

The Employee Retention Credit – Fraudulent and Improper Claims Will Be the Focus of Extensive IRS Examinations in the Next Few Years (IRS Commissioner: “A Terrible Scenario is Unfolding”)

By Mike Batts, CPA

August 29, 2023

In yet another in a series of escalating warnings, the IRS has sounded the alarm in a big way about fraudulent and improper Employee Retention Credit (ERC) claims in its [Information Release 2023-135](#) (the IR) issued on July 26, 2023. In the IR, IRS Commissioner Danny Werfel was quoted as saying, “...the agency has entered a new phase of increasing scrutiny on dubious submissions while reviewing consumer warnings against aggressive marketing.”

Our firm has [written](#) extensively and spoken publicly on the problematic issues associated with fraudulent and improper ERC claims. I have stated that the matter may represent “[the biggest tax fraud scandal of all time](#)” – a belief I continue to hold.

In a new twist, [Commissioner Werfel mentioned the possibility of the IRS and Treasury Department proposing legislative changes to help deal with the problems. Werfel specifically mentioned the possibility of asking Congress to set an earlier ending date for claiming the ERC – something we predicted in our \[Alert dated March 8, 2023\]\(#\)](#). Werfel’s full comment on that point was:

This was not how the law was meant to work, and Congress can help with this situation. We will work with Treasury to explore legislative solutions we can share with Congress to help address fraud and error, including potentially putting an earlier ending date for businesses to claim the credit and increase IRS oversight of return preparers.

[In light of the possibility that Congress could soon curtail the time period for filing ERC claims \(something I see as likely\), organizations that validly qualify for the ERC should file their claims as soon as possible. Under current law, claims for the ERC related to 2020 can be made through April 15, 2024, and claims related to 2021 can be made through April 15, 2025. I find it difficult to believe that Congress will allow the claims period to remain open for that long.](#)

[I also expect that Congress will extend the period of time during which the IRS can examine ERC claims.](#)

[Werfel also stated, “A terrible scenario is unfolding that hurts everyone involved – except the promoters.” The IR noted that the IRS Criminal Investigation Division is working to identify fraud and promoters of fraudulent claims.](#)

In a recent Tax Forum, Werfel told participants the IRS remains deeply concerned about the impact of the ERC on tax professionals who are doing the right thing while their clients are being lured by aggressive marketing claims.

“Hard-working tax professionals who play by the rules see their clients go elsewhere, lured by false promises and wild exaggerations,” Werfel added. “The resulting number of claims prevents the IRS from doing other priority work. But the biggest risk is being taken by the promoters pushing these schemes and businesses filing these claims. This is an area where we urge caution; those improperly claiming the credit could face follow-up action from the IRS.”

The IR also provides warning signs of aggressive ERC marketing, information on how promoters lure victims, and information on how employers can protect themselves from fraudulent ERC promoters. One particularly poignant element of the IRS’s guidance in the IR is its reference to “wildly aggressive suggestions” from ERC marketers. As an agency known more for its subdued tones in communications – even about serious issues – the IRS’s use of such language in an official document illustrates the unique level of concern it has over the problematic issues surrounding fraudulent ERC claims.

Key considerations in selecting a vendor/provider to evaluate or assist your organization with an ERC claim:

- Will the vendor provide your organization documentation with adequate detail to support the claim in the event of an IRS examination? Your organization is responsible for the validity of the claim.
- Will the vendor provide adequate documentation to support how the ERC claim is reported in your organization’s audited financial statements? [This can be a rather immediate issue.]
- Who will represent the organization in the event of an IRS examination? [Will the vendor be in existence/accessible in the event you have an IRS examination?]
- What if your ERC claim is denied in whole or in part as a result of an IRS examination after you have received the funds and paid the vendor? Will the vendor be accessible if you have a claim against them for a return of your fees? What evidence is there that the provider will exist and/or be willing or able to pay at that time? What if your organization has already spent the funds?
- Who actually signs the amended payroll tax returns claiming the credit under penalty of perjury?
- Is there any potential for a criminal investigation or penalties?
- It is likely that providers found by the IRS to be helping employers make improper claims will be subject to IRS examinations of their entire client base.

What should an employer do if it is concerned that it may have made an invalid or improper claim?

- Have the claim evaluated by an independent, trusted source.
- Re-amend returns if necessary – before the initiation of an IRS examination.

Press release: BMWL forms new team to represent nonprofits in IRS Employee Retention Credit audits

On July 28, 2023, BMWL managing partner, Mike Batts, announced the formation of a special team within the firm to represent nonprofit organizations in IRS audits of Employee Retention Credit (ERC) claims.

“It is both clear and understandable that the IRS is gearing up in a major way and will be conducting an extensive number of examinations over the next few years of employers who claimed the ERC,” said Batts. “Given the extraordinary amount of fraud and impropriety that has arisen in the arena of ERC claims, the IRS must engage in a big way to protect Americans from bad actors who are effectively stealing taxpayer dollars. It’s a very big deal,” added Batts.

At the beginning of this year, Batts went on record stating that improper ERC claims may represent “the biggest tax fraud scandal of all time.” He has also predicted that due to the massive fraud, Congress will shorten the time period during which ERC claims can be made and that Congress will extend the time period during which the IRS can audit ERC claims.

