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EMPLOYEE RETENTION CREDIT

*By Mike Batts, CPA*

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## Countless Churches, Schools, Ministries, and Other Nonprofits Are on Track to Miss Out on Very Substantial Federal Aid

### Many Aren't Carefully Analyzing Eligibility Requirements for the Employee Retention Credit

By Mike Batts, CPA

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To date, our firm has assisted nonprofit organizations in validly claiming millions of dollars of federal aid in the form of the Employee Retention Credit (ERC).

*On average, clients we have helped to claim the ERC are receiving benefits in the hundreds of thousands of dollars. Some individual organizations qualify for an ERC in the millions of dollars.*

The ERC is a form of federal relief/stimulus/financial aid available to eligible employers, including nonprofit organizations.

An eligible employer receives the ERC funds by way of a payroll tax refund. If the amount of the ERC for which the employer qualifies exceeds the employer's applicable payroll taxes for the relevant period, the employer still receives the full amount of the ERC from the federal government. The federal government refers to this as a "refundable credit." A better term that might more accurately describe such payment is an "excess refund." That is, the federal government provides a refund in the amount of the ERC even if it exceeds the employer's applicable payroll taxes for the relevant period. The reality is that the ERC has nothing to do with an organization's payroll taxes. Congress simply chose the payroll tax refund process as the way to deliver the ERC to eligible employers.

The ERC can be as much as \$5,000 per employee for 2020 and as much as \$21,000 per employee for 2021. That is a very significant benefit for those employers who qualify.

In conversing with nonprofit leaders across the country, it is my observation that many, many eligible churches, schools, ministries, and other nonprofit organizations are on the path to missing out on the opportunity to receive this very significant federal aid.

The reason for this is simple...many nonprofit leaders are not carefully analyzing the ERC eligibility requirements in detail and evaluating their circumstances to determine if they qualify for the aid.

The purpose of this article is not to describe the details of the ERC and its eligibility criteria. Our firm has done that in a separate article available on our website.<sup>1</sup> Rather, this article serves as my attempt to shout from the rooftops about the availability of this poorly understood form of federal aid and to help spur nonprofit leaders to look carefully at their situations to see if their organizations qualify.

While I won't get into the details of eligibility criteria here, I do want to hit some high spots. The ERC is available to employers who experience either or both of the following effects of the pandemic between March 13, 2020, and September 30, 2021:

- a significant decrease in "gross receipts" for any calendar quarter as compared to the same quarter (generally) in 2019
- or
- suspension of more than a nominal part of operations due to government orders.

I would point out that for this purpose, the term "gross receipts" is defined very broadly to include:

the gross amount received by the organization during its accounting period from all sources without reduction for any costs or expenses,

<sup>1</sup> Source: <https://nonprofitcpa.com/the-employee-retention-credit-a-potential-source-of-sizable-federal-aid-for-qualifying-nonprofits/>

including, for example, cost of goods or assets sold, cost of operations, or expenses of earning, raising, or collecting such amounts.

Thus, gross receipts include, but are 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.

*For example, gross receipts for any period include not only regular contributions received but also the receipt of noncash assets (real estate, publicly traded securities, etc.) given as gifts, as well as the gross sales proceeds from selling such assets after your organization receives them. Gross receipts also include gross proceeds from the sales of securities that regularly occur in the management of an investment portfolio. Gross receipts would exclude unrealized and realized gains or losses (but would include the gross proceeds from asset sales). Gross receipts also exclude PPP loan proceeds.*

## Key Points

1. To qualify for the ERC during the period March 13, 2020, through December 31, 2020, based on a reduction in gross receipts, gross receipts for the applicable quarter of 2020 must be less than 50% of the amount for the corresponding quarter of 2019. Very few organizations had that much of a drop in gross receipts, and few organizations qualify for the ERC in 2020 based on the gross receipts reduction criterion.
2. To qualify for the ERC during the period January 1, 2021, through September 30, 2021, based on a reduction in gross receipts, gross receipts for the applicable quarter of 2021 must be less

than 80% of the amount for the corresponding quarter of 2019. And there are special, flexible rules for determining which quarter of 2021 the employer can use as a comparison. Given the easier (as compared to 2020) criterion of only having to have a reduction of gross receipts of more than 20%, and given the flexibility allowed in selecting the comparison quarter, many organizations qualify for the ERC based on the gross receipts reduction criterion in 2021.

