taxnotes federal

Volume 180, Number 10 ■ September 4, 2023

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Reprinted from *Tax Notes Federal*, September 4, 2023, p. 1615

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In this article, Sheppard continues his examination of ever-evolving guidance on the employee retention credit, focusing on recently released chief counsel advice addressing whether federal credit unions can make claims.

I. Introduction

You start with the macro and then move to the micro as time permits and need demands. This method is followed in many contexts, including taxes. Congress first introduced the employee retention credit in early 2020 and made several legislative tweaks thereafter. The IRS, likewise, issued multiple notices over the past couple years supplying more detail. Naturally, as time passes and unanticipated issues arise, the guidance becomes more focused, more granular. That is precisely the case with ERCs. This article summarizes the main ERC rules, prior guidance on whether governmental employers are eligible for ERCs, and new chief counsel advice exploring the status of federal credit unions (FCUs).

II. Congressional and IRS Guidance

Congress passed four laws in less than two years regarding the ERC, and the IRS supplemented this by issuing multiple notices, revenue procedures, and other items to implement the legislative mandates. This article only touches the surface. Readers seeking more details are invited to consult other ERC articles by the same author.[1]

A. First Law

Congress enacted the Coronavirus Aid, Relief, and Economic Security Act in March 2020.[2] This was a complicated piece of legislation, which introduced key aspects that evolved over time. The CARES Act generally provided that an "eligible employer" could get an ERC against "applicable employment taxes" equal to 50 percent of the "qualified wages" that it paid to each employee for each quarter, subject to a maximum.[3] Those three key terms are defined below.

An eligible employer meant one that was carrying on a trade or business in 2020 and met one of the following two tests. First, the employer's operations were partially or fully suspended during a quarter by an order from an appropriate governmental authority that limited commerce, travel, or group meetings for commercial, social, religious, or other purposes because of COVID-19 (the governmental order test).[4]

[1] *See* Hale E. Sheppard, "Employee Retention Credits: Issues Arise as Finger-Pointing Begins," *Tax Notes Federal* (coming Sept. 11, 2023); Sheppard, "New ERC Guidance About Suspended Operations and Supply Chains," *Tax Notes Federal*, Aug. 28, 2023, p. 1413; Sheppard, "Employee Retention Credits: Analyzing Key Issues for Promoters and Other Enablers," *J. Tax'n* (coming 2023); Sheppard, "Employee Retention Credits: Analyzing Key Issues for Taxpayers Facing IRS Audits," *J. Tax'n* (coming 2023); and Sheppard, "Employee Retention Credits: Analyzing Congressional and IRS Guidance From Start to Finish," *J. Tax'n* (coming 2023).

[2] Joint Committee on Taxation, "Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security Act," JCX-12R-20 (Apr. 23, 2020).

[3] CARES Act section 2301(a).

[4] CARES Act section 2301(c)(2)(A)(ii)(I).

Second, the employer suffered a significant decline in gross receipts during a particular period (the reduced gross receipts test).[5] The period started with the quarter during which the gross receipts were less than 50 percent of the gross receipts during the same quarter the previous year, and ended the quarter after the gross receipts of the employer were greater than 80 percent of the gross receipts the previous year.[6]

The term "employment taxes" ordinarily refers to three items: (1) federal income taxes paid solely by employees through mandatory withholding by their employers; (2) amounts under FICA, which are paid partly by employees and partly by employers; and (3) amounts under FUTA, which are paid entirely by employers.[7] The term "applicable employment taxes" initially means FICA amounts for ERC purposes.[8]

The notion of qualified wages under the CARES Act depended on the number of full-time employees working for an eligible employer before things went downhill. If an eligible employer had an average of more than 100 full-time employees (a large eligible employer), qualified wages meant those paid to any employee *who was not providing services* as a result of the governmental order test or the reduced gross receipts test.[9] The tax treatment was more favorable when it came to less substantial businesses. When an eligible employer had an average of 100 or fewer full-time employees (small eligible employer), qualified wages meant *all wages* paid during a quarter, regardless of whether the employees were actually working.[10] In addition to the amounts described above, qualified wages included the qualified health plan expenses of the eligible employer properly allocable thereto.[11]

