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Nonprofits, Don't Overlook Your Potential Refund Under the Employee Retention Tax Credit

By: Steven M. Woolf

With half a dozen federal COVID relief laws coming out of Washington since the pandemic began – and each new law amending the prior ones – it's hard to keep up with which provisions provide the biggest benefits for the nonprofit bottom line. That's the case with the Employee Retention Tax Credit (ERTC), created by the CARES Act in late March 2020. As originally enacted, nonprofits and other employers could not claim the ERTC if they also received a Paycheck Protection Program (PPP) loan. In virtually every case, the PPP loan was more valuable than the ERTC. At year end, however, Congress changed this restriction so employers can now claim the ERTC for wages not part of their forgiven PPP loan. In short, nonprofits that ignore the ERTC may be leaving money on the table that could be well spent on mission.

What is the Employee Retention Tax Credit?

Designed to provide a financial incentive to keep employees on the payroll despite the hardships caused by the COVID-19 pandemic, the ERTC is a *refundable* tax credit in 2020 for an eligible employer's portion of Social Security (payroll) taxes. For 2020, eligible employers were those that met one of two requirements: (1) operations were either fully or partially suspended by a government order limiting commerce, travel, or group meetings due to COVID-19; or (2) gross receipts were less than 50 percent of those for the same quarter in the previous year. The maximum amount of the ERTC was limited to 50 percent of $10,000 of an employee's qualified wages or $5,000 per qualified employee per year. For smaller eligible employers (100 or fewer full-time employees), qualified wages were those paid to any employee. For a large employer (more than 100 full-time employees), qualified wages were those paid to an employee for time that the employee was not providing services to the employer.

Can you claim the ERTC for 2020?

Provisions in the Consolidated Appropriations Act (CAA) passed by Congress at the end of December 2020 now permit qualifying nonprofits and other employers that received PPP loans to retroactively apply for the ERTC -- as long as they are not claiming the ERTC for the same wages that were used for PPP forgiveness.

An employer can't claim PPP forgiveness and an employee retention tax credit for the same payroll expenses, so it is important to maximize the rules under each program. In calculating which expenses to claim under either the PPP or ERTC, it's important to keep in mind the PPP 60/40 rule. Last June, Congress directed that employers seeking loan forgiveness must spend at least 60 percent of their PPP loans on payroll expenses. Employers are free to devote the whole loan to payroll expenses, but are permitted to apply up to 40 percent on other qualified non-payroll expenses such as rent and utilities. As the IRS recently explained in an example included in Notice 2021-20 (released March 1, 2021), an employer that includes all of its payroll expenses in a PPP loan application, even if there were other non-payroll expenses that would have also counted, can't later claim the payroll costs under ERTC.

The IRS guidance demonstrates that the nonprofits and other employers should attempt to maximize the amount of qualified non-payroll expenses (up to the 40 percent statutory limit) when applying for PPP loan forgiveness in order to ensure that excess payroll expenses can produce the greatest amount of the ERTC.

How has the ERTC changed for 2021?

The year-end COVID relief law, combined with the newly enacted American Rescue Plan Act, extend and significantly expand the ERTC. For the each quarter of 2021:

- Employers need only show a reduction in gross receipts of 20 percent compared to either the same quarter in 2019 or the prior quarter compared to that quarter in 2019. (Note that the partial or full government shut-down order alternative also still applies.)
- The credit for 2021 is now 70 percent of the qualified wages per employee up to $10,000 of wages per quarter, for a per-quarter refundable credit of $7,000 per eligible employee.
- The definition of large employer is now more than 500 full-time employees, meaning that more nonprofits and other businesses will be able to claim the refundable credit for more employees.

How does the ERTC work with PPP Second Draw loans?

Employers applying for and receiving PPP Second Draw loans can also claim the expanded ERTC. However, similar rules apply that prevent payroll costs that are eligible for the ERTC to be eligible for PPP loan forgiveness and vice versa. Similar strategies of maximizing non-payroll expenses should be applied.

For more information on the ERTC, contact your state association of nonprofits.

NOTE: After this article was printed the IRS issued guidance regarding claiming an expanded ERTC for the first and second quarters of 2021. The following summarizes that guidance:

The Internal Revenue Service has issued guidance on the employee retention tax credit (ERTC) for the first two quarters of 2021 (See IRS Notice 2021-23). The notice provides additional guidance on the ERTC which was extended and expanded by the budget bill passed by Congress at the end of last year. Organizations are eligible to claim the expanded ERTC if they: (1) have a decline in gross receipts of 20 percent or more in the first or second quarter of 2021; or (2) are subject to a full or partial *government-ordered shutdown due to the COVID virus. Notably, the ERTC is increased to 70 percent of the first $10,000 of qualified wages per quarter or up to $14,000 per employee for the first two quarters of 2021. The notice also provides guidance for eligible "small employers" (those with 500 employees or less) that can request an advance payment of the credit.*

The American Rescue Plan enacted in mid-March extended the ERTC for the remainder of 2021.

The Employee Retention Tax Credit for the fourth quarter of 2021 was retroactively repealed halfway through the quarter after the Infrastructure Investment and Jobs Act was signed into law November 15, 2021. The ERTC Reinstatement Act (H.R. 6161 /S.3625) would restore eligibility for the fourth quarter of 2021.

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