THE EMPLOYEE RETENTION CREDIT

MONEY LEFT ON THE TABLE?

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1

BACKGROUND

- FIRST PASSED BY THE CARES ACT IN MARCH 2020 – GENERALLY PROHIBITED FOR ANY EMPLOYER WHO OBTAINED A PPP LOAN
- ENHANCED BY TCDTRA IN DECEMBER 2020 – CHANGED TO ALLOW IF A PPP LOAN WAS OBTAINED BUT USING DIFFERENT WAGES AND MODIFIED AND EXTENDED TO JUNE 30, 2021
- FURTHER ENHANCED BY ARPA IN FEBRUARY 2021 – FURTHER MODIFIED AND EXTENDED TO DECEMBER 31, 2021

2

PURPOSE

- PROVIDES A CREDIT TO EMPLOYERS WHO RETAINED STAFF EVEN THOUGH BUSINESS DECLINED, OR OPERATIONS WERE AFFECTED BY GOVERNMENT ORDERS

3

ELIGIBLE EMPLOYER

2020

- OPERATIONS WERE FULLY OR PARTIALLY SUSPENDED DUE TO GOVERNMENT ORDERS AFFECTING COMMERCE, TRAVEL OR SIZE OF GATHERING

OR

- REVENUES FOR THE QUARTER ARE LESS THAN 50% THAN REVENUES FOR THE SAME QUARTER IN 2019
  - CONTINUES UNTIL THE CALENDAR QUARTER AFTER THE FIRST QUARTER IN WHICH REVENUE EXCEEDS 80% OF SAME QUARTER FOR 2019

2021

- OPERATIONS WERE FULLY OR PARTIALLY SUSPENDED DUE TO GOVERNMENT ORDERS AFFECTING COMMERCE, TRAVEL OR SIZE OF GATHERING

OR

- REVENUES FOR THE QUARTER ARE LESS THAN 80% THAN REVENUES FOR THE SAME QUARTER IN 2019
  - IF YOU FAIL FOR A QUARTER, YOU MAY ELECT TO LOOK TO THE PREVIOUS QUARTER FOR QUALIFICATION

Note: Comparisons to 2020 are only allowed if the employer was not in business in 2019.

4

ELIGIBILITY EXAMPLE

2020

- CHURCH'S GROSS RECEIPTS FOR 2020 ARE 48% FOR QUARTER 2; 83% FOR QUARTER 3 AND 92% FOR QUARTER 4 WHEN COMPARED TO 2019.
- QUARTER 2 IS THE INITIAL ELIGIBLE QUARTER
- THAT ELIGIBILITY ENDS ON THE FIRST DAY OF THE QUARTER FOLLOWING THE QUARTER WHERE RECEIPTS ARE MORE THAN 80% COMPARED TO 2019, SO IT ENDS ON THE 1ST DAY OF QUARTER 4

2021

- CHURCH'S GROSS RECEIPTS FOR 2021 ARE 48% FOR QUARTER 1; 83% FOR QUARTER 2 AND 92% FOR QUARTER 3 WHEN COMPARED TO 2019.
- QUARTER 1 IS ELIGIBLE
- QUARTER 2 IS ELIGIBLE BECAUSE YOU ELECT TO BASE THE DETERMINATION ON THE PREVIOUS QUARTER WHICH IS QUARTER 1

5

AMOUNT OF THE CREDIT

2020

- 50% OF ELIGIBLE WAGES NOT TO EXCEED $10,000 PER EMPLOYEE FOR THE PERIOD MARCH 13, 2020 TO DECEMBER 31, 2020
- $5,000 MAXIMUM CREDIT PER EMPLOYEE FOR THE YEAR

2021

- 70% OF ELIGIBLE WAGES NOT TO EXCEED $10,000 PER EMPLOYEE PER CALENDAR QUARTER
- $28,000 MAXIMUM CREDIT PER EMPLOYEE FOR THE YEAR

6

ELIGIBLE WAGES

- WAGES AS DEFINED BY IRC SECTION 3121(A) – THE DEFINITION OF WAGES SUBJECT TO FICA TAXES
- HEALTHCARE COSTS ASSOCIATED WITH EMPLOYEES WITH ELIGIBLE WAGES AND INCLUDES ANY ELECTIVE DEFERRALS BY EMPLOYEES INTO SECTION 125 PLANS
- DOES **NOT** INCLUDE ANY WAGES PAID TO A MINISTER OR RELATED HEALTHCARE COSTS
- MAY NOT INCLUDE ANY WAGES USED TO JUSTIFY FORGIVENESS OF A PPP LOAN OR FOR THE CREDITS PROVIDED BY THE FFCRA FOR SPECIAL SICK LEAVE OR SPECIAL FAMILY LEAVE OR WORK OPPORTUNITY CREDITS
- SPECIAL RULES APPLY TO EMPLOYERS WITH MORE THAN 100 FULL TIME EMPLOYEES IN 2020 AND MORE THAN 500 FULL TIME EMPLOYEES IN 2021

