NOTE: There was an additional act of Congress that impacted this topic. Information can be found here:
--The American Rescue Plan Act of 2021 Further Extends COVID-19 Relief

COVID-19 Update
CARES Act—IRS Tax Credits (Employee Retention Credit)—2021 CAA Update

February 3, 2021

As described in prior summaries provided by Wespath Benefits and Investments (Wespath) and the General Council on Finance and Administration (GCFA),[1] the Coronavirus Aid, Relief and Economic Security Act (CARES Act)[2] passed in March 2020 contained an incentive that encourages employers to retain—rather than terminate—employees despite current economic constraints due to COVID-19. In an Update issued in May 2020, we provided a summary of the Employee Retention Credit (ERC) available for tax year 2020.

The recently passed Consolidated Appropriations Act, 2021 (CAA)[3] extended the ERC into the first two calendar quarters of tax year 2021 and made significant changes, including increasing the credit amount and making it available to more employers. The ERC available for the first two calendar quarters of 2021 is summarized below, with key changes compared to the 2020 credit in **bold and underlined**. *Unless otherwise noted, the changes discussed below apply only to calculating credits for the first two calendar quarters of 2021*.

Expanded Eligibility

The ERC is available to large and small churches (and tax-exempt organizations generally) **for the first two calendar quarters of 2021** if they have either:

- Suffered a decline in gross receipts[4] of more than **20%** when comparing either (i) the applicable calendar quarter of 2021 to the same quarter in 2019 **or (ii) the calendar quarter immediately preceding the applicable calendar quarter of 2021 to the same quarter in 2019**,[5] or
- Had to fully or partially suspend operations "due to orders[6] from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to the coronavirus disease."

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[1] See the links provided at the end of this document.

[2] See CARES Act, Section 2301.

[3] These provisions were in Sections 206 and 207 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, which was included in the CAA.

[4] In general, "gross receipts" includes the total amount a tax-exempt organization received from all sources during its tax year, without subtracting any costs or expenses. The IRS issued an FAQ in 2020 that defined "gross receipts" for a tax-exempt employer for purposes of the ERC. See FAQ 46 available here (note that the numbering of the FAQs may change over time as the IRS adds new FAQs).

[5] For example, there are two options to meet this gross receipts test when determining eligibility for the credit for the *first quarter of 2021*. First, the church could compare gross receipts from the first quarter of 2021 to the first quarter of 2019. Second, the church could compare the fourth quarter of 2020 (i.e., the calendar quarter immediately preceding the first quarter of 2021) to the fourth quarter of 2019.

[6] Orders include state or local orders to shelter in place, as long as the organization is not one that was deemed essential. Statements from a governmental official do not rise to the level of an order. If an organization volunteers to shut down or slow operations, it must rely on a decline in gross receipts of more than 20% to be eligible for the ERC in 2021.

A United Methodist local church would likely be eligible for this credit if it was subject to an order limiting group meetings. However, if a church-related organization does not rely on group meetings for its operations and is able to continue operating in a way that is comparable to its operations prior to an applicable closure order by requiring its employees to telework, it would *not* be eligible for the ERC on that basis and would instead need to show a decline in gross receipts of more than 20%.

Under the CARES Act, employers that received a Paycheck Protection Program (PPP) loan[7] were prohibited from claiming the ERC in 2020 (unless such loan was repaid by May 18, 2020). Under the CAA, however, **employers that received a PPP loan are no longer prohibited from claiming the ERC**. In addition to being eligible to claim the credit available for the first two calendar quarters of 2021, the CAA also **allows these employers to claim the ERC *retroactively* for 2020 wages paid after March 12, 2020**, *excluding any wages paid with the proceeds of a forgiven PPP loan*. The IRS is expected to release additional guidance regarding how to claim this retroactive credit for 2020 wages.

Calculating the Tax Credit

Applicable wages are capped at $10,000 per employee **per calendar quarter**. Credit can be taken for **70%** of the wages paid, meaning a maximum credit of **$7,000** per employee is available to eligible employers per calendar quarter, for a total of **$14,000 in 2021**.

The ERC rules regarding wages are different for "small" and "large" employers, as described below. For 2020, the threshold for this purpose was 100 employees. **The CAA increased the threshold to 500 employees for 2021**. This change makes the ERC more beneficial for employers with between 100 and 500 employees, as they are now eligible for the more favorable provisions previously applicable to only small employers.

For employers with **500 or fewer** employees, all wages,[8] including qualified health plan expenses[9] that are properly allocable to the wages, **paid on or after January 1, 2021 and before July 1, 2021** are eligible for the ERC. The credit can be taken for wages paid to all employees, regardless of whether they are able to work. For such an employer (with 500 or fewer employees), because qualified health plan expenses are considered "wages," such expenses are eligible for the credit even if the employer does not pay employees any other wages.

