National Council of Nonprofits

Champions for the public good

Hearing before the House Committee on Ways and Means
Subcommittee on Oversight

THE EMPLOYEE RETENTION TAX CREDIT EXPERIENCE: CONFUSION, DELAYS, AND FRAUD

July 27, 2023

Written Statement of the

National Council of Nonprofits

The National Council of Nonprofits (NCN) welcomes this opportunity to provide testimony to the House Committee on Ways and Means' Subcommittee on Oversight regarding the experiences of charitable nonprofits in accessing the Employee Retention Tax Credit (ERTC). Our nationwide networks of organizations welcome this hearing, "The Employee Retention Tax Credit Experience: Confusion, Delays, and Fraud."

In this statement, we review the history of this important tax incentive, share common challenges charitable nonprofits have experienced, identify some of the causes for these challenges, and recount numerous steps taken by our network and others to overcome confusion, delays, and fraud. Our comments are informed by the experiences of thousands of charitable organizations nationwide, most notably by smaller, frontline organizations that might not still be in operation but for the ERTC.

At the outset, we emphasize that the Employee Retention Tax Credit provided essential relief that enabled thousands of charitable nonprofit employers to retain employees and continue serving their communities during extremely harsh times. Confusion arose from the many changes in the law and qualification requirements. Delays in the receipt of checks threatened the ability of employers to keep workers on staff and maintain operations. Fraud, always a threat with a new or confusing law, remains a reason for employers and the government to remain vigilant. But despite these challenges – all of which can be remedied or avoided through conscientious lawmaking and rulemaking – the Employee Retention Tax Credit must be respected as a successful, vital, and appropriately measured response to disastrous health and economic crises.

We stand ready to assist all Members on the Committee in identifying concerns and connecting with impacted charitable organizations in their states.

Common Challenges in Accessing the ERTC

The ERTC served as a vital lifeline for many charitable nonprofits as it provided a financial incentive for nonprofit employers to keep their employees on their payrolls, enabling them to continue delivering important services to the public during the pandemic and in its immediate aftermath. The underlying public policy of the ERTC is sound. In practice, however, there have been problems with confusion, delays, and the appearance of fraud that need to be addressed in the future. These challenges will be discussed in turn.

1. Confusion: Complying with a Constantly Moving Target.

While beneficial, the ERTC has confused many employers, accountants, and regulators, partly because Congress changed the policy several times over an 18-month period. Everyone recognizes that Congress was attempting to improve the program; Congress needs to know why so many people were so confused.

The refundable payroll tax credit, enacted in Section 2301 of the **Coronavirus Aid, Relief, and Economic Security (CARES) Act**, originally applied only to employers that did not receive forgivable loans under the Paycheck Protection Program, also enacted in the CARES Act. For the period of March 12, 2020, through December 31, 2020, the law allowed a 50% credit of qualified wages (up to a maximum of $10,000 per employee), or a credit of up to $5,000 per employee. In most cases, the economic benefits of a potential forgivable PPP loan of up to $10 million provided a greater economic benefit than the ERTC.

ERTC Summary

	2020 Rules	2021 Rules
Credit Type	***Refundable*** Payroll Tax credit to eligible employers	***Refundable*** Payroll Tax credit to eligible employers
Credit Applicability	Qualified Wages paid after March 12, 2020 and or before December 31, 2020	Qualified Wages paid after December 31, 2020 and or before September 30, 2021
Credit Amount	50% of Qualified Wages (Maximum of $10,000 per employee per year)	70% of Qualified Wages (Maximum of $10,000 per employee per quarter)
Maximum Credit (Credit ERTC against employer social security taxes before reducing other employment taxes-Credit can reduce all payroll tax deposits with reconciliation on Form 941)	$5,000 per employee	$21,000 per employee