In preparation for IRS examinations of ERC claims by nonprofit organizations, Batts appointed appropriately experienced members of the firm to a new IRS ERC Audit Representation Team. The team will consist of the following professionals within BMWL:

- Mike Batts
- Michele Wales
- Kaylyn Varnum
- Sophie Chevalier
- Jessica Hebb

Members of the BMWL IRS ERC Audit Representation Team have extensive knowledge and experience in the rules surrounding the ERC, as well as extensive knowledge about the IRS audit process involving nonprofits.

“Our special IRS ERC Audit Representation Team will be giving careful and unique consideration to every aspect of the IRS examination process...including the special rules the IRS must follow in conducting an inquiry or examination of a church or association of churches,” said Kaylyn Varnum, a partner in BMWL and a senior member of the new IRS audit team. “Senior members of our team will guide the strategy in every examination. We will work with our clients to help them navigate the process in a professional manner, and of course, we will help them support and defend their valid ERC claims before the IRS,” added Varnum.

“The ERC is a great source of valuable financial aid to eligible organizations,” said Batts. “We will have to help the IRS see that valid claims made by eligible organizations are justified.”

Nonprofit organizations that have been notified of an IRS inquiry or examination in connection with an ERC claim can reach the BMWL IRS ERC Audit Representation Team at ERCAuditTeam@NonprofitCPA.com.

We Received Our ERC Refund – What Happens Next?

By Kaylyn Varnum, CPA & Mike Batts, CPA

August 16, 2023

The IRS Commissioner has commented recently¹ that the IRS has made significant progress in successfully clearing the backlog of valid ERC claims. As a result, many organizations that filed ERC refund claims have received refund checks from the IRS, often including significant interest. But given the multiple IRS communications about examining ERC claims, many organizations that have received ERC funds are understandably wondering whether there is still a risk that the IRS may challenge their refund.

The purpose of this article is to provide guidance regarding the period during which the IRS can initiate an examination of an ERC claim or otherwise recover an organization's ERC refund under current law, as well as to provide practical considerations during any period of uncertainty.

Statute of limitations for IRS examinations – A developing landscape

The ERC statute of limitations is a changing landscape. We expect that Congress will, in the coming months, extend the statute of limitations for the IRS to examine and challenge ERC claims.

For informational purposes, our current understanding of the potential exposure period for IRS claims related to the Employee Retention Credit under current law (which is subject to change) is as follows:

Statute of Limitations – 2020 ERC claims	Expires April 15, 2024
Statute of Limitations – Q1 and Q2 2021 ERC claims	Expires April 15, 2025
Statute of Limitations – Q3 2021 ERC claims	Expires April 15, 2027

This is the period during which the IRS can initiate an examination of an organization's Forms 941 or Forms 941-X that were filed to make an ERC claim. Currently, organizations have until April 15, 2024, to make an ERC claim for 2020 and until April 15, 2025, to make an ERC claim for 2021. Because the statute of limitations for IRS examinations expires on the same date that the period ends for making claims (for claims related to all periods other than the third quarter of 2021), and because of the well-known existence of massive fraud and impropriety in the ERC claims arena, we expect that Congress will, in the coming months, extend the statute of limitations for the IRS to examine and challenge ERC claims.

IRS civil lawsuits to recover “erroneous refunds”

In addition to the IRS examination process, the IRS has another tool at its disposal for recovering “erroneous

¹ Source: <https://www.irs.gov/newsroom/irs-commissioner-signals-new-phase-of-employee-retention-credit-work-with-backlog-eliminated-additional-procedures-will-be-put-in-place-to-deal-with-growing-fraud-risk>

refunds” – filing a civil lawsuit against an organization. While we believe it is unlikely that the IRS would use this tool in a significant way in recovering ERC claims, it is important for employers who have received ERC refunds to be aware of this possibility.

The period by which the IRS can file a civil suit to recover an “erroneous refund” is generally as follows:

Date by which the IRS may file a civil suit to recover an “erroneous refund” other than for fraud or misrepresentation of material facts	Two years from the date of the refund
Date by which the IRS may file a civil suit to recover an “erroneous refund” due to fraud or misrepresentation of material facts	Five years from the date of the refund

Practical considerations while the dust settles

Often, a determination regarding an organization’s ERC eligibility is based on the organization’s specific and unique facts and circumstances, as well as on federal guidance that is not abundantly clear in some respects. Therefore, it is possible that an organization that made a good-faith ERC claim may have some uncertainty regarding whether its claim will be upheld in the event of an IRS challenge.

If an ERC claim is determined to be improper or erroneous, organizations will be required to return the funds received together with interest and, in many cases, penalties. Therefore, an organization may wish to hold ERC refunds in high-yield, safe, liquid accounts until it concludes the risk of an IRS challenge has been substantially mitigated.

Additionally, as we have outlined in prior communications², if an organization is concerned that its ERC claim is invalid or improper, the organization should have the claim evaluated by an independent, trusted source and should re-amend its payroll tax returns if necessary – before the initiation of an IRS examination.

What to do if you receive an IRS examination notice

We always recommend organizations obtain reputable, knowledgeable representation before the IRS in IRS examinations. As we outlined in a recent press release³, our firm has formed a special team dedicated to representing nonprofits in IRS Employee Retention Credit audits. Nonprofit organizations that have been notified of an IRS inquiry or examination in connection with an ERC claim can reach the BMWL IRS ERC Audit Representation Team at ERCAuditTeam@NonprofitCPA.com.

