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PODCAST

Episode 13: Retention Credit Opportunities for Tax-Exempt Organizations

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Audio Transcript:

Tara Moss: Welcome to another episode of the Winston & Strawn Benefits Blast podcast. My name is Tara Moss, and I am pro bono counsel for Winston & Strawn. Here at Winston, we run a robust pro-bono practice that services over thousands of individual and organizational clients each year, tackling challenging problems. Just last calendar year volunteer lawyers across the firm contributed nearly 90,000 pro bono hours towards important causes and high-impact cases. In light of the COVID crisis erupting in 2020, Winston responded through its commitment to pro bono legal service by supporting over a hundred nonprofit organizations and individual clients with specific issues caused by the pandemic. We hope that today's informational podcast will be a further assistance to our nonprofit clients and community partners navigating these unprecedented times. The topic of today's featured podcast is "Retention Credit Opportunities for Tax Exempt Organizations." I am honored to introduce our speakers from Winston and Strawn. First, we have former Winston partner, Ruth Wimer. Along with Ruth, you will also hear from David Rogers. David is the managing partner of Winston's Washington DC office with extensive experience in tax, corporate, labor, and employee benefits law. Now we will get started with our podcast discussion and I'll turn it over to David Rogers. Thank you all for tuning in.

David Rogers: Thank you, Tara. My name is David Rogers. We are happy to provide today's information regarding a tax credit available to many nonprofit organizations. Today we will cover what is the retention credit and how much it is, which employers are eligible, how to calculate the retention credit and the implications of a PPP loan or some of the other tax credits that you might take advantage of. So we'll start first with what is the retention credit and how can it help your tax exempt organization for 2020 and 2021?

Ruth Wimer: Great, thanks David. The employee retention credit is a refundable tax credit against certain employment taxes for employers experiencing difficulties like who doesn't relate it to the COVID-19 pandemic under one of two criteria, even tax exempt organizations can take advantage.

David Rogers: So, let's talk about what is available under the retention credit and how much cash can an organization get for 2020, and then for 2021.

Ruth Wimer: Again, it's a refundable credit against employment tax that's equal to 50% of the qualified wages an eligible employer paid to employees after March 12th, 2020, and before January 1, 2021. The qualified wages are equal to $10,000 per employee for the year, and thus the maximum cash to the employer is $5k per employee for calendar year 2020, it's different numbers for 2021. So, for example, if an employer had 20 employees and the credit is a $100k, the employer will receive a hundred thousand from the IRS following the IRS procedures.

David Rogers: Thanks. So note on this point that you can retroactively apply for this credit for 2020. And we'll explain further in a little bit how you would do that. So, we have the same question though, for 2021. How much is available for 2021?

Ruth Wimer: The employee retention credit for 2021 is even better than compared to 2020. It's also refundable against certain employment taxes, but it's equal to 70% of the qualified wages an eligible employer pays two employees between January 1, 2021 and July 1, 2021. Qualified wages are equal to $10k per employee per quarter. Note, the American Rescue Plan Act added the retention credit to the internal revenue code and then extended it all the way through the end of the year. So by way of an example, an employer has 20 employees, the credit is $140,000. The employer will receive $140,000 from the IRS following high-risk procedure.

David Rogers: So, to keep that in mind, last year it was $5,000 and this year it can be up to $14,000. So how do we define wages that are used for purposes of determining the credit?

Ruth Wimer: You said $7,000 a quarter, and since it was recently extended, you get that for all four quarters, equaling $28,000 for 2021. So what's the definition of wages? That's simple. Look at your FICA wages, that's what it is. And so what that means is independent contractors don't qualify.

David Rogers: Okay. And now a lot of tax exempt organizations were unaware that they were available for this credit because they thought it was a tax credit against federal income taxes. But as Ruth just explained, it is a credit against employment taxes as well. So which tax-exempt organizations though can get the retention credit?

Ruth Wimer: The tax-exempt organizations must meet one of two threshold to be eligible for the credit. Tax exempt organizations may qualify if they had to close due to a COVID-19 shutdown order, or if they experience a significant decline in revenue. And this is called meeting the government orders test or the gross receipts test, and these tests are a little different for 2020 and 2021.

David Rogers: Okay. So how do we know if our organization is an eligible employer for 2020?

Ruth Wimer: For 2020, if the employer has a full or partial suspension of their operations during any calendar quarter because of government orders limiting commerce travel or group meetings due to the pandemic, the threshold is met for that quarter. Or, if there is a significant decline in gross receipts, defined as at least 50% reduction in gross receipts as compared to the same quarter in 2019, that's the gross receipts test. And I note that this is the criteria on receipts for 2020. It is at 50%, which is very significant. It loosened up in 2021.

David Rogers: So, Ruth, let's talk about the significant decline in gross receipts and how that gets calculated for 2020.

Ruth Wimer: Sure. There's a significant decline in gross receipts. It begins on the first day of the first calendar quarter of 2020 in which an employer's gross receipts are less than 50% of its gross recripts as compared to the same calendar quarter in 2019. That's a big drop. And then this ends on the first day of the calendar quarter where the gross receipts are more than 80% of gross receipts as compared to the same calendar quarter in 2019. So once they organization is recovered to that extent, they could no longer get it for that quarter.