3

Amendments to the ERTC made by section 206 of the **Taxpayer Certainty and Disaster Tax Relief Act** of 2020 broadened the scope of the ERTC and allowed additional nonprofits and other employers to qualify for additional needed relief beyond the scope of two rounds of PPP loans. Specifically, the ERTC was extended through June 30, 2021, and improved to apply the credit to 70% of qualified wages up to a maximum of $10,000 per employee per quarter, or a credit of up to $7,000 per quarter. The amendments also allowed employers that had received Paycheck Protection Program funds to also qualify for the ERTC with respect to wages that were not paid for with forgiven PPP proceeds. Because the ERTC was calculated based on calendar quarters (12-13 weeks in length) and PPP loans cover 8-week periods, most employers should have credit-eligible wages for either 2020 or 2021.

The Section 9651 of the **American Rescue Plan Act** extended the ERTC even longer, allowing employers to claim the credit for wages paid after June 30, 2021, and before January 1, 2022. However, Title VI, Section 80604 of the **Infrastructure Investment and Jobs Act** (also known as the "Bipartisan Infrastructure Law) terminated the ERTC for calendar quarters ending after September 30, 2021, creating additional confusion both for employers and the IRS. The retroactive repeal of the tax credit meant that many nonprofit and for-profit employers owed payroll taxes on ***advance payments*** received under the ERTC for the fourth quarter (Q4) of 2021 and on ***reduced payroll tax deposits*** withheld by the employer in anticipation of qualifying for the ERTC. The IRS issued Notice 2021-65 to provide guidance to employers, but it did not provide a waiver of penalties for payments due after December 20, 2021.

In sum, the ERTC changed numerous times between March 2020 and November 2021, involving revisions that affected eligibility, application, and obligations. It should be no wonder that people got confused. As will be seen, many organizations, including the networks of the National Council of Nonprofits, engaged in vigorous education and outreach programs to help ensure employers, employees, and communities could effectively benefit from this important tax incentive.

A Few Thoughts About ERTC Qualification Criteria

Qualification criteria for the ERTC have also been a source of confusion to employers in both the for-profit and nonprofit sectors. Credit eligible entities needed to be "active trades or businesses" within the definition of the Internal Revenue Code (see generally IRC section 162). To qualify for the ERTC for a specific calendar quarter, an eligible employer had to meet either a full or partially suspension test or experience a reduction in gross revenue test. Both the full or partial suspension and the gross receipts test have been problematic in their application, especially for nonprofit organizations.

In the case of full or partial suspension, the requirement that operations suspend in response to orders from a government authority limiting commerce, travel, or group meetings due to COVID-19 required organizations to parse through numerous city, county and state proclamations and orders, as well as react to potential judicial decisions. In addition, such local government orders had to be read in relation to voluminous interpretations from the Internal Revenue Service that attempted to rationalize the operation of such orders in practice. The result has been a patchwork of qualification standards that could vary from jurisdiction to jurisdiction, making it difficult for organizations to determine whether or not they qualified for the credit. And as noted below, overly aggressive advertisements and unscrupulous "professionals" may be resulting in fraudulent ERTC claims.

The reduction in gross receipts test also has been problematic for nonprofit organizations. In addition to a significant change in the eligibility percentage, there have been multiple interpretative questions regarding the proper definition of nonprofit "gross receipts," which differs from the definition of gross receipts for purposes of PPP. This challenge appears to have been most frequently experienced by arts and cultural organizations.

Further confusing matters, most nonprofits do not compute gross receipts on the basis of calendar quarters as required by the ERTC. In sum, all of these changes and computational complexities explain why it has been difficult for nonprofits and other employers to determine whether they qualify for the credit for calendar quarters in 2020 and 2021.

2. Delays: Undermining the Intent of Congress.

Charitable nonprofits have been vocal in their concerns that the promise of the Employee Retention Tax Credit is frustrated when bureaucratic delays result in employers having to wait for more than half a year or longer to receive checks. The delays for nonprofit and for-profit employers were very long in 2021 and 2022, a fact raised repeatedly during the Senate confirmation process for IRS Commissioner Daniel Werfel earlier this year.