The sky was *not* the limit under the CARES Act. Indeed, the amount of qualified wages for any one employee could not be more than $10,000 for *all* applicable quarters combined. This meant that the maximum ERC per employee for all of 2020 was $5,000.[12]

Coverage of the ERC changed several times, but it originally applied to wages paid after March 12, 2020, and before January 1, 2021. In other words, the CARES Act had the ERC benefiting eligible employers during the second, third, and fourth quarters of 2020.[13]

The IRS soon stepped in to explain or expand various aspects of the CARES Act. It did so by releasing Notice 2021-20, 2021-11 IRB 922, in March 2021. The information in Notice 2021-20 was *massive*, with much of it far exceeding the express language of the CARES Act.[14]

B. Second, Third, and Fourth Laws

Congress enacted three more pieces of legislation after the CARES Act, and the IRS followed suit with more guidance. These featured *many* critical clarifications and changes, of course, but only the few that are directly relevant to this article are highlighted below.

Congress passed the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Relief Act) in December 2020.[15] The IRS, for its part, issued Notice 2021-23, 2021-16 IRB 1062. Among other things, the Relief Act expanded the time during which eligible employers might benefit. They could claim ERCs not only for the second, third, and fourth quarters of 2020 (as they could under the CARES Act), but also for the first and second quarters of 2021.[16] Eligible employers also could get increased amounts of ERCs, as follows. Initially, under the CARES Act, an eligible employer could claim ERCs for only 50 percent of qualified wages, up to $10,000 per employee for all of 2020. Simple math shows that eligible

[5] CARES Act section 2301(c)(2)(A)(ii)(II).

[6] CARES Act section 2301(c)(2)(B).

[7] IRC sections 3101, 3111, 3301, and 3401. When dealing with compensation paid to railroad employees and representatives, the term "employment taxes" also encompasses amounts imposed by the Railroad Retirement Tax Act. *See* section 3221.

[8] These consist of Social Security and Medicare taxes. CARES Act section 2301(c)(1).

[9] CARES Act section 2301(c)(3)(A)(i).

[10] CARES Act section 2301(c)(3)(A)(ii)(I) and (II).

[11] CARES Act section 2301(c)(3)(C)(i).

[12] CARES Act section 2301(b)(1); JCX-12R-20, *supra* note 2, at 38.

[13] CARES Act section 2301(m).

[14] *Id.* at Section III.

[15] Division EE of the Consolidated Appropriations Act, 2021 (Relief Act), at section 207; JCT, "Description of the Budget Reconciliation Legislative Recommendations Relating to Promoting Economic Security," JCX-3-21, at 66-70 (Feb. 8, 2021).

[16] Notice 2021-23, Section III.A.

employers could get no more than $5,000 per employee that year. Things changed in two ways for the first and second quarters of 2021 thanks to the Relief Act: The percentage increased from 50 percent to 70 percent, *and* the amount was calculated per quarter, not per year. As a result, if an eligible employer were to pay an employee $10,000 in qualified wages in each of the first and second quarters of 2021, the ERCs would total $14,000 ($7,000 per quarter).[17]

Congress passed the American Rescue Plan Act of 2021 in March 2021.[18] Importantly, ARPA codified the ERC for the first time, making it section 3134 of the code. The IRS contributed with Notice 2021-49, 2021-34 IRB 316.[19] Like its predecessor, ARPA further expanded the ERC; it covered the third and fourth quarters of 2021.[20] Thus, at that point, the ERC was available for the second, third, and fourth quarters of 2020 (under the CARES Act), the first and second quarters of 2021 (under the Relief Act), and the third and fourth quarters of 2021 (under ARPA). ARPA also inserted a new type of eligible employer, the so-called recovery start-up business. That was an employer that (1) began operating a trade or business after February 15, 2020; (2) had average annual gross receipts of not more than $1 million during the relevant period; and (3) did not otherwise qualify as an eligible employer under the governmental order test or the reduced gross receipts test.[21]

Things came to a close when Congress enacted the Infrastructure Investment and Jobs Act in November 2021. That legislation announced the end of the ERC and, to the surprise of many, *retroactively* shortened the periods for which eligible employers could claim benefits. Except recovery start-up businesses, eligible employers could no longer solicit ERCs for fourth quarter 2021. The IRS, often the bearer of bad news, issued Notice 2021-65, 2021-51 IRB 880, explaining that advance ERC payments received by most eligible employers for fourth quarter 2021 constituted erroneous refunds, that they had to be timely repaid, and that delinquencies would be penalized.[22]

III. Prior Guidance on Governmental Employers

The treatment of governmental employers, like many other things, changed over time.