## Example

Pine Church had gross receipts in the first quarter of 2019 of \$1,000,000, which included an estate gift of \$200,000 and gross proceeds from stock sales of \$100,000. In the first quarter of 2021, Pine Church had gross receipts of \$700,000, which included gross proceeds from stock sales of \$50,000. Pine Church had gross receipts in Q1 of 2021 of less than 80% of its gross receipts in Q1 of 2019. Accordingly, Pine Church qualifies for the ERC for Q1 of 2021 based on the gross receipts reduction criterion. Additionally, due to the applicable flexibility rules, Pine Church also qualifies in Q2 of 2021 – even if its gross receipts in Q2 of 2021 were not less than 80% of the gross receipts for Q2 of 2019. *Note here that the mechanical, mathematical test causes Pine Church to qualify. The combination of Pine Church's lower "regular" gross receipts in Q1 of 2021, together with the estate gift received in Q1 of 2019, makes the math work. Only a careful analysis of quarterly gross receipts would reveal the church's eligibility.*

*Other similar scenarios that could cause an organization to qualify based on the gross receipts reduction criterion include:*

- *A special fundraising or capital campaign that occurred in 2019 that did not recur in 2020 or 2021*
- *Sales of significant assets in 2019 that did not recur in 2020 or 2021*

***Note that, in many cases, only a quarterly analysis of gross proceeds in the applicable quarters as compared to the corresponding quarters of 2019 would reveal an organization's eligibility for the ERC. Comparing numbers only on an aggregate annual basis is not adequate.***

3. To qualify for the ERC during any eligible period based on having suspended more than a nominal part of an organization's operations due to government orders (hereinafter, I will refer to this as the "government orders criterion"), the organization did not have to "shut down." Additionally, the "government orders" that caused the suspension of more than a nominal part of an organization's operations are not required to have been orders directed specifically at or to the organization. They simply need to have been orders that caused a suspension of more than a nominal part of the organization's operations.

#### Example

Pine School is a nonprofit school. The school operates a variety of interscholastic activities and competitions, including, but not limited to, academic competitions, art competitions, band competitions, athletic competitions, college fairs, and other similar activities. Pine School's interscholastic activities extensively include engagement by area public schools. Pine School is in a jurisdiction where neither state nor local authorities issued mandates regarding school activities for private schools. However, the county school boards in Pine School's county and surrounding counties mandated that all public schools cease interscholastic activities from mid-March of 2020 through the end of 2020 and for part of 2021. As a result of the mandatory cessation of interscholastic activities by area public schools, Pine School's interscholastic activities ceased...regardless of whether Pine School had a desire to continue them since such activities required engagement and participation by area public schools. Accordingly, Pine School may conclude, under the advice of its legal counsel, that government orders caused the cessation of its interscholastic activities. The school was effectively required to suspend its interscholastic activities due to government orders, even though no government entity ever ordered the school directly to suspend any part of its activities. If the school's interscholastic activities constituted more than a nominal part of its operations, the school qualifies for the ERC for the period during which the activities were suspended due to government orders.

*Other scenarios that may, depending on the circumstances, cause an organization to qualify under the government orders criterion:*

- *A nonprofit charity that serves the elderly in person operates in a county that mandated the closure of its facilities during part of 2020. The organization was not able to operate in a comparable manner by working remotely.*
- *A church operates in a city that mandated no physical assembly of groups of more than 10 people, including churches, for a period of time during 2020. While the church continued to offer certain services through online channels, such services were not comparable to the church's customary activities; and the church had to completely cease its fellowship and children's ministry activities during that time.*
- *A church operates in a city that mandated social distancing of at least six feet in all gatherings during a certain period. The church's facility size was such that the mandate made it impossible to continue its customary activities due to capacity constraints imposed by the city mandate. While the church continued to offer certain services through online channels, such services were not comparable to the church's customary activities; and the church had to completely cease its fellowship and children's ministry activities during that time.*
- *A nonprofit school was forced to suspend its international student program due to government orders banning international travel for a range of time. The school may conclude, under the advice of its legal counsel, that government orders caused the cessation of its international student program.*
- *A nonprofit school operates in a county that ordered a cessation of all extracurricular gatherings for private schools, including athletics, drama, chorus, and other similar activities during a certain period.*

## **Aggregation of Related Organizations for ERC Purposes**

The law and guidance surrounding the ERC are not abundantly clear with respect to whether affiliated nonprofit organizations are required or permitted to aggregate their activities and operations in determining eligibility for or the amount of an ERC claim. For example, assume that a charity has the authority to control its separately incorporated foundation via the appointment of the foundation's board members or that a church has such authority with respect to its separately incorporated school. In such cases, are the "parent" organizations required or permitted to aggregate their activities and operations with their "subsidiary" organizations for ERC purposes? The answer could make a huge difference in eligibility for, or the amount of, an ERC claim depending on the circumstances.

For example, assume that a charity had 450 full-time employees in 2019 and that its subsidiary foundation had 70 employees in 2019. Aggregation would have a very negative effect on the potential amount of an ERC claim since the total 2019 full-time employee count is over 500.

