Retention Credit Opportunities for Tax-Exempt Organizations

What is the Retention Credit and how can it help my tax-exempt organization for 2020 – 2021?

- The Employee Retention Credit is a **refundable** tax credit against certain **employment taxes** for employers experiencing difficulties related to the COVID-19 pandemic, under one of two criteria.

- Thus, even tax-exempt organizations can benefit because the credit is not against federal income tax, but rather employment taxes withheld or owed on the organization's payroll.

Sounds great! How much cash can I get to help my tax-exempt organization for 2020?

- The Employee Retention Credit is a **refundable** tax credit against certain employment taxes equal to <u>50%</u> of the **qualified wages** an **eligible employer** paid to employees after March 12, 2020, and before January 1, 2021.
- The qualified wages are equal to $10K per employee for the year and thus the maximum cash to the employer is $5K per employee for calendar year 2020.
- **Example:** Employer has 20 employees and the Retention Credit is $100K. The employer will receive $100K from the IRS following IRS procedures.

Same question for 2021. How much cash can I get to help my tax-exempt organization for 2021?

- The Employee Retention Credit for 2021 is a refundable tax credit against certain employment taxes equal to 70% of the **qualified wages** an **eligible employer** pays to employees between January 1, 2021 and July 1, 2021.
- Qualified wages are equal to $10K per employee per quarter.
- Note: the American Rescue Plan Act added the Retention Credit to the Internal Revenue Code, extending this opportunity through December 31, 2021.
- **Example:** Employer has 20 employees and the Retention Credit is $140K. The employer will receive $140K from the IRS following IRS procedures.

What is the definition of wages generally? Can I get the credit for independent contractors?

- Qualified wages are generally your employees’ FICA wages. Qualified wages also includes health insurance expenses, even in instances where no other wages are paid.
- Since qualified wages are generally those wages subject to FICA tax, independent contractors are not included.

Which Tax-Exempt Organizations can get the Retention Credit?

- Like other eligible employers, Tax-Exempt Organizations under Section 501(c)(3) are eligible for the Retention Credit if one of the two eligibility requirements are met.
- More specifically, Tax-Exempt Organizations may qualify if they had to close due to a COVID-19-related shutdown order or if they experienced a significant decline in revenue (meeting the Government Orders Test or the Gross Receipts test).

How can I tell if I am an "Eligible Employer" for 2020?

- Employers, including tax-exempt organizations, are eligible for the credit if they operated a trade or business during calendar year 2020 and experienced either:
  1. A full or partial suspension of the operation of their trade or business during any calendar quarter because of government orders limiting commerce, travel, or group meetings due to COVID-19 ("Government Orders Test"); OR
  2. A "significant decline" in gross receipts, defined as an at-least 50% reduction in gross receipts as compared to the same quarter in 2019 ("Gross Receipts Test").

Tell me more about the Gross Receipts Test for 2020

- A significant decline in gross receipts begins:
  1. on the first day of the first calendar quarter of 2020
  2. in which an employer's gross receipts are less than 50% of its gross receipts
  3. as compared to the same calendar quarter in 2019.
- The significant decline in gross receipts ends:
  1. on the first day of the first calendar quarter following the calendar quarter
  2. in which gross receipts are more than of 80% of its gross receipts
  3. as compared to the same calendar quarter in 2019.

How can I tell if I am an “Eligible Employer” for 2021?

- Employers, including tax-exempt organizations, are eligible for the credit if they operate a trade or business during calendar year 2021 and experience:
  1. A full or partial suspension of the operation of their trade or business during any calendar quarter because of government orders limiting commerce, travel, or group meetings due to COVID-19 under the Government Orders Test; OR
  2. A “significant decline” in gross receipts, under the Gross Receipts Test defined as either:
     - A 20% reduction in gross receipts for the quarter when comparing to the same quarter in 2019; or
     - A 20% reduction in gross receipts calculated by using prior-quarter receipts as compared to the same quarter in 2019.

Tell me more about the Gross Receipts test for 2021

- A significant decline in gross receipts begins:
  1. on the first day of the first calendar quarter of 2021
  2. for which an employer's gross receipts are less than 80% of its gross receipts
  3. as compared to the same calendar quarter in 2019.
- The significant decline in gross receipts ends:
  1. on the first day of the first calendar quarter following the calendar quarter
  2. in which gross receipts are more than of 80% of its gross receipts
  3. as compared to the same calendar quarter in 2019.