The CARES Act, which pertained to the second, third, and fourth quarters of 2020, prohibited governmental employers from benefiting from ERCs. That initial law expressly stated that the incentives shall *not* apply to "the Government of the United States, the government of any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing."[23]

The corresponding administrative guidance from the IRS, Notice 2021-20, also made that restriction quite clear. It first underscored that the ERC "does not apply to the Government of the United States, the government of any State or political subdivision thereof, or any agency or instrumentality of those governments, [such that] these entities are not Eligible Employers."[24] Next, Notice 2021-10 pondered how an organization can determine whether the IRS will consider it an instrumentality of the federal, state, or local government for ERC purposes. It explained that the IRS generally considers six factors in this regard: (1) whether the organization is used for a governmental purpose and performs a governmental function; (2) whether the function is carried out on behalf of one or more states or political subdivisions; (3) whether any private interests are involved, or whether the relevant states or political subdivisions have the powers and interests of an owner; (4) whether control and supervision of the organization are vested in one or more public authorities; (5) if express or implied statutory or other authority is necessary for the creation or use of that instrumentality; and

[17] *Id.* at Section III.D.

[18] ARPA section 9651.

[19] Notice 2021-20 continues to apply to the second, third, and fourth quarters of 2020, and Notice 2021-23 continues to apply to the first and second quarters of 2021. *See* Notice 2021-49, Section I.

[20] Notice 2021-49, Section III.A.

[21] *Id.* at Section III.D.

[22] Notice 2021-65, Section III.B.

[23] CARES Act section 2301(f).

[24] Notice 2021-20, Section II(B) (background).

(6) the degree of the organization's financial autonomy and the source of its operating expenses. Notice 2021-10 added that no one factor is determinative and that the IRS must examine all the facts and circumstances.[25]

The second round of ERC standards, derived primarily from the Relief Act, dramatically changed things. The rules expanded the ERC, broadening it to include first and second quarters of 2021.[26] The Relief Act preserved the original ban on governmental employers but created a notable exception. It stated that the existing restriction shall *not* apply to (1) any organization described in section 501(c)(1) and exempt from tax under section 501(a), or (2) any governmental employer that is a college or university, or whose principal purpose or function is providing medical or hospital care.[27]

Clarifying this change by the Relief Act, the legislative history stated: "As a result [of the amendment], such organizations and entities are not prevented from claiming the credit by reason of the general prohibition against certain government employers claiming the credit."[28] The corresponding guidance from the IRS, found in Notice 2021-23, contained much of the same information, with a few extra touches. For example, it reminded governmental employers that they still must meet all the requirements to be an eligible employer, particularly the governmental order test or the reduced gross receipts test. It also supplied details about meeting the definition of college or university, and the "principal purpose or function" of providing relevant care. Finally, and perhaps most importantly, it stated that governmental employers could be eligible employers, and thus apply for ERCs, *only* from first quarter 2021 forward. They did *not* enjoy retroactive eligibility back to the second, third, and fourth quarters of 2020.[29]

The third and fourth rounds of IRS rules, introduced by ARPA and the Infrastructure Investment and Jobs Act, did not offer additional guidance about governmental employers and ERC benefits. However, they expanded the coverage of ERC benefits to third quarter 2021 for all eligible employers, and to fourth quarter 2021 for recovery start-up businesses.