² Source: <https://nonprofitcpa.com/irs-commissioner-describes-the-terrible-scenario-unfolding-involving-employee-retention-credit-fraud-irs-identifies-wildly-aggressive-suggestions-from-marketers/>

³ Source: <https://nonprofitcpa.com/bmw-forms-new-team-to-represent-nonprofits-in-irs-employee-retention-credit-audits/>

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The Employee Retention Credit – A Potential Source of Sizable Federal Aid for Qualifying Nonprofits

By Kaylyn Varnum, CPA; Michele Wales, CPA; and Mike Batts, CPA

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Quick Overview

If your nonprofit organization either:

- experienced a significant decline in gross receipts, or
- fully or partially suspended or reduced any significant part of its operations due to a federal, state, or local government mandate

during any calendar quarter since the COVID-19 pandemic was first recognized in the U.S. up through the quarter ended September 30, 2021,

your organization may be eligible for a special payment from the federal government, which is provided via a credit against your payroll taxes. This special credit is labeled the **Employee Retention Credit**.

The credit amount could be ***very significant*** for your organization if:

- your organization experienced either of the adverse events described above in **2020**, and had **100** or fewer full-time employees in **2019**, or
- your organization experienced either of the adverse events described above in **2021** and had **500** or fewer full-time employees in **2019**.

Background and Context

The Employee Retention Credit (ERC) is a relief provision originally contained in the CARES Act passed into law on March 27, 2020. The Relief Act of 2020, enacted as a part of the Consolidated Appropriations Act, 2021 (CAA) and passed in late December 2020, made significant changes to the ERC. The most significant change from the CAA was that the ERC became **available to Paycheck Protection Program (PPP) borrowers, subject to other eligibility requirements, and with the proviso that wages funded by forgiven PPP loan proceeds cannot be used as a basis for the ERC.**

Eligible employers claim the ERC as a credit against certain *employer* payroll taxes on their Form 941 for the applicable calendar quarter(s). The credit is refundable...meaning that if the employer qualifies for a credit that exceeds the applicable employer payroll taxes against which it is claimed for the applicable quarter, the excess credit is refunded to the employer in cash. The ERC is essentially relief/stimulus money paid by the government to eligible employers. The credit has no actual relationship to the employer-paid payroll taxes against which it is claimed. Claiming the credit against these employer payroll taxes on Form 941 is simply the government's delivery method for transferring funds to eligible employers.

To claim the ERC for a prior quarter for which the employer has already filed Form 941, the employer must file a Form 941-X (amended Form 941) for the applicable quarter(s). Special rules provide that the ERC for the *first* quarter of 2020 is claimed on the Form 941 or Form 941-X for the *second* quarter of 2020.

In March and April 2021, the IRS released IRS Notice 2021-20¹ and IRS Notice 2021-23², providing guidance regarding the ERC that applies from March 13, 2020, through December 31, 2020, and from January 1, 2021, through June 30, 2021, respectively. On March 11, 2021, The American Rescue Plan Act of 2021 (ARPA) was signed into law, extending the ERC from July 1 through December 31, 2021. In August 2021, the IRS released IRS Notice 2021-49³, providing guidance regarding the ERC that applies from July 1 through December 31, 2021. However, in November 2021, The Infrastructure Investment and Jobs Act eliminated the ERC for the period October 1, 2021, through December 31, 2021 (except for recovery startup businesses). Therefore, with limited exception, the 2021 version of the ERC is only available from January 1 through September 30, 2021.

We note here that the general Employee Retention Credit (which is the primary subject of this article) is distinguished from the Employee Retention Credit for “qualified disasters.” The Employee Retention Credit for qualified disasters is addressed at the end of this article.

Following is a summary of the Employee Retention Credit requirements and rules, as modified and interpreted by the CAA, ARPA, and IRS Notices as we understand them. *(Note that entities that are part of a controlled group of entities are generally aggregated in making all determinations and calculations – see additional commentary below regarding the application of the aggregation rules to nonprofit organizations. Also, note that additional guidance may be issued by the IRS, further clarifying the rules for applying the credit. Additional guidance may render portions of the information provided herein incomplete and/or inaccurate.)*

For the Period March 13, 2020, through December 31, 2020

1. Provides eligible employers – including tax-exempt organizations – a refundable credit against the employer’s share of Social Security tax [the 6.2% portion – not the 1.45% Medicare tax]. (As described below, the fact that it is a refundable credit means that it is simply money from the government.) [The IRS has published special guidance⁴ to address coordination of the ERC with the employer Social Security tax payment deferral also available during 2020 pursuant to the CARES Act. The deferral of employer Social Security tax payments does not impact the calculation of the ERC.]
 - a. Eligible employers must have carried on a trade or business during 2020 and satisfy one of two economic hardship tests (for tax-exempt organizations described in Section 501(c) of the Internal Revenue Code, all operations of the organization are considered a trade or business for this purpose):
 - i. Had fully or partially suspended business operations during any calendar quarter of 2020 due to orders from a governmental entity limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes). The guidance clarifies that a business is considered partially suspended if, under the facts and circumstances, the operations that are closed or modified are “more than a nominal portion of its business operations and cannot be performed remotely in a comparable manner.” Selections from IRS Notice 2021-20 Q&A Items 10 – 22, which provide

¹ Source: <https://www.irs.gov/pub/irs-drop/n-21-20.pdf>

² Source: <https://www.irs.gov/pub/irs-drop/n-21-23.pdf>

³ Source: <https://www.irs.gov/pub/irs-drop/n-21-49.pdf>

⁴ Source: <https://www.irs.gov/newsroom/deferral-of-employment-tax-deposits-and-payments-through-december-31-2020#12>

additional information regarding the full or partially suspended business operations economic hardship test, are outlined below - see the Notice for full details.