7

CLAIMING THE CREDIT

2020

- THE CREDIT IS FIRST APPLIED AGAINST THE EMPLOYER'S PORTION OF THE OASDI
- EXCESS CREDIT AFTER THE ABOVE APPLICATION IS THEN REFUNDED TO THE EMPLOYER
- IF THE CREDIT IS FOR WAGES PAID FROM MARCH 13, 2020 TO MARCH 31, 2020 – CLAIM THE CREDIT ON THE FORM 941 FOR THE 2ND QUARTER OF 2020

2021

- FOR THE 1ST AND 2ND QUARTERS OF 2021, THE CREDIT IS FIRST APPLIED AGAINST THE EMPLOYER'S PORTION OF THE OASDI
- FOR THE 3RD & 4TH QUARTERS, THE CREDIT IS APPLIED AGAINST THE EMPLOYER'S PORTION OF MEDICARE TAXES
- EXCESS CREDIT AFTER THE ABOVE APPLICATION IS THEN REFUNDED TO THE EMPLOYER

Note: Amended Forms 941 may be filed to claim the credit for 2020 or the 1st or 2nd quarter of 2021.

8

CLAIMING THE CREDIT EARLY

IF THE EMPLOYER DOESN'T WANT TO WAIT FOR A REFUND FROM THEIR FORM 941, THEN THEY MAY . .

- REDUCE PAYROLL TAX DEPOSITS FOR THE QUARTER BY THE AMOUNT OF THE ANTICIPATED CREDIT. THIS REQUIRES ADJUSTMENTS TO SCHEDULE B FILED WITH THE FORM 941. SCHEDULE B IS ADJUSTED FOR THE "NONREFUNDABLE" PORTIONS OF THE CREDIT.
- SMALL ELIGIBLE EMPLOYERS MAY FILE FORM 7200 TO REQUEST ADVANCE PAYMENT OF THE CREDIT (AFTER REDUCING PAYROLL TAX DEPOSITS)

9

TERMINOLOGY

- SUSPENSION OF OPERATIONS – REQUIRES GOVERNMENT MANDATE AND NOT A SUGGESTION. CHURCHES SHOULD TAKE CARE IN EVALUATING THIS REASON FOR ELIGIBILITY IF THEY WERE DEEMED TO BE ESSENTIAL BUSINESSES
- GROSS RECEIPTS – THIS IS GROSS RECEIPTS AND THAT IS EVERYTHING INCLUDING FUNDS THAT MAY HAVE BEEN RUN THROUGH A CHURCH'S RESTRICTED ACCOUNTS AND ARE NOT IN THE REGULAR PROFIT AND LOSS STATEMENT AND GROSS PROCEEDS FROM SALES OF INVESTMENTS
- FULL TIME EMPLOYEE – USE THE DEFINITION FOR FULL TIME EMPLOYEES THAT IS IN THE ACA

10

CHOOSE PROFESSIONAL ASSISTANCE WISELY

- PROFESSIONAL ETHICS PROHIBIT THOSE WHO PRACTICE BEFORE THE IRS FROM CHARGING CONTINGENCY FEES, SO BEWARE OF THESE POTENTIAL OFFERS THEY MAY CREATE AN UNREASONABLE FEE ARRANGEMENT
- CONFIRM A PROFESSIONAL IS EXPERIENCED IN WORKING WITH CHURCHES AND IS AWARE OF THE NUANCES RELATED TO MINISTERS AND THE DEFINITION OF ELIGIBLE WAGES

11

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12

Employee Retention Credit

Are Churches Leaving Money on the Table?

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With new rules in play, churches may benefit from a much improved employee retention credit. While the maximum potential credit for 2020 is $5,000 per employee, it has been increased for 2021 to $28,000 per employee. Even though the employee retention credit is not applicable to wages paid to ministers, the credit may still provide significant resources to churches. Additionally, changes to the rules mean that even if a church reviewed the requirements in 2020, after the credit's original enactment, a fresh look is warranted today. The following information assists churches in determining if the credit is worth pursuing for 2020, 2021, or for both years.

