This article presents general guidelines for Georgia nonprofit organizations as of the date written and should not be construed as legal advice. Always consult an attorney to address your particular situation.

Employee Retention Credit for Small Nonprofits

The Employee Retention Credit ("ERC") was established by the CARES Act. It provides another option to help encourage eligible employers to keep employees on their payroll through the use of payroll tax credits during the COVID-19 pandemic. On December 27, 2020, The Economic Aid Act ("EAA") amended the ERC to make it a much more useful option for eligible small nonprofits. This article will cover the original ERC under the CARES Act (the "Original ERC") and will explain the ERC's expansion under the EAA (the "Expanded ERC") for employers with less than 100 employees.

The Original ERC (2020)

The ERC is a payroll tax credit. The credit offsets the employer's share of social security taxes (i.e. the 6.2% social security tax).

What are the Eligibility Requirements for the Original ERC?

Small tax-exempt organizations **with less than 100 full-time employees** are eligible. A full-time employee is an employee who, for any calendar month in 2019, worked an average of at least 30 hours per week or 130 hours in the month.[1]

However, employers that obtained a First Draw Paycheck Protection Program ("PPP") or COVID-19 Economic Injury Disaster Loan are not eligible for the Original ERC under the CARES Act.

To qualify, the employer must meet one of two tests in a 2020 calendar quarter:

1. The employer's business or programs were fully or partially suspended by a COVID-19-related government order during the calendar quarter ("government order test") OR
2. The employers' gross receipts are less than 50% for the same quarter in 2019 ("gross receipts decline" test).

While the CARES Act did not originally define gross receipts, it has since been defined as: contributions, gifts, grants, dues or assessments, sales or receipts from unrelated business activities, sale of assets, and investment income (e.g., interest, dividends, rents, and royalties). Gross receipts are not reduced for any associated costs or expenses.[2]

[1] This is the same definition as in Internal Revenue Code section 4980H.
[2] This is the same definition as in Internal Revenue Code section 6033.

An employer may take the Original ERC for the quarter in which it first meets the gross receipts decline test and for the quarters thereafter through and including the first quarter in which gross receipts are greater than 80% of the same calendar quarter in 2019. The IRS provides the following example:

Example: Employer's gross receipts were $100,000, $190,000, and $230,000 in the first, second, and third calendar quarters of 2020, respectively. Its gross receipts were $210,000, $230,000, and $250,000 in the first, second, and third calendar quarters of 2019, respectively. Thus, Employer's 2020 first, second, and third quarter gross receipts were approximately 48 percent, 83 percent, and 92 percent of its 2019 first, second, and third quarter gross receipts, respectively. Accordingly, Employer 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 percent of the same quarter in 2019) and ending on the first day of the third calendar quarter of 2020 (the quarter following the quarter for which the gross receipts were more than 80 percent of the same quarter in 2019). Thus, Employer is entitled to a retention credit with respect to the first and second calendar quarters.

New organizations (those not in existence for all or part of tax year 2019) are permitted to receive the Original ERC. The IRS provides specific details for such organizations in its ERC FAQs. For more details, see the IRS ERC FAQs - *Determining When an Employer Has a Significant Decline in Gross Receipts Question 44*.

How is the Original ERC Calculated?

Only qualified wages are eligible for the credit. Qualified wages include:

- Wages paid after March 12, 2020, and before January 1, 2021
- Cash payments including regular salary and hourly wages (typically amounts listed in W-2 Box 5)
- Health benefits including both costs paid by the employer and costs paid by the employee with pre-tax salary reduction (typically amounts listed in W-2 Box 12)
- Vacation, parental, family, medical or sick leave or other PTO

The amount of the tax credit is 50% of qualifying wages paid up to $10,000 per employee per year in total. Thus, the maximum credit per employee in 2020 is $5,000 ($10,000 x 50%).

Certain wages are not eligible for the credit. Employers that obtained tax credits under the Families First Coronavirus Relief Act or other federal tax credits cannot apply the Original ERC to the same wages. In addition, 401(k) matching contributions and any state or local taxes that are assessed on compensation paid to employees do not count as qualified wages.

How the Credit Works for the Original ERC

The Form 941 Employer's Quarterly Federal Tax Return has been modified to calculate the Original ERC along with other CARES Act and other Coronavirus-related credits. The Original ERC is calculated in two parts: an employer's nonrefundable tax credit and the employer's refundable tax credit. A "nonrefundable tax credit" means an employer obtains a refund only up to the amount the employer owes in tax. A "refundable tax credit" means an employer gets a refund even it it's more than the employer owes in taxes.

STEP 1: Determining the employer's share of social security tax to be applied against the Original ERC.

> The revised Form 941 Worksheet 1 determines the employer's share of social security tax on employee wages. Then, the social security tax amount is multiplied by .5. This amount is then reduced by any other federal credits for that same tax, with the amount left equal to the final employer share of social security tax remaining. For example, total employee wages are $5,000. Employer social security taxes are $5,000 x .124 = $620. Then $620 x .5 = $310. Employer has no other credits so the amount of the employer's share of social security tax remaining is $310.