1. IRS Notice 2021-20, Q&A Item 10 clarifies that 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.

2. IRS Notice 2021-20, Q&A Item 11 provides a safe harbor threshold that may be used by an organization to support a position that suspended operations were a more than nominal portion of the organization’s business operations. The guidance indicates that business operations will be deemed to constitute more than a nominal portion of an employer’s business operations if either:

- The gross receipts from that portion of the business operations is not less than 10% of the total gross receipts (using the gross receipts of the same quarter in 2019)

or

- The hours of service performed by employees in that portion of the business is not less than 10% of the total number of hours of service performed by all employees in the employer’s business (using number of hours of service performed by employees in the same quarter in 2019)

3. IRS Notice 2021-20, Q&A Item 18 indicates that modifications of a business operation due to orders from a governmental entity may be considered a full or partial suspension of business operations if such modifications had more than a nominal effect on the business operations. Whether or not business operations were more than nominally affected is a facts and circumstances determination. Examples of modifications that should be considered include limiting occupancy to provide for social distancing, requiring services to be performed only on an appointment basis (for businesses that previously offered walk-in service), changing the format of service, etc.

4. IRS Notice 2021-20, Q&A Item 21 indicates that all members of an aggregated group are considered to have their operations partially suspended for purposes of the employee retention credit if the operations of one member of the aggregated group are suspended due to a governmental order. If one member’s business operations are partially suspended, it appears based on available guidance that the safe harbor threshold is based on 10% of the member, as opposed to 10% of the aggregated group.

Or

ii. Experienced a reduction in **gross receipts** of more than 50% in any calendar quarter of 2020 as compared to the same calendar quarter of 2019. If an organization meets this test for any calendar quarter in 2020, it is deemed to continue meeting this test through the end of the first *subsequent* calendar quarter of 2020 in which gross receipts exceed 80% of the amount for the corresponding quarter of 2019. (If, after declining by more than 50% in a quarter, gross receipts do not increase for any subsequent quarter in 2020 to more than 80% of the amount for the corresponding quarter in 2019, the credit continues through the end of 2020.) For nonprofit organizations, the IRS guidance indicates that the term *gross receipts* is defined in the same manner as described in Internal Revenue Code Section 6033, which is interpreted by Treasury Regulations (Reg. §1.6033-2(g)(4)), further described below.

1. The term “gross receipts” means the gross amount received by the organization during its annual accounting period from all sources without reduction for any costs or expenses including, for example, cost of goods or assets sold, cost of operations, or expenses of earning, raising, or collecting such amounts. Thus “gross receipts” includes, but is 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.

2. *The rules do not appear to make a distinction between restricted and unrestricted contributions with respect to nonprofit organizations.*

3. In Notice 2021-33⁵, the IRS confirmed that an employer can elect to exclude forgiveness of a PPP loan from gross receipts for purposes of this evaluation. An employer makes this election by simply excluding the amount of forgiveness of the PPP loan from its gross receipts.

4. Unrealized gains/losses are not included in the definition of gross receipts.

5. IRS Notice 2021-20, Q&A items 23 – 28 provide additional information regarding the determination of whether an organization experienced a significant reduction in gross receipts for purposes of ERC eligibility.

Example: Employer A’s gross receipts were \$100,000, \$190,000, \$230,000, and \$250,000 in the first, second, third, and fourth calendar quarters of 2020, respectively. Its gross receipts were \$210,000, \$230,000, \$250,000, and \$250,000 in the corresponding calendar quarters of 2019. Thus, Employer A’s 2020 first, second, third, and fourth quarter gross receipts were approximately 48%, 83%, 92%, and 100% of its 2019 corresponding quarterly gross receipts. Accordingly, Employer A 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% of the same quarter in 2019) and ending on the last day of the second calendar quarter of 2020 (the first subsequent quarter in 2020 for which the gross receipts were more than 80% of the amount in the same quarter in 2019). Thus, Employer A is eligible for a retention credit with respect to the first and second calendar quarters of 2020.

2. The credit is 50% of the first \$10,000 in qualified wages per employee (including the value of qualified group health plan benefits as further described in IRS Notice 2021-20, Q&A items 40 – 48). IRS Notice 2021-49 clarifies that an employee’s status as a full-time or part-time employee is irrelevant in determining qualified wages (i.e., qualified wages paid to both full-time and part-time employees are counted in calculating the ERC). [Note, however, that wages paid with forgiven PPP loan proceeds may not be used as a basis for the ERC.] *Qualified wages are further defined in IRS Notice 2021-20, Q&A items 30 – 48, and the ERC’s interaction with PPP loans is further described in IRS Notice 2021-20, Q&A item 49. Additionally, Q&A item 58 describes a special rule for claiming an ERC for wages funded by a PPP loan that was not forgiven.*

⁵ Source: <https://www.irs.gov/pub/irs-drop/rp-21-33.pdf>

Note – Wages for purposes of the ERC are generally FICA wages...clergy compensation is not ordinarily considered FICA wages.

