if the employee retention credit is available. The potential credit is $5,000 per employee for 2020 and $28,000 for 2021. The credit is first applied to various payroll taxes and then is refundable to the employer. Representing a change from its initial creation, the credit is available to organizations receiving a PPP loan if the wages utilized to justify forgiveness of a PPP loan are not utilized to justify the employee retention credit. While eligibility may be based on an organization's reduction in revenue, eligibility is also available to those suffering a reduction in operations due to governmental shutdown orders.

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