STEP 2: Determining the Original ERC.

> This is simply adding the qualified wages together and multiplying by .5. Using the example above, the employer has $5,000 wages and $150 in qualified health plan expenses amounting to total qualified wages of $5,150. $5,150 x .5 = $2,575. $2,575 is the amount of the employer's Original ERC for the quarter.

STEP 3: Determining the nonrefundable and refundable portions of the Original ERC.

> Once the Original ERC is determined, that amount is compared against the employer's share of social security tax remaining and the smaller of the two is the employer's nonrefundable portion of the Original ERC. In this example, $310 is smaller than $2,575, so the nonrefundable portion of the Original ERC is $310. Then the nonrefundable portion is subtracted from the employer's Original ERC to determine the refundable portion of the Original ERC. In this example, $2,575 - $310 = $2,265.

STEP 4: Determining total employment taxes due or any overpayments made.

> The employer's total employment taxes including both social security and Medicare taxes are then added up accounting for certain adjustments. In our example, the social security taxes were $620 and the Medicare taxes are $5,000 of wages x .029 = $145. Thus, all employment taxes are $620 + $145 = $765. Then, any nonrefundable tax credits are subtracted from that amount ($765 - $310 = $455) which determines all taxes owed, and in our example, $455 in employment tax is owed. So, the nonrefundable portion of the Original ERC reduces the amount of taxes owed.

Assuming the employer has been making its regular tax deposits throughout the quarter when it pays its payroll, the employer should have paid the full $765. This amount is then added to the refundable portion of the Original ERC to determine the total deposits and credits. In this example, $765 +$2,265 = $3,030. The $3,030 is considered the total amounts attributed towards employer's employment tax bill. However, if the employer used Form 7200 and requested an advance credit, that amount will be subtracted from the total amounts attributed towards the employer's tax bill.

The final step is to subtract from the $3,030 the amount of employment taxes owed. Using our example $3,030 - $455 = $2,575 which is an overpayment of employment taxes by employer. This amount can be applied to the next Form 941 taxes or the employer may request a refund.

Employers can choose to not make deposits in anticipation of the receiving the credit and no failure to deposit penalty will be applied. In our example, if employer paid no taxes, the total amounts attributed towards the employer's tax bill would be $2,265 instead of $3,030 and the resulting overpayment would be $1,810.

It is very important for employers to coordinate with their payroll providers to obtain the Original ERC.

Documentation That Should be Maintained for the Original ERC

While the CARES Act doesn't provide a specific list of documentation, employers should create a system to gather and keep for four years the following information and records:

- How the employer figured the amount of an Original ERC for each individual employee or group of similarly situated employees;
- How the employer figured the amount of qualified plan expenses that it allocated to wages; and
- The employer's eligibility for the Original ERC based on suspension of operations or a significant decline in gross receipts.

The Expanded ERC (2021)

The EAA made significant changes to the ERC, making it a much better option for small nonprofits. The changes are described below. To the extent there is no specified change or only a partial change, the Original ERC parameters apply.

Eligibility Requirement Changes in the EAA

The EAA now provides that even if an employer received a PPP payment, the employer is allowed to take an ERC so as long as the ERC is used for wages **not** paid with PPP funds. This change is effective retroactively to the enactment date of the CARES Act (March 27, 2020). So, small nonprofits can amend their 2020 Form 941 returns and take the credit if it now applies. The 50% credit and $10,000 maximum for 2020 per employee still applies for 2020.

The availability of the ERC has been expanded through June 30, 2021. For any quarter in 2021, the "decline of gross receipts" test has been reduced from a 50% decline in gross income to a 20% decline and allows employers to compare gross receipts from either the same quarter in 2019 or the immediately preceding quarter in determining eligibility.

Changes in How to Calculate the ERC

Qualified wages now include wages paid in the first and second quarter of 2021.

Further, for small nonprofits with less than 100 employees, the ERC is now equal to 70% of qualified wages paid to employees (whether actually working or not) after December 31, 2020, and before July 1, 2021 (which is an increase from 50% for wages in 2020). During the first two quarters of 2021, a maximum of $10,000 in qualified wages for each employee **per calendar quarter** may be counted in determining the 70% credit. Therefore, the maximum tax credit that can be claimed by an eligible employer in 2021 is $7,000 per employee per calendar quarter. (This is a huge increase from the $10,000 maximum per employee per year in 2020.)

Changes to How the Credit Works

The credit works in the same basic way as described above under the Original ERC. Advance payment of credits to small nonprofits are also permitted, provided that such advance payments do not exceed 70% of the average quarterly wages paid by the employer in 2019. It is expected that more guidance will be provided in this area.

For a chart comparing the Original ERC and the Expanded ERC by Clifton Larson Allen, click here.

Small nonprofits should review their gross receipts, employee counts, operations and PPP loan usage to determine the extent to which they may be eligible for the Original ERC or enhanced or increased credits or new credits under the Expanded ERC.