The explanations typically given for why the backlog had grown so significantly were lack of in-person staff in the early days of the pandemic, the labor-intensive process required to review paper tax returns, and the crush of additional new burdens, such as processing millions of Child Tax Credits and Economic Impact Payments. Anecdotally, we believe that many long-waiting organizations have received the relief to which they are eligible at this point.

In the early days of the pandemic, charitable organizations reported to NCN that they found the ERTC process relatively straightforward and quick. Many nonprofits shared in 2020 that they had received checks within eight-to-ten weeks after submitting the proper paperwork. Over time, however, delays in receiving ERTC checks became a significant burden for nonprofit employers. The National Council of Nonprofits joined with many in the charitable nonprofit sector in reaching out to the IRS and to Congress seeking administrative or legislative solutions.

As an organization, the National Council of Nonprofits experienced a 21-month delay in receiving a small ERTC payment that may prove instructive. Like many organizations, NCN has contracted out some of its human resources operations to a professional employer organization (PEO). As a result, NCN could not apply directly for ERTC relief, but had to work through the PEO that had both legal and internal rules that frustrated the application process. First, unlike most charitable employers that enjoy the benefit of electronic filing, PEOs are required to file tax returns via paper forms. This, of course, put NCN's application in the pile of paper forms that took the longest amount of time to process.

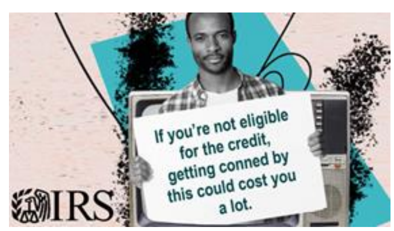
Also, many PEOs, ours included, adopted precise rules for when and how they would file amended tax returns on behalf of their clients. These *sui generis* rules, combined with the frequently changing law on the ERTC, meant that some deadlines were missed, revisions to forms were required, and delays grew even longer. Some organizations that were eligible for the ERTC missed out completely because of deadlines imposed by PEOs to be part of their amended return, even though the deadline for the program itself still had months to go.

3. Fraud: Scam Artists Are Proliferating.

Through extensive educational outreach efforts by many nonprofit organizations, discussed in the next section, we believe the occurrence of intentional fraud in the nonprofit sector is extremely low. Indeed, NCN is not aware of improper activities or allegations of fraud against legitimate organizations.

However, individuals cannot listen to the radio, go online, or watch broadcast TV without being bombarded with ads claiming that employers are entitled to free money. Bogus ERTC claims, promoted by entities seeking to charge exorbitant fees, clog the IRS processing pipeline and exacerbate the delays suffered by legitimate employers.

Nonprofits have shared with NCN that some of these promoters have aggressively pushed their services long after being told no, filling inboxes with solicitations, making repeated calls, and seeking to secure signatures on contracts that promise quick results while charging high processing fees. These actors do a disservice to the public and improperly call into question the otherwise sound policy underlying the ERTC as a refundable payroll tax credit.



We believe the IRS was right to include "aggressive marketing schemes" to promote the ERTC on the Dirty Dozen list of tax scams for 2023. The IRS has publicized "blatant attempts by promoters to con ineligible people to claim the credit," denouncing "schemes from promoters who have been blasting ads on radio and the internet touting refunds involving Employee Retention Credits." The IRS has also posted a series of videos on the threat to the ERTC: *Don't Fall for Employee Retention Credit Scams* in English | Spanish | ASL | Chinese | Korean | Vietnamese | Haitian Creole | Russian. NCN has publicized this information in two publications, our biweekly *Nonprofit Champion* and our monthly *Nonprofit Essentials*, posted warnings on our website, and raised awareness through social media posts.