3. The credit is reduced by any credits claimed for emergency sick pay or emergency family leave pay under the Families First Coronavirus Response Act (FFCRA) or for other credits applicable to the same wages.

4. To the extent the credit exceeds the employer's Social Security tax due, the excess is considered a refundable overpayment.

5. For employers with an average of more than 100 full-time employees in 2019, only wages paid to employees for periods during which they were not providing services due to an economic hardship (either (1) a full or partial suspension of operations by order of a governmental authority due to COVID-19 or (2) a significant decline in gross receipts) are eligible for the credit. For eligible employers with an average of 100 or fewer full-time employees in 2019, **wages** paid to **all employees** (regardless of whether they were providing services) during a period of economic hardship (as defined above) are eligible for the credit.

a. Aggregation of employee counts of affiliated entities may be required – see additional commentary below regarding the application of the aggregation rules to nonprofit organizations. *Q&A items 7, 8, 9, 32, and 55 within Notice 2021-20 provide additional information regarding the aggregation rules applicable to the ERC.*

b. Employee counts are made using the methods applicable under the Affordable Care Act⁶ in determining whether an employer is an “applicable large employer.” IRS Notice 2021-49 clarifies that employers are not required to include full-time equivalents when determining the average number of full-time employees – just full-time employees. (Note that only the counting method is applicable... the employee count thresholds for the Employee Retention Credit are unrelated to the thresholds for the Affordable Care Act.) *Q&A item 31 within Notice 2021-20 provides additional information regarding the calculation of employee counts for purposes of the ERC.*

6. IRS Notice 2021-20, Q&A items 70 and 71 provide information regarding documentation that should be kept in an employer's records as support for the ERC.

7. The Employee Retention Credit, as described in this section of this article, is effective for wages paid after March 12, 2020, and before January 1, 2021.

Observations for Churches, Schools, and Other Organizations Subject to Mandatory Suspension of Group Meetings

Thankfully, few churches, schools, and charities have experienced revenue declines in a calendar quarter of 2020 in excess of 50% as compared to 2019 – so that aspect of ERC eligibility has limited application. We note, however, that churches, schools, and other organizations that were subject to **mandatory** government orders that resulted in the full or partial suspension of operations or group meetings (including mandatory government orders that required or resulted in capacity limitations in connection with such operations or group meetings, assuming the capacity limitations had more than a nominal effect on the operations) seem to be eligible for the Employee Retention Credit regardless of whether they were able to continue carrying on certain of their activities via remote participation.

⁶ Source: <https://www.irs.gov/affordable-care-act/employers/identifying-full-time-employees>

Applying this interpretation would require the organization to evaluate whether it had “operations that were **fully or partially suspended** during any calendar quarter in 2020 due to **orders** from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19.” Such a determination may not be easy to make in every instance, since certain safety protocol communications made by government officials or agencies may not have reached the level of authority of “**orders**.” (See Notice 2021-20, Q&A Item 10 for additional information on what qualifies as a governmental order for this purpose.) Additionally, language in the IRS Notice 2021-20, Q&A Item 15 states that if the “employer is able to continue operations comparable to its operations prior to the closure by requiring its employees to telework, the employer’s operations are not considered to have been fully or partially suspended as a consequence of a governmental order.”

While it may be tempting to assume that such language means that churches that offered virtual worship services were able to “continue operations comparable to its operation prior to the closure,” we would argue that such is not the case. Not only are virtual worship services not comparable to regular in-person worship meetings, most churches stopped or limited other significant aspects of their operations in addition to in-person worship services...such as children’s ministries, Sunday Schools, fellowship events, and more. Similarly, even though schools may have continued conducting classes online, many other school functions were stopped or limited...including athletics and other extracurricular activities. Our firm believes that, until and unless additional official contrary guidance is published, the position we have described herein with respect to churches and schools is reasonable, assuming that the suspended operations are more than a nominal portion of the church or school’s business operations as defined in IRS Notice 2021-20.

Assuming the IRS agrees with the interpretation described in the preceding paragraph, the Employee Retention Credit could represent a significant financial benefit to churches, schools, and other entities required to suspend or limit group meetings – particularly those with 100 or fewer full-time employees in 2019. The reason is that for such organizations, the credit is half of the first \$10,000 in wages paid to **all** employees during the applicable period, regardless of whether such employees are providing services for the organization or not. That treatment contrasts dramatically with the treatment of organizations with more than 100 full-time employees in 2019. For those organizations, the credit is half of the first \$10,000 in wages paid during the applicable period **only to employees while they are not currently providing services to the organization.**

Example – Church with 85 Full-Time Employees in 2019 and 2020

Note – The IRS has published guidance on the interaction between the ERC and PPP loan rules as they relate to identifying the wages applicable to each – see IRS Notice 2021-20, Q&A items 49 and 58. The ERC cannot be claimed with respect to wages paid with PPP loan funds that are forgiven. This example specifically notes that the employer ignored wages paid with PPP loan funds in calculating wages paid by the employer for purposes of the ERC.