What are Gross Receipts for a tax-exempt organization?

- "Gross Receipts" means the gross amount received by the Tax-Exempt Organization from all sources without reduction for the expenses of raising and collecting such amounts.
- Examples include:
  - Gross amounts received as contributions, gifts, and grants;
  - Gross amounts received as dues or assessments from members or affiliated organizations;
  - Gross sales or receipts from business activities;
  - Gross amount received from the sale of assets; and
  - Gross amount received as investment income (e.g., interest, dividends, rents, royalties).

Does it matter how many employees I have for determining Qualified Wages?

- The definition of Qualified Wages depends on how many employees an eligible employer has. The number of employees is determined on an affiliated group basis.

- ***Smaller employers can more easily claim the credit because they may claim the credit for all employees, whether working or not.***

- ***Larger employers may only claim the credit for wages paid to employees while on furlough or otherwise not performing services.***

Qualified Wages for 2020 – Employee Count

- If an employer averaged 100 or fewer full-time employees during 2019, qualified wages are those wages, including health care costs (up to $10,000 per employee), paid to any employee during the period operations were suspended or the period of the decline in gross receipts, ***regardless of whether its employees provided services***.
- These employers can only count wages up to the amount that the employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period of economic hardship.
  - E.g., recent bonuses or pay-rate increases would be excluded.

Qualified Wages for 2021 – Employee Count

- If an employer averaged 500 or fewer full-time employees during 2019, qualified wages are those wages, including health care costs (up to $14,000 per employee), paid to any employee during the period operations were suspended or the period of the decline in gross receipts, regardless of whether its employees are providing services.
- Unlike for 2020, there is no limitation on the amount of wages paid to the employee in the last 30 days.
  - E.g., An employer increasing an employee's pay from $15/hour to $17/hour during a hardship period could count the entire new wage of $17/hour as a qualified wage. In 2020, the $2 pay raise would have been excluded, so only $15/hour would be qualified.

Qualified Wages for 2021 – Distressed Employers

- The American Rescue Plan Act of 2021 extends the retention credit through 12/31/2021 for wages paid after June 30, 2021 and before January 1, 2022.
- If an employer qualifies as a "severely financially distressed employer," the qualified wages eligible for the retention credit are any wages paid – they are not restricted to wages paid to employees who are not providing services.
- To qualify as a "severely financially distressed employer" for this purpose, the gross receipts for the employer for the calendar quarter must be less than 10% of the gross receipts for such quarter in 2019.
- The effect is that even very large employers meeting the distressed criteria, e.g., those with over 500 employees, are eligible for the credit for employees who remain working during the last two quarters of 2021.

My organization got a PPP loan. Am I out of luck?

- Originally, if an employer received a CARES Act Small Business Interruption Loan under the Paycheck Protection Program, then the employer was not eligible for the Employee Retention Credit.
- Now, retroactively, employers can get the retention credit if they meet the Government Orders Test or the Gross Receipts test, **but not on the same wages used for PPP loan forgiveness.**
- Most employers will have other wages not used for the loan forgiveness because the period of wages covered for the loans are less than the entire year in any regard.

How does retroactive coordination between the PPP loan and Employee Retention Credit work?

- The IRS guidance, Notice 2021-20, clarifies that if an employer applied for and received a PPP loan in 2020, such employer is “deemed” to have elected *not* to have taken the retention credit for the amount of qualified wages included in payroll costs up to (but not exceeding) the **minimum** amount of payroll costs, plus other eligible expenses sufficient to support the amount of the PPP loan that was forgiven. If the employer reported on its PPP loan application *more* in eligible expenses than it received in loan payments, the balance for qualified wages can generally be applied for the retention credit.

- E.g, an employer applied for a $200,000 PPP loan. This employer was required and did report a minimum of $120,000 of payroll costs and also reported $80,000 of other eligible expenses on the loan forgiveness application. The SBA approved forgiveness of the $200,000 PPP loan, so this employer may now claim a retroactive retention credit on qualified wages paid above the $120,000 covered by the PPP loan during 2020.