David Rogers: So, these rules sound pretty complicated, and we understand and appreciate that this is an audio podcast. We will be making available our slide deck if you are interested because that outlines all of these rules. So let's talk now about the rules for 2021, because as we've talked about, the amount of the credit is different for 2020 versus 2021, as well as who's eligible is, is a different criteria. So Ruth, can you tell us about 2021 as to who is an eligible employer and how to calculate that?

Ruth Wimer: Thank you, David. Well, the full or partial shutdown due to government orders is the same as for 2020. So, if the organization was experiencing and continues to experience such a poor partial shutdown, they qualify. Alternatively, if that is not applicable, they can get the retention credit based on a significant decline in gross receipts, which now is only at 20% reduction in gross receipts for the quarter when compared to the same quarter in 2019. For 2021, the organization may also look to the prior quarter for determining whether there's been a significant decline. So by way of example, this first quarter in 2021, you can look to the last quarter of 2020 and compare it to the last quarter of 2019 to see if there's been a 20% reduction. So, tax exempt organizations may already be able to get out their calculators and determine whether they qualify on that basis.

David Rogers: Okay. So Ruth, let's talk about how we calculate gross receipts for tax exempt organizations. We've had a number of clients who have asked us really how in our world should we calculate gross receipts? And we have some advice so far, and I'm sure that there will be some additional guidance issued, but let's explain what we know as of now.

Ruth Wimer: It's actually pretty straightforward and the definition has been clarified so that now a tax-exempt organization would look at in determining gross receipts, the gross amounts received as contributions, gifts, and grants, gross amounts received as dues and assessments from members or affiliated organizations, gross sales or receipts from business activities, gross amount received from the sale of assets, and gross amounts received as investment income. Pretty straightforward. No expenses can be taken against this.

David Rogers: Okay, thank you. And so now let's talk about the changes and the rules for 2020 and 2021 regarding the number of employees the tax exempt organization can have in order to determine their qualified wages and those rules. So, let's start with 2020.

Ruth Wimer: The definition of qualified wages depends on how many employees in eligible employer has. The number of employees is determined on an affiliated group basis, which is still unclear on how that determination is made for tax exempt organizations. If you only have a tax-exempt organization, not affiliated with another one, it's straightforward. Smaller employers can more easily claim that credit because they claim the credit for all employees, whether working or not. Larger employers may only claim the credit for wages paid to employees while on furlough or otherwise not performing services. So, there's less employees eligible.

David Rogers: Yeah. So that rule is an important one to understand for all employers trying to get the employee retention credit. If you're a smaller employer, you can include the wages that you pay for people to work. And if you're a larger employer, which we'll define now between 2020 and 2021, who constitutes a larger employer, you really only get the employee retention credit for wages paid to an employee or benefits when they're not actively at work. So let's talk about 2020.

Ruth Wimer: Sure. So, for 2020, again, the rules in general, as we mentioned for the retention credit 2020, were more restrictive for 2020 to get the more robust payroll eligible for the retention credit. An employer had to have less a hundred employees, and it's referenced by 2019 numbers.

David Rogers: And a large number of our not-for-profit pro bono clients fall into this category. So we do believe that there will be a lot of opportunities for many of you with respect to the retroactive 2020 employee retention credit. Okay. In 2021, Ruth?

Ruth Wimer: For 2021, it got a lot better. And now if an employer had 500 or fewer during 2019, all the qualified wages, as we mentioned, everyone working, qualify for the retention credit that 2021, $7,000 a quarter. So very favorable.

David Rogers: So next, we're going to go to how this credit works if your organization also got a PPP loan. Originally, if you got a PPP loan in 2020, you were ineligible for the employee retention credit, but that changed. So, Ruth, let's talk about how these rules work together.

Ruth Wimer: Very favorably, Congress decided the retention credit could be made available even to employers who needed a PPP loan to keep operations. And thus, the law was changed and said, an employer can go back to 2020 and get the retention credit, even if it got a forgivable PPP loan, as long as the same wages are not counted for purposes of the PPP loan forgiveness.

David Rogers: So, let's give an example and talk about how the retroactive coordination between the PPP loan and the employee retention credit are intended to work.

Ruth Wimer: The IRS has issued guidance in the form of notice 2021-20, clarifying that if an employer applied for and received the loan in 2020, the employer is deemed to have elected not to have taken the retention credit for the amount of qualified wages included in the payroll costs up to, but not exceeding, the minimum amount of payroll costs plus other eligible expenses sufficient to support the amount of the PPP loan.

David Rogers: So, we have been advising many clients with respect to their PPP loan and forgiveness of that loan for 2020. And there is now an issue or question as to whether employers can swap their wages that they paid that weren't reimbursed necessarily by the PPP loan and use that for the 2020 retention credit. So let's talk a little bit about that.