Oak Church obtained a PPP1 loan that was fully forgiven in 2020. It does not qualify for any wage-related credits other than the ERC. Oak Church had 85 full-time non-clergy employees in 2019 and 2020 and no part-time employees. On March 15, 2020, Oak Church was ordered by government officials to stop holding in-person worship services. That mandate continued through May 31, 2020, at which time government officials permitted the church to hold limited-capacity worship services. The mandate for limited capacity worship services continued through December 31, 2020, and included a prohibition against conducting certain of the church’s other activities involving gatherings. Oak Church continued to pay all of its employees for the entire time during which in-person worship services were prohibited or limited. The operations that ceased as a result of government orders met IRS criteria for being more than nominal.

Ten of its employees (other than clergy) performed no services for Oak Church during the period from March 15 through May 31, 2020 (due to government orders to cease holding worship services), but were paid, nonetheless. During the period from March 15, 2020, through December 31, 2020, Oak Church paid its 85 non-clergy employees \$42,000 each in wages (including qualified health plan benefits). Oak Church ignored the wages it paid employees with PPP loan funds. Half of the first \$10,000 of non-PPP wages paid to each of its employees during the applicable period is \$5,000 per employee. Oak Church is entitled to an Employee Retention Credit of \$425,000 (85 x \$5,000). The credit is refundable. To the extent that the credit exceeds Oak Church's employer Social Security tax due on its Form 941s for the applicable quarters of 2020, Oak Church may reduce its federal employer payroll tax deposits for the applicable periods to zero and receive a refund of the credit amount in excess of the otherwise required deposits.

[Note that if Oak Church had an average of more than 100 full-time employees in 2019, the credit would apply only with respect to the wages paid to the 10 employees who did not provide services and only during the period in which they were paid while not providing services.]

For the Period January 1, 2021, through June 30, 2021

IRS Notice 2021-23 amplifies IRS Notice 2021-20 and specifically addresses the ERC for the period January 1, 2021, through June 30, 2021. Unless otherwise noted below, information included in IRS Notice 2021-20 (applicable to the ERC for March 13, 2020 – December 31, 2020), including the Q&A references above, continues to apply to the ERC for the period January 1, 2021, through June 30, 2021.

1. Provides eligible employers – including tax-exempt organizations – a refundable credit against the employer's share of Social Security tax [the 6.2% portion – not the 1.45% Medicare tax]. (As described below, the fact that it is a refundable credit means that it is simply money from the government – if the amount of the credit exceeds the employer's share of Social Security tax against which it is a credit, the organization can reduce the amount that it deposits to cover other payroll tax obligations. If the credit exceeds all such taxes owed by the employer, the employer receives a refund of the excess credit amount.)

a. Eligible employers must have carried on a trade or business during 2021 and satisfy one of two economic hardship tests (for tax-exempt organizations described in Section 501(c) of the Internal Revenue Code, all operations of the organization are considered a trade or business for this purpose):

i. Have fully or partially suspended business operations during either the **first or second quarter of 2021** due to **orders** from a governmental entity limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes)

or

ii. Experience a reduction in **gross receipts** of more than **20%** in either the **first or second quarter of 2021** as compared to the same calendar quarter of **2019**. (Special rules apply for organizations not in operation during the applicable quarter of 2019 and for seasonal employers.) For quarters in 2021, a special rule allows organizations to elect to use the immediately preceding quarter to compare to 2019. For example, in measuring a decline in gross receipts for the second quarter of 2021, an organization can elect to use the first quarter of 2021 to compare to the first quarter of 2019. IRS Notice 2021-49 confirms that the IRS does not require consistency from quarter to quarter in making such an election. Gross receipts are defined in the same manner as for the 2020 ERC described above. *See notes above for special considerations in the definition of gross receipts for purposes of the ERC.*

Example: Employer A's gross receipts were \$150,000 and \$190,000 in the first and second calendar quarters of 2021, respectively. Its gross receipts were \$210,000 and \$230,000 in the first and second calendar quarters of 2019, respectively. Thus, Employer A's 2021 first and second quarter gross receipts were approximately 71% and 83% of its 2019 first and second quarter gross receipts, respectively. Accordingly, Employer A had a qualifying decline in gross receipts for the first calendar quarter of 2021 (the calendar quarter in which gross receipts were less than 80% of the amount in the same quarter in 2019) but not for the second quarter of 2021 (because gross receipts for that quarter were not less than 80% of the amount in the same quarter of 2019). Thus, Employer A is eligible for an Employer Retention Credit with respect to the first quarter of 2021. However, if Employer A elected (with respect to the second quarter) to use the immediately preceding quarter as a basis for comparison to 2019, it would have a qualifying decline in gross receipts for the second quarter as well.

2. The credit is 70% of the first \$10,000 in wages per employee (including the value of qualified health plan benefits) paid during **each of the first two calendar quarters of 2021**, during which the employer qualifies. Thus, the maximum credit per employee is \$7,000 per quarter for the first two quarters of 2021 (for a total of \$14,000).

Note – Wages for purposes of the ERC are generally FICA wages...clergy compensation is not ordinarily considered FICA wages.

3. The credit is reduced by any credits claimed for emergency sick pay or emergency family leave pay under the Families First Coronavirus Response Act (FFCRA) or for other credits applicable to the same wages.

4. To the extent the credit exceeds the employer's Social Security tax due, the excess is considered a refundable overpayment.