Education and Fraud Prevention

Starting within days of passage of the CARES Act, the National Council of Nonprofits has taken every opportunity to inform the charitable nonprofit community about the availability of the ERTC and multiple other relief programs that would enable organizations to continue to advance their missions during the severe public health and economic emergencies. These actions have ranged from hosting nationwide webinars for audiences of thousands to publishing articles and presenting lectures and webinars for state- and subsector-specific audiences. Here is a sample of educational materials focusing on the ERTC:

- Nonprofits, Don't Overlook Your Potential Refund Under the Employee Retention Tax Credit
- Attention Nonprofit Employers: Did You Forget to Claim Refundable Tax Credits from the IRS?
- COVID-Related Tax Credits Available to Nonprofit Employers

In late 2021, the networks of the National Council of Nonprofits conducted a survey of workforce shortages in the sector. Fifteen percent of responding nonprofits reported having claimed the ERTC, suggesting that the word did indeed get out. Interestingly, ERTC utilization in some states was considerably higher, according to survey responses, including Kentucky (24%), North Carolina (24%), and Oregon (21%).

The point of sharing these activities is to show that the charitable nonprofit community had access to accurate, high-quality information about the ERTC. These outreach efforts continue and, we trust, the outcome of today's hearing will provide further clarity and reduce the prevalence of fraud by unscrupulous profiteers.

A Closing Comment of Appreciation for the Revised ERTC

The current version of the Employee Retention Tax Credit (ERTC), in effect for parts of calendar years 2020 and 2021, is the solution to a tax incentive that unfairly excluded millions of employers in the United States. During the past two decades, Congress has established a variety of tax incentives in response to a series of human and natural disasters beginning with the terrorist attacks in New York and DC on 9/11. Congress later granted employee retention tax credits in response to several natural disasters including Hurricanes Katrina, Rita, and Wilma in 2005. See generally Internal Revenue Code (IRC) Section 1400R. These temporary incentives helped profitable for-profit employers keep workers on the payroll in the aftermath of disasters that otherwise would have forced mass layoffs and greater economic distress. The credits were claimed as part of and subject to the limitations of the general business credit under IRC Section 38.

The fundamental problem with the older version of the ERTC was that it provided neither relief nor incentives for the 1.3 million charitable nonprofits that are exempt from income taxes and their 12.5 million employees or for businesses without income tax liabilities. For more than a decade, charitable organizations advocated for improvements to the ERTC to ensure that the very organizations on the scene in natural disasters received the same assistance as their for-profit counterparts. When the Covid-19 pandemic hit, Congress converted the ERTC to the refundable payroll tax credit at issue in today's hearing. Structuring the ERTC as such finally ensured that all employers, regardless of their tax status or profitability, could qualify for the economic relief provided by the credit when they retained their workforce during the pandemic.

Conclusion

The Employee Retention Tax Credit, when implemented in the form of a refundable payroll tax credit, has been a vital lifeline of support for charitable organizations, their employees, and the individuals and communities they serve. This unqualified statement is true despite the delays and the risks of confusion and fraud. The ERTC was borne of a need to extend relief to employers who are exempt from income taxes but pay other taxes, namely payroll taxes, as they contribute to society through dedicated public service. While this hearing may shed light on unanticipated challenges that arose when the ERTC was included in the CARES Act, the unmistakable truth is that the ERTC saved nonprofits and businesses, reduced unemployment and hardship, and helped alleviate untold suffering that would have occurred in our communities. Improvements should always be envisioned and analyzed, but the public and tax policy foundation of the ERTC has proven to be sound.

Respectfully submitted,

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About the National Council of Nonprofits

Communities thrive when nonprofits succeed. For more than 30 years, the National Council of Nonprofits has mobilized the largest network of nonprofits in the United States to achieve transformative results. We focus on the 97% of charitable nonprofits with budgets under $5 million – food banks, neighborhood health clinics, community theatres, domestic violence shelters, senior centers, and more – the organizations whose absence would leave huge voids in their communities. We champion, inform, and connect nonprofits to get things done for nonprofits and the people and communities they serve. Learn more at www.CouncilofNonprofits.org.