Ruth Wimer: Sure. This is where the math gets a little tricky, but for those employers that already filed for forgiveness and they could have used some non-payroll costs, but they didn't, they are out of luck for saying that they could have used the non-payroll costs. So in determining what wages are in a sense "freed up" due to this retroactive credit, one looks at the PPP loan application and looks at the actual wages that were used that needed to be used for forgiveness of the loan, and those wages are not eligible for the retention credit. Now I would add, this will probably not inhibit many tax-exempt organizations from getting the retention credit for last year because the PPP loan only covered a several months period. So that means in the loan forgiveness, there likely could be an entire quarter of wages that weren't used anyway. So the rule of, geez, if you already applied for the forgiveness, it's not very harsh at all. Most organizations will have extra wages to use for the retention credit.

David Rogers: Yeah. So, it's important for you all to think through those issues, but we do believe as Ruth just said that there will be wages that were not covered or submitted for the forgiveness of the PPP loan that will still be available for the 2020 retroactive retention credit. Okay. So, Ruth, let's talk now about how employers can claim the credit.

Ruth Wimer: This is the good part. The IRS has made it really quite simple. There's three ways to claim the credit. And remember, this is dollar for dollar, the government giving the tax exempt organization cash for having employees on the payroll. The three ways include withholding employment taxes and anticipation of receiving the credit, requesting a refund via employment tax returns (i.e. the form 941), or requesting an advance through the form designated by the IRS, which is generally form 7200. They had the guidance for 2020 on exactly what is permissible. And we do not have it yet for 2021, but in summary, the employer will be able at a minimum to get it back by putting a line item on the 941 and say, I'm out of pocket, this amount of credit.

David Rogers: Okay. So let's talk about maybe what is the easiest way to claim the credit and what we are recommending to clients. And some of you, we appreciate, might not necessarily know what the form 941 does. But let's just talk briefly Ruth, about how to claim the credit.

Ruth Wimer: Okay. The first one is what I call immediate gratification. If the employer knows what his credit is for a quarter, then it can curtail making the same number in employment tax deposits. As they go around, payroll is being generated the employee's income taxes and social security and Medicare taxes, as well as the employer share security taxes, are also being required to be deposited with the IRS. And the employer can work it like this – the employer says, I have a credit coming to me of $50,000. I owe the IRS $50,000 and all these employment tax withholdings, let's call it even, you give me the money back. So, I hold it back because you will owe this to me, so I just won't pay it.

David Rogers: And we appreciate that some of you out there are probably reluctant to withhold payroll taxes. So, let's talk about the two other ways that you can also claim the credit.

Ruth Wimer: I totally agree with David. It's a little nerve wracking to hold back employment taxes that are required to be deposited with the IRS. And so, employers may wish to use the second way to claim the credit. Eligible employers (remember you need to meet the threshold) can also report their total qualified wages and related health expenses for each quarter on their quarterly employment tax return, the form 941 for most employers. The credit is currently permitted to be taken against all the federal employment tax owed for the quarter on the form 941. An example is an employer has 10 employees and a retention credit of $50,000. The employer paid $60,000 and all federal employment taxes – it's already paid in there, and it's showed on this form 941 that reports what was paid in and what was owed. The employer puts a line item on this 941 and can claim a refund credit of $50,000 and that other $60,000. And that's returned to him in a check from the IRS.

David Rogers: Okay. That's probably the easiest way or the one that we will see most clients doing. There is a third way route. So why don't you explain that rather quickly?

Ruth Wimer: Yes. The employer can file for an advance of employer credits due to COVID-19 on form 7200. It appears that even the IRS doesn't really like this method. An employer can only use this method if there are insufficient taxes set aside for deposit to cover the amount of the anticipated credit. In addition, effective for January 1, 2021, the form 7200 can only be used for employers with less than 500 employees, which again may be most of you out there in the tax-exempt organizations.

David Rogers: Okay. So that's kind of what's happening right now and how we are withholding or requesting the retention credit for 2021. But let's talk about how to request the retention credit retroactively for 2020.

Ruth Wimer: It's actually very straightforward and pretty simple. Employers that had received a PPP loan in 2020 may be eligible for the retention credit and can claim it retroactively. And I would add, even employers that they didn't have the PPP loan, if they weren't aware that the retention credit was available, they can apply retroactively by using the second method that we mentioned and asking for the refund on the form 941, and here, the employer files an amended 941, which is called the form 941X. Very straightforward.

David Rogers: Okay. Well, for all of you out there, we do hope that you have enjoyed this informational podcast. And thank you, Ruth and thank you, Tara. You can also receive a lot more information from the IRS website. There is a Coronavirus website dealing with the employee retention credit. As well as I mentioned earlier, we will be posting this PowerPoint on our website. So, you can also get this in writing, which has the details and some of the examples that we went through. We'd be happy to help any of you with your analysis of whether you're eligible for the employee retention credit, whether you qualify for it. So please reach out to either one of us or to your regular Winston & Strawn attorney. Thank you to our listeners for listening to another edition of our Benefits Blast podcast. You can subscribe to the Benefits Blast podcast via Apple iTunes or Google, or by visiting the Winston & Strawn website for more insights on the latest legislative, regulatory, and practice developments concerning employee benefits, labor and employment, and executive compensation issues.

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