

PUBLICATION

IRS Issues New Guidance on ERC Program – Should You Hold or Fold?

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Over the past week, the IRS has announced two significant developments in its administration and enforcement of the Employee Retention Credit (ERC). Last week, the IRS' three-part announcement signaled: (i) an end to the moratorium on processing certain ERC claims; (ii) an acceleration of processing legitimate ERC claims; and (iii) an intensification of efforts to deny and audit potentially fraudulent as well as improper ERC claims. Following this announcement, which provided relief for some and anxiety for others, the IRS just announced the reopening of its ERC Voluntary Disclosure Program (VDP) following the program's successful first iteration which ended earlier this year. *Now, the question for many taxpayers is: what to do?*

Payments for Valid Claims and Partial Removal of ERC Moratorium

For those who have been waiting for the IRS to finally process their ERC claims, there is some hope! The IRS has identified approximately 50,000 "low-risk" ERC claims that will be processed starting in September. The IRS is digitizing paper filings to speed up processing. In addition, the IRS plans to begin processing the moratorium claims, including those filed through January 31, 2024. It still plans to hold ERC claims filed after January 31, 2024, in case the proposed legislation to cut off ERC filings after January 31, 2024, is passed.

Heightened Scrutiny on Improper Claims

At the same time, the IRS is ramping up its efforts to deny and recover improper ERC payments. For example, the IRS has mailed approximately 28,000 disallowance letters to businesses with claims identified as "high-risk." These disallowances are estimated to total up to \$5 billion. In addition, the IRS has just indicated it will send out an additional approximately 30,000 more "disallowance letters." Taxpayers whose claims have been disallowed may still appeal that decision by taking the case to the IRS Appellate Division or, alternatively, filing a refund suit in either the U.S. District Court or the Federal Claims Court. At that point, it appears that many of these disallowances are focused on the 3rd quarter 2021 tax period, with the IRS stating that there is no basis for a partial suspension. This, however, may not be correct, and further analysis is required to determine whether the taxpayer may actually qualify while also analyzing the impact the disallowance may have on earlier ERC tax filings, whether paid or still pending.

Furthermore, the IRS has initiated thousands of civil audits and 460 criminal investigations related to perceived fraudulent ERC claims. To date, 37 investigations have resulted in federal charges, with 17 convictions and nine sentencings. This further highlights the importance for taxpayers to revisit their respective ERC filings in light of certain factual and legal issues that may exist. This is a complicated analysis and there actually may be a fully legitimate basis for the ERC filings beyond what was originally contemplated.

A Way Out through Voluntary Disclosure

With the announcement of its second ERC-VDP, which the IRS has said is its final one for ERC claims, the IRS is offering a lifeline to those watching the intensification of enforcement efforts while becoming less certain of the efficacy of their own ERC claims. The ERC-VDP, which will accept applications through November 22, 2024, offers taxpayers with questionable claims the opportunity to self-correct and **repay 85 percent** of the ERC tax amount they received and avoid future audits, penalties, and interest. Taxpayers accepted into the ERC-VDP are not required to repay the interest received on their refunds. In addition, those who are unable to

pay the required 85 percent may be eligible for an installment agreement, pending IRS approval. However, taxpayers who enter into an installment agreement will be required to pay interest and penalties under the standard installment agreement policy.

Who is Eligible

Any taxpayer who received the ERC for a 2021 tax period may apply for the ERC-VDP, provided that the following is also true:

- The taxpayer did not apply for the first ERC-VDP for the same tax periods;
- The taxpayer is not under criminal investigation or IRS examination for the tax period for which they are applying to the ERC-VDP;
- The taxpayer has not received a Letter 6577-C, Employee Retention Credit Recapture, or other IRS notice and demands for repayment of their ERC claim;
- The taxpayer has not filed an amended return to eliminate their ERC; and
- The IRS has not received information from a third party or directly from an enforcement action that the taxpayer is not in compliance.

How to Apply

Taxpayers seeking to apply to the ERC-VDP must file an IRS Form 15434, Application for Employee Retention Credit Voluntary Disclosure Program, and submit the application through the IRS' portal. If a taxpayer uses a third-party company to process its payroll (such as a PEO), the payroll company must apply for the ERC-VDP on the taxpayer's behalf. In addition, many taxpayers may be unable to pay the required 85 percent of their 2021 ERC. Those seeking to repay their ERC claims through an installment agreement must also file IRS Form 2750 and Form 433-B.

Key Implications for Businesses

1. **Compliance Risks:** Businesses that have claimed or are planning to claim the ERC should be vigilant about ensuring compliance with the ERC program's complex requirements. The IRS' ongoing audits and investigations underscore the importance of accurate and substantiated claims. Businesses should be prepared for potential audits or inquiries and should maintain thorough documentation to support their claims. In addition, as we have seen, having an additional analysis undertaken may provide further insights
2. **Appeals Process:** As noted above, taxpayers who received an ERC "disallowance" letter, may request a hearing with the IRS' Appellate Division for further consideration and possible settlement. This is important especially as some of the recently issued ERC disallowance notices did not formally include the usual detailed instructions on the IRS appellate process and, in point of fact, *all taxpayers have the right to appeal*. Businesses should respond promptly to any disallowance notices and consult with tax professionals to better understand the IRS' appellate process or, alternatively, file a refund suit in a Federal District Court or the Federal Claims Court.
3. **Options to Withdraw or Amend Claims:** Taxpayers can withdraw claims that have not been paid, or that have been paid but the refund check has not been cashed. Further, Taxpayers who have received the ERC for the 2021 tax period may consider whether to apply to the ERC-VDP. Either way, taxpayers should consult with tax professionals regarding these options.

Recommendations for Businesses

- **Evaluate Claims Thoroughly:** The legal rules and proper application for the ERC are still evolving and will be shaped further as claims are litigated. There are many overlooked nuances with respect to how to determine eligibility, both under the gross receipts test, and the partial suspension test. We

recommend having a tax professional evaluate each ERC claim, especially for those involving the 2021 tax year which seems to be more likely to be audited. Taxpayers in certain industries, such as health care, are also more likely to be audited. Businesses should conduct a thorough review of their ERC claims to ensure they meet the eligibility criteria. This is particularly important for businesses that relied on third-party promoters, as the IRS has identified third-party promoters through its first Voluntary Disclosure Program and is expected to use that data in conducting audits.

- **Prepare for Potential Audits:** Given the increased audit activity, businesses should be prepared for the possibility of an IRS audit. Maintaining detailed records and documentation will be crucial in defending any claims made under the ERC program.

Conclusion

The IRS' recent actions signal that it is devoting significant resources to ERC claims, both: (i) to resolve the backlog of claims; and (ii) to undertake extensive enforcement action given the IRS' current view that the ERC program is riddled with fraudulent and improper claims. Because ERC claims involve payroll taxes – i.e., "trust fund taxes" – there is the potential for personal liability if claims are disallowed and the business does not pay the claim. Businesses that have claimed or plan to claim the ERC should take steps to evaluate the merit of the claims and be prepared for possible scrutiny. By staying informed and taking proactive steps, businesses can mitigate the risks associated with ERC claims and minimize the likelihood of enforcement action including penalties.

For further guidance or to discuss specific concerns related to your ERC claim, please contact a member of Baker Donelson's [Tax Team](#).