IV. New IRS Guidance About FCUs

Talk about governmental employers fell silent for nearly three years, but the IRS resuscitated it last month by issuing ILM 202333001.[30] The internal legal memorandum from the IRS Office of Chief Counsel presents four questions about FCUs:

1. Can they claim ERCs for the second, third, and fourth quarters of 2020 under the CARES Act?
2. Can they claim ERCs for the first and second quarters of 2021 thanks to the Relief Act?
3. Can they claim ERCs for third quarter 2021 under ARPA?
4. Can they claim ERCs for fourth quarter 2021, again under ARPA, if they qualify as recovery start-up businesses?

The IRS began the chief counsel advice by summarizing the relevant portions of the ERC legislation and related IRS guidance. It then turned to FCUs. The IRS explained that the Federal Credit Union Act, enacted nearly a century ago, allowed the creation of FCUs to combat limited credit availability and high interest rates by encouraging average citizens to pool their resources. It further indicated that each FCU acts as a "fiscal agent" of the U.S. government, performing various services associated with collecting, lending, borrowing, and repaying money. The IRS noted that the National Credit Union Administration Board has authority to investigate FCUs, suspend or revoke their charters, and even place them into involuntary liquidation. Finally, the IRS underscored that FCUs are exempt from all income taxes.

[25] *Id.* at Section III, Question 2 (citing Rev. Rul. 57-128, 1957-1 C.B. 311).

[26] Relief Act section 207(a).

[27] Relief Act section 207(d)(3).

[28] JCX-3-21, *supra* note 15, at 69.

[29] Notice 2021-23, sections III(B) and IV; *see also* Relief Act section 207(k).

[30] *See* Fred Stokeld, "IRS Clarifies Availability of Retention Credit for Credit Unions," *Tax Notes Federal*, Aug. 28, 2023, p. 1524.

Consistent with its earlier guidance in Notice 2021-10, the IRS stated that it contemplates six primary factors when determining whether an entity is an instrumentality of a federal, state, or local government.[31] The IRS concluded that FCUs are, indeed, instrumentalities for ERC purposes because they are created by federal statute, serve the governmental purpose of fomenting the economic well-being of underserved populations, perform governmental functions when they act as fiscal agents, and are controlled and supervised by a public authority (that is, the National Credit Union Administration Board). The IRS explained that because FCUs are instrumentalities of the federal government, and because they are tax exempt, they might qualify as eligible employers in the context of ERCs. The IRS emphasized that this determination conforms to several prior ones in similar situations.

Grounded in the preceding reasoning and conclusions, the chief counsel advice answers the four relevant questions as follows:

1. FCUs *cannot* claim ERCs for the second, third, and fourth quarters of 2020 because the CARES Act explicitly prohibits instrumentalities of the federal government from doing so.
2. FCUs *can* claim ERCs for the first and second quarters of 2021 because, although they are instrumentalities, they meet the exception introduced by the Relief Act.
3. FCUs *can* claim ERCs for third quarter 2021 in accordance with ARPA because they are excepted instrumentalities.
4. FCUs *can* claim ERCs for fourth quarter 2021 for the same reason, as long as they are also recovery start-up businesses.

V. Conclusion

Is the accessibility to ERCs by FCUs a riveting issue for the majority of taxpayers? Of course not, but the new IRS chief counsel advice remains interesting in the broader context for several reasons. It shows, for instance, that ERC issues are complex and confusing, even for the very people tasked with enforcing the law. The chief counsel advice does not constitute a dialogue between a low-level field agent and a superior. Rather, the document shows guidance being sought by a deputy managing counsel for the Tax-Exempt and Government Entities Division from the deputy associate chief counsel in the Employee Benefits, Exempt Organizations, and Employment Taxes Division. The memo further demonstrates that ERC issues are far from settled. For more than two years, the IRS has been issuing at a steady clip guidance in the form of notices, revenue rulings, frequently asked questions, and more. Finally, the chief counsel advice expressly states that "this document may not be used or cited as precedent," presumably with equal application to taxpayers and the IRS. This disclaimer might have many scratching their heads, asking why the IRS would issue "guidance" and simultaneously warn taxpayers that they cannot rely on it. How various items of guidance should be interpreted, to what quarters and taxpayers do they apply, and what legal status they possess are critical issues on which many eyes will be focused as ERC battles develop over the coming years. ■

[31] *See* Notice 2021-20, Section III, Question 2 (citing Rev. Rul. 57-128).