For employers with **more than 500** employees, the ERC is limited to wages paid to employees for periods when they are not working. For these employers, qualified health plan expenses are considered "wages" to the extent they can be allocated to periods when employees are not working but such expenses are still being paid. (For example: if such an employer was subject to an order partially suspending its operations and reduced employee hours by 50% while paying 100% of their health plan expenses, only the 50% of health expenses allocable to the time when employees were not working would be eligible for the credit.)

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[7] We recently issued an update related to the PPP available here.

[8] Wages include payment for paid time off (PTO) taken by employees under pre-existing policies, but not wages associated with paid leave provided by the Families First Coronavirus Response Act (FFCRA). For more details regarding the FFCRA, see the additional resources listed at the end of this document.

[9] Qualified health plan expenses include premiums, including both the cost paid by the employer and the cost paid by the employee with pre-tax salary reduction contributions. Qualified health plan expenses also include employer contributions to a health reimbursement arrangement (HRA) and a health flexible spending arrangement (FSA). But: qualified health plan expenses do not include employer contributions to a health savings account (HSA) or a qualified small employer health reimbursement arrangement (QSEHRA).

IMPORTANT: *In 2020, the IRS stated that wages paid (including any designated housing allowance) to clergy employees of a church do not qualify for the ERC. This has not changed for 2021.*

UMC Example 1

A qualifying local church has a non-clergy employee that was paid an annual salary of $40,000 (i.e., $10,000 per calendar quarter) in 2020. The church should have received an ERC of $5,000[10] (the maximum for the year) for that employee for 2020. The employee will be paid the same annual salary in 2021. Assuming the church meets the applicable eligibility requirements in 2021, it could anticipate receiving a total of $14,000 in ERC for the first two quarters of 2021.[11]

UMC Example 2

Assume the same facts as Example 1, except the local church received a PPP loan on July 1, 2020. The church exhausted the loan proceeds in paying for all eligible employee costs it incurred in the third quarter of 2020—no loan proceeds were remaining to pay for eligible costs in the last quarter of 2020. The church then applied for forgiveness of its PPP loan, which was granted. Because the PPP loan was not used for the $10,000 paid to the employee in the last quarter of 2020, the church would still be able to receive an ERC of $5,000 for that employee for 2020, as well as the $14,000 credit for the first two quarters of 2021.

Applying for the ERC

The easiest way to take the ERC is still via the employer's *IRS Form 941* (Employer's Quarterly Federal Tax Return) by reducing the employment taxes[12] the employer would otherwise deposit. The IRS has amended *Form 941* to include lines for ERC-qualified wages and health plan expenses on lines 21 and 22, respectively.

If an employer can claim a credit that exceeds the amount of employment taxes it was due to deposit with *Form 941*, the employer can request a "refund" of the difference by filing *IRS Form 7200*. Alternatively, the employer can request a refund of the overpayment when it files Form 941.

Under the CAA, **an employer with an average of 500 or fewer full-time employees in 2019 may elect to receive an advance payment of the ERC** each calendar quarter before qualified wages are paid. The advance may be in an amount not to exceed 70% of the average quarterly wages paid by the employer in 2019. The advance would later be reconciled against the actual credit determined at the end of the quarter. The IRS is expected to release additional guidance regarding how to claim this advance.

Limitations

The CAA also extended certain provisions of the Families First Coronavirus Response Act (FFCRA), which was passed in March 2020. For more information about which provisions of the FFCRA were extended, see the links below. Qualified sick or family leave wages paid under the FFCRA are eligible for a separate

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[10] The original ERC rules apply to the wages paid to this employee in 2020. Thus, the wage cap is $10,000 per employee for the year and the credit is limited to 50% of the wages paid.

[11] For 2021, the $10,000 per employee limit is applied on a quarterly basis, and a credit can be taken for 70% of the wages paid.

[12] The ERC may be taken against both income taxes withheld and the employer and employee shares of Social Security and Medicare taxes.

tax credit under FFCRA, as opposed to the ERC. The CAA extended the FFCRA tax credits through **March 31, 2021**. An employer may claim both the ERC and FFCRA credits, but they cannot claim both credits for the same wages (to prevent redundancy of benefits). See IRS Instructions for *Form 7200* for more details.

As noted above, **employers that received a PPP loan are no longer prohibited from claiming the ERC**.

ADDITIONAL RESOURCES

Paycheck Protection Program (PPP)

- PPP Summary
- PPP Q&A

Families First Coronavirus Response Act (FFCRA)

- FFCRA Summary
- FFCRA Q&A

More Information Related to COVID-19

- General Council on Finance and Administration
- Wespath Benefits and Investments

The information above should not be considered legal or tax advice. Plan participants, annual conferences, local churches, or other employers or parties affiliated with The United Methodist Church (UMC) should consult with counsel and other advisors in considering the application of the coronavirus-related laws and guidance to their circumstances.

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