Background

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 with the credit now available through December 31, 2021. The rules for 2020 changed at the very end of 2020 allowing more employers to benefit from the credit for 2020. 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.

Warning - Choose Professional Assistance Wisely

As with other laws, there are nuances to this credit applicable to churches and religious orgaziations easily overlooked or misunderstood. For example, the definition of eligible wages is different for churches and religious organizations than for other employers. A church should select professionals experienced in working with federal tax law and with churches and religious organizations.

Churches should beware of percentage fee arrangements charged for assisting with credit refund claims. It is tempting for advisors to pursue a percentage fee arrangement based on the ERC achieved for a client. However, percentage fee, or contingency fee, arrangements are significantly restricted by the ethics rules of IRS Circular 230 governing those who practice before the IRS and the ethics rules governing CPAs and attorneys. It is the position of the AICPA that contingency fee arrangements related to claims associated with the employee retention credit are not allowed under the current rules. Additionally, the ethics rules of Circular 230 also prohibit "unconscionable" fees, i.e., fees excessive for the services. The ERC may be substantial, so a percentage fee arrangement may easily become an “unconscionable” fee. For many employers, determining the credit may not be overly complicated and obtaining the credit may not be a time consuming task. For others, determining eligibility may be the most time consuming task taking a combination of a church’s internal staff,the church’s CPA, and/or its legal advisor.

The Employee Retention Credit for 2020

For 2020, the maximum credit equals 50% of qualified wages not to exceed $10,000 per employee. 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
- 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 is 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 an HSA through a Section 125 cafeteria plan.

Large Employer Caution – If an employer averaged over 100 full-time employees during 2019, qualified wages (as defined above) are limited to wages associated with employees who performed no 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 moves 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, since no services were performed for them. (Provided the wages were not utilized to justify forgiveness of a PPP loan.)

Employers cannot double dip into the pandemic benefit pool, so wages **not** eligible for the ERC 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.

End of Eligibility
For 2020, if eligibility is based on a decline in revenue, the significant decline in revenue ends with the first calendar quarter that follows the calendar quarter in which the revenue of the organization exceeds 80% or more of the revenue for the comparison quarter in 2019.

> Example: A church's gross receipts for the second, third and fourth quarters of 2020 were 48%, 83% and 92% respectively of its comparative quarters for 2019. The church's significant decline in revenue is deemed to end on the first day of the calendar quarter following the quarter in which the gross receipts are above 80% of the 2019 comparative quarter. Therefore, the church can claim the credit for the second quarter and the third quarter of 2020.

The result is that an employer may be eligible for the credit in a quarter that one would normally be considered as ineligible.

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. This is a significant increase over the 2020 credit amounts.

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% of the revenues in 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. This election provides an additional quarter that may be eligible beyond what may be normally considered.) 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 HSA through a Section 125 cafeteria plan.

Large Employer Caution -For employers of fewer than 500 full-time 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 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 for the credit 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 for the 3rd and 4th quarters of 2021, it is claimed against the employer portion of Medicare taxes. 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 may claim the credit on an 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.

Cautions in Working with 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. It is best to seek legal counsel when reviewing the applicable governmental orders.

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 statements of revenue and expenses because these statements only report budgeted revenue and expenses. However, this accounting treatment does not remove the 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 statement of revenue and expenses 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 Employee

For testing the 100 full-time employees for 2020 and the 500 full-time employees for 2021, the definition of a full-time employee under 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 employees (or 100 full-time employees for 2020).

Filing an Amended Form 941

Amending the Form 941 for any applicable quarter to claim the credit requires filing a Form 941-X for the applicable quarter. Most Forms 941-X must be filed on paper forms. The processing of any paper returns is proceeding slowly at the IRS. Additionally, the IRS must have processed the original Form 941 for the quarter before it will process a Form 941-X for the same quarter. Since the IRS is still behind in processing paper filed returns, any Form 941-X associated with a paper filed Form 941 not processed will be slowed in its own processing.

Extension of the Statute of Limitations

Forms 941 claiming the ERC will have an extended statute of limitations. For 2021 returns, the 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.

Summary

All churches and nonprofits should review operations to determine if the employee retention credit is available. With the rule changes and a potential credit of $5,000 per employee for 2020 and $28,000 for 2021, the credit is worthy of review by all employers. Representing a change from its initial creation, the credit is available to organizations receiving a PPP loan. 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.