Can I “swap” payroll expenses I previously reported to the SBA for PPP loan purposes for other eligible expenses?

- When applying for a 2020 PPP loan, many employers listed payroll expenses only, while leaving off other eligible expenses because they exceeded the PPP loan cap.
- Because both the PPP loan and retention credit can now be claimed for 2020, employers would be tempted to “swap out” payroll expenses in place of other PPP-eligible expenses to take advantage of the retroactive retention credit (while avoiding “double dipping”). The IRS takes the position that this is not allowed.
  - E.g., An employer applied for a $200,000 PPP loan. This employer also had $70,000 in other eligible expenses but did not report this to the SBA in the forgiveness application. Although the employer would be tempted to argue that the PPP loan actually covered only $130,000 in payroll and $70,000 in other eligible expenses, the IRS prohibits this type of after-the-fact recalibration. This employer is deemed to have elected not to have taken the retention credit for the full wages covered by $200,000 PPP loan.

Impact of other credit and relief provisions

- An eligible employer's ability to claim the Employee Retention Credit is impacted by other credit and relief provisions as follows:
  - Wages for this credit do not include wages for which the employer received a tax credit for paid sick and family leave under the Families First Coronavirus Response Act.
  - Wages counted for this credit can't be counted for the credit for paid family and medical leave under Section 45S of the Internal Revenue Code.
  - Employees are not counted for this credit if the employer is allowed a Work Opportunity Tax Credit under Section 51 of the Internal Revenue Code.

How can I claim the credit?

- There are generally 3 ways to claim the Employee Retention Credit:
  1. Withhold employment taxes in anticipation of receiving the credit;
  2. Request a refund via employment tax returns (i.e., Form 941); or
  3. Request an advance through the form designated by the IRS (with some limitations).

- **Note that IRS guidance is anticipated on how to properly claim the retention credit following the enactment of the American Rescue Plan Act.**

What is the first way to claim the credit?

- In anticipation of claiming the credit, employers can retain a corresponding amount of the employment taxes that otherwise would have been deposited, including:
  - federal income tax withholding;
  - the employees' share of Social Security and Medicare taxes; and
  - the employer's share of Social Security and Medicare taxes for all employees, up to the amount of the credit, without penalty, taking into account any reduction for deposits in anticipation of the paid sick and family leave credit provided in the Families First Coronavirus Response Act.

Is there a second way to claim the credit?

- In order to claim the new Employee Retention Credit, eligible employers can also report their total qualified wages and related health insurance costs for each quarter on their quarterly employment tax returns (Form 941 for most employers).

- The credit is currently permitted to be taken against all the Federal employment tax owed for the quarter on Form 941.

- Example: Employer has 10 employees and a Retention Credit of $50K. Employer paid $60K in all Federal employment taxes shown on the Form 941 for the quarter. Employer claims a refund or credit of $50K of the $60K shown on the Form 941.

Is there a third way to claim the credit?

- Some eligible employers can also request an advance of the Employee Retention Credit by submitting Form 7200, Advance of Employer Credits Due To COVID-19.
- Note that under IRS guidance, the employer can only use this method if there are insufficient employment taxes set aside for deposit to cover the amount of the anticipated credit.
- In addition, effective January 1, 2021, this method is limited to small employers (i.e., employers with an average of 500 or fewer full time employees in 2019).
- **Example:** an employer who is eligible for a $10,000 retention credit but has an employment tax liability of $8,000 for the relevant quarter may withhold the $8,000 and use Form 7200 to request an advance of the remaining $2,000.

How can I claim the Retention Credit retroactively for 2020?

- Employers who received a PPP loan in 2020 may be eligible for the Employee Retention Credit and can claim it retroactively.
- Employers who filed quarterly tax returns in 2020 but did not claim the retention credit can now file a claim for a refund using a Form 941-X, *Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund*, for a past calendar quarter.

Where can I get more information?

- IRS Frequently Asked Questions:
  - https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act
- IRS Guidance on Claiming the Retention Credit:
  - https://www.irs.gov/coronavirus/employee-retention-credit
- Latest IRS Guidance on Claiming the Retention Credit Including PPP Loan Coordination:
  - https://www.irs.gov/pub/irs-drop/n-21-20.pdf

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