5. For employers with an average of more than **500** full-time employees in 2019, only wages paid to employees for periods during which they are not currently providing services due to an economic hardship (either (1) a full or partial suspension of operations by order of a governmental authority due to COVID-19 or (2) a significant decline in gross receipts) are eligible for the credit. For eligible employers with an average of 500 or fewer full-time employees in 2019, **wages** paid to **all employees** (regardless of whether they were providing services) during a period of economic hardship (as defined above) are eligible for the credit.

a. Aggregation of employee counts of affiliated entities may be required – see additional commentary below regarding the application of the aggregation rules to nonprofit organizations.

b. Employee counts are made using the methods applicable under the Affordable Care Act⁷ in determining whether an employer is an "applicable large employer." (Note that only the counting method is applicable...the employee count thresholds for the Employee Retention Credit are unrelated to the thresholds for the Affordable Care Act.)

Observations for Churches, Schools, and Other Organizations Subject to Mandatory Suspension of Group Meetings

Some churches, schools, and charities may experience revenue declines in the first or second calendar quarter of 2021 in excess of 20% as compared to the same quarter of 2019 and may qualify for the credit

⁷ Source: <https://www.irs.gov/affordable-care-act/employers/identifying-full-time-employees>

accordingly. Additionally, churches, schools, and other organizations that were subject to **mandatory** government orders that resulted in the full or partial suspension of operations or group meetings (including mandatory government orders that required or resulted in capacity limitations in connection with such operations or group meetings, assuming the capacity limitations had more than a nominal effect on the operations) seem to be eligible for the Employee Retention Credit regardless of whether they were able to continue carrying on certain of their activities via remote participation.

Applying this interpretation would require the organization to evaluate whether it had “operations that were **fully or partially suspended** during any applicable calendar quarter due to **orders** from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19.” Such a determination may not be easy to make in every instance, since certain safety protocol communications made by government officials or agencies may not have reached the level of authority of “**orders**.” (See Notice 2021-20, Q&A Item 10 for additional information on what qualifies as a governmental order for this purpose.) Additionally, language in the IRS Notice 2021-20, Q&A Item 15 states that if the “employer is able to continue operations comparable to its operations prior to the closure by requiring its employees to telework, the employer’s operations are not considered to have been fully or partially suspended as a consequence of a governmental order.”

While it may be tempting to assume that such language means that churches that offered virtual worship services were able to “continue operations comparable to its operation prior to the closure,” we would argue that such is not the case. Not only are virtual worship services not comparable to regular in-person worship meetings, most churches stopped or limited other significant aspects of their operations in addition to in-person worship services...such as children’s ministries, Sunday Schools, fellowship events, and more. Similarly, even though schools may have continued conducting classes online, many other school functions were stopped or limited...including athletics and other extracurricular activities. Our firm believes that, until and unless additional official contrary guidance is published, the position we have described herein with respect to churches and schools is reasonable, assuming that the suspended operations are more than a nominal portion of the church or school’s business operations as defined in IRS Notice 2021-20.

Assuming the IRS agrees with the interpretation described in the preceding paragraph, the Employee Retention Credit could represent a significant financial benefit to churches, schools, and other entities required to suspend or limit group meetings – particularly those with 500 or fewer full-time employees in 2019. The reason is that for such organizations, the credit is 70% of the first \$10,000 in wages paid to **all** employees during the applicable quarter, regardless of whether such employees are providing services for the organization or not. That treatment contrasts dramatically with the treatment of organizations with more than 500 full-time employees in 2019. For those organizations, the credit is 70% of the first \$10,000 in wages paid during the applicable quarter **only to employees while they are not currently providing services to the organization.**

Example – Church with 285 Full-Time Employees in 2019 and 2021

Oak Church obtained and fully spent a PPP1 loan in 2020. It did not obtain a PPP2 loan. It does not qualify for any wage-related credits other than the ERC. Oak Church had 285 full-time non-clergy employees in 2019, 2020, and 2021 and no part-time employees. On March 15, 2020, Oak Church was ordered by government officials to stop holding in-person worship services. That mandate continued through May 31, 2020, at which time government officials permitted the church to hold limited-capacity worship services. The mandate for limited capacity worship services continued through March 31, 2021, and included a prohibition against conducting certain of the church’s other activities involving gatherings. Oak Church continued to pay all of its employees for the entire time during which in-person

worship services were prohibited or limited. The operations that ceased as a result of government orders met IRS criteria for being more than nominal.

80 of its employees (other than clergy) performed no services for Oak Church during the period from March 15 through May 31, 2020 (due to government orders to cease holding worship services), but were paid, nonetheless. During the period from January 1, 2021, through March 31, 2021, Oak Church paid its 285 non-clergy employees \$12,000 each in wages (including qualified health plan benefits). 70% of the first \$10,000 of wages paid to each of its employees during the first quarter of 2021 is \$7,000 per employee. Oak Church is entitled to an Employee Retention Credit of \$1,995,000 (285 x \$7,000). The credit is refundable. To the extent that the credit exceeds Oak Church's employer Social Security tax due on its Form 941s for the first quarter of 2021, Oak Church may reduce its federal employer payroll tax deposits for that quarter to zero and receive a refund of the credit amount in excess of the otherwise required deposits.