On the other hand, assume that a church and its subsidiary school had a total of 300 full-time employees in 2019 (200 in the church and 100 in the school). Assume further that the school (but not the church) had a partial suspension of its operations due to government orders during the first three quarters of 2021. Based on IRS guidance as we understand it, aggregation of the church and the school would mean that the church is deemed to have a partial suspension of operations due to government orders for the same period as the school for ERC claim purposes. Aggregation would cause the church to be eligible for a very sizable ERC claim, even though it would not otherwise qualify on its own.

Since there is very little official guidance on the matter of aggregation of affiliated tax-exempt entities for ERC purposes, our firm works with our clients on a case-by-case basis in addressing this issue, together with special legal counsel. Thus far, legal counsel seems to be generally advising our clients that aggregation is required in situations where one exempt organization controls another exempt organization...except in cases where one of the exempt organizations is a church. Where one of the entities is a church, counsel seems to generally

be concluding that the church may elect to aggregate but is not required to do so. Notwithstanding my commentary here about conclusions generally being reached by our clients' legal counsel, I would reiterate my strong recommendation that this issue should be addressed case-by-case and that special legal counsel should provide guidance to each affiliated group on the matter of aggregation – especially if the amounts of ERC that would be claimed would be significantly affected by the conclusion.

## **Frequently Asked Questions**

Following are a few questions that often arise from nonprofit leaders about the ERC:

### **1. Did my organization have to experience a reduction in revenue in order to claim the ERC?**

*No. A qualifying reduction in "gross receipts" (see above) is one way an organization can qualify. Congress also allows organizations to qualify that suspended more than a nominal part of their operations due to government orders. If an organization qualifies under the government orders criterion, it is not required to have experienced a reduction in gross receipts to qualify for the ERC.*

### **2. What are "government orders" for purposes of the ERC?**

*According to the IRS (Notice 2021-20, Q&A Item 10), "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.*

*We are aware that some service providers assisting employers in claiming the ERC have different perspectives regarding what constitutes government orders. In some cases, it seems that some service providers are considering government agency recommendations to constitute government orders. We have not found authoritative guidance to support that position. For situations in which it is not clear whether government orders apply or not, the organization should consult its legal counsel for advice.*



**3. My organization obtained a PPP loan that was forgiven. Can we still claim the ERC?**

*An organization that obtained a PPP loan that was forgiven is not prohibited from claiming the ERC. In claiming the ERC, however, you cannot use the same wages that you used to qualify for PPP loan forgiveness. Many organizations that obtained PPP loans that were forgiven have validly claimed the ERC with respect to wages other than the wages used to qualify for PPP loan forgiveness.*

**4. My organization qualifies based on the technical criteria, but we weathered the pandemic reasonably well, and we're not sure we feel right about claiming the credit. Should we?**

*Only your organization's leadership can answer that question. Congress was intentional about allowing the credit for either a reduction in gross receipts (with a specific definition and flexibility) or a suspension of part of operations due to government orders. Clearly, Congress created this benefit with definitions and criteria that allow employers (including both businesses and nonprofits) to qualify for it even if they did not have a significant reduction in revenue or experience financial impairment. Congress had plenty of lawyers and tax professionals involved in drafting the legislation, and they made specific choices about the eligibility criteria – going out of their way to be generous in some of the criteria and definitions. Aside from meeting the technical criteria for claiming the credit, an organization is not required to otherwise demonstrate financial need or impairment.*

**5. Are there other rules beyond what you have described in this article that bear on qualifying for the ERC and determining the amount of it?**

*Yes, absolutely. For our firm's article describing those rules, please visit our website.<sup>2</sup> Our article also provides links to relevant IRS guidance.*

<sup>2</sup> Source: <https://nonprofitcpa.com/the-employee-retention-credit-a-potential-source-of-sizable-federal-aid-for-qualifying-nonprofits/>

**6. The ERC is available for part of 2020 and part of 2021. It's now June of 2022. Can I still claim it?**

*Yes. Employers generally have until April 15, 2024, to claim the ERC for 2020 and until April 15, 2025, to claim it for 2021.*

**7. Will the names of employers claiming the ERC be made public like PPP loans were?**

*Information about payroll tax returns and refunds is confidential under federal law. We have seen no guidance or information that would cause us to believe that the names of organizations claiming the ERC will be made public.*

## **Concluding Comments**

There are many details involved in determining whether an organization qualifies for the ERC and, if so, the amount for which it qualifies. As noted previously, the amount of the ERC benefit for an organization can potentially be very significant. Given the potential size of the available benefit, nonprofit leaders should ensure that they have carefully evaluated whether they qualify for the ERC.

## **BMWL Can Help**

BMWL has a task force that assists clients in addressing the ERC and certain other pandemic-related matters. That team can be reached directly at [C19Taskforce@NonprofitCPA.com](mailto:C19Taskforce@NonprofitCPA.com).