[Note that if Oak Church had an average of more than 500 full-time employees in 2019, the credit would not apply. For employers of that size, the credit would apply only with respect to the wages paid to employees who did not provide services and only during the period in which they were paid while not providing services. Oak Church did not have employees who were paid while not providing services during the first quarter of 2021.]

For the Period July 1, 2021, through September 30, 2021

The American Rescue Plan Act of 2021 (ARPA), enacted on March 11, 2021, created Internal Revenue Code Section 3134, which provides an employee retention credit for wages paid from July 1, 2021, through December 31, 2021. However, the Infrastructure Investment Act enacted in November 2021 eliminated the ERC for the period October 1, 2021, through December 31, 2021 (except for recovery startup businesses). The ERC for the third quarter 2021 generally follows the same rules for the first and second quarter 2021 (described in the immediately preceding section), with specific changes noted below. The IRS released IRS Notice 2021-49⁸ that provides additional guidance regarding the ERC for this time period (which has not yet been updated to reflect the elimination of the ERC for the fourth quarter of 2021).

1. The ERC for this period is a refundable credit against the employer's share of **Medicare** tax [the 1.45% portion – not the 6.2% Social Security tax as in prior quarters]. (To reiterate, the fact that the ERC is a refundable credit means that it is simply money from the government – if the amount of the credit exceeds the employer's share of Medicare tax against which it is a credit, the organization can reduce the amount that it deposits to cover other payroll tax obligations. If the credit exceeds all such taxes owed by the employer, the employer receives a refund of the excess credit amount.)
2. An election may be made by the employer in evaluating its eligibility for the ERC in the third quarter of 2021 to calculate its gross receipts reduction threshold based on the immediately preceding calendar quarter as compared to the same quarter in 2019. For example, for purposes of determining whether the employer meets the gross receipts reduction threshold for ERC eligibility in Q3 2021, the employer may elect to compare its Q2 2021 gross receipts with its gross receipts in Q2 2019. IRS Notice 2021-49 confirms that the IRS does not require consistency from quarter to quarter in making such an election. (Special rules continue to apply for organizations not in operation during the applicable quarter of 2019 and for seasonal employers.)

⁸ Source: <https://www.irs.gov/pub/irs-drop/n-21-49.pdf>

3. A special rule was created for employers that have experienced a reduction in gross receipts in a quarter in excess of 90% of the gross receipts for the same quarter in 2019.

Not-So-Obvious 2020 and 2021 ERC Eligibility Considerations

Nuances within the ERC eligibility rules and definitions described above create opportunities for organizations to be eligible for the ERC that may not be obvious to an organization without careful consideration of an organization's particular facts. We have included some examples of "not-so-obvious" scenarios that may cause your organization to be eligible for the ERC. This is not an exhaustive list of possibilities but is intended to demonstrate that the definitions and rules described in the guidance above must be carefully considered and evaluated.

- In considering the gross receipts reduction thresholds for 2020 and 2021, did your organization engage in a special fundraising or capital campaign in 2019, such that the mechanical calculation of gross receipts in a particular quarter in 2020 or 2021 as compared to the same quarter in 2019 meets the ERC gross receipts reduction thresholds?
- In considering the gross receipts reduction thresholds for 2020 and 2021, did your organization liquidate a significant asset or assets in 2019, such that the mechanical calculation of gross receipts in a particular quarter in 2020 or 2021 as compared to the same quarter in 2019 meets the ERC gross receipts reduction thresholds?
- In considering the gross receipts reduction thresholds for 2020 and 2021, did your organization receive an unusual grant or gift in a particular quarter in 2019? If so, have you considered whether your organization's gross receipts in 2020 or 2021 for that same quarter may meet the ERC gross receipts reduction thresholds?
- In considering the full or partial suspension of business operations economic hardship test, have you considered capacity limitations that your organization imposed in its operations in order to adhere to a government mandate regarding social distancing – even if your organization was considered an "essential business?" Did such capacity limitations more than nominally affect your organization's operations?
- In considering the full or partial suspension of business operations economic hardship test, have you considered whether a key supplier or landlord's operations were suspended due to government orders, which impacted your organization in more than a nominal manner?

Not-So-Obvious Partial Suspension of Activities Examples:

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.

2020 ERC for Qualified Disasters

The Taxpayer Certainty and Disaster Tax Relief Act of 2020, enacted as a part of the CAA in late 2020, created a separate ERC for wages paid or incurred by nonprofit employers located in qualified disaster zones after the nonprofit employer's business became inoperable because of damage from a 2020 qualified disaster. Qualified disaster zones are specifically designated for each federally-declared disaster. The qualified disaster ERC is equal to 40% of up to \$6,000 of wages for each qualifying employee for the 2020 tax year. Wages for this purpose are generally FICA wages and do not include any wages claimed in applying for the COVID-19 relief ERCs described above. Unlike the general COVID-19 relief ERC credit described above, the qualified disaster ERC is a **non**-refundable credit against the employer's share of Social Security tax [the 6.2% portion – not the 1.45% Medicare tax]. Nonprofits may claim the credit by filing Form 5884-D⁹. A list of 2020 federally-declared disasters will be included in the Form 5884-D instructions (the Coronavirus pandemic is not included in the list of 2020 federally-declared disasters for this purpose).

⁹Source: <https://www.irs.gov/pub/irs-pdf/f5884d.pdf>

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