GrayRobinson **July 25, 2023**
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Re: The Employee Retention Credit

The Stakeholder Liaison department of the IRS's Communications & Liaison Division hosted a webinar this afternoon to explain the Employee Retention Credit (ERC) created during the COVID-19 lockdown. The IRS has seen a surge in fraudulent claims for the credit, facilitated by promoters who advertise easy access and guaranteed returns.

Fraudulent ERC claims topped the IRS's annual "Dirty Dozen" list of most common tax scams: "some third parties continue to widely advertise their services targeting taxpayers who may not be eligible for the ERC. Unfortunately, these advertisements, along with the increased prevalence of websites touting how easy it is to qualify for the ERC, lend an air of legitimacy to abusive claims for refund. Tax professionals have reported receiving undue pressure from clients to participate and claim the ERC, even when the tax professional believes the client is not entitled to the credit."

Today's program was targeted at tax preparers. The message was clear: the ERC was set up to serve a specific group of business owners who were not being helped by other relief programs (the Paycheck Protection Program, etc.), and double dipping is explicitly prohibited.

The IRS is aggressively pursuing fraudulent claims by both taxpayers and tax preparers, with an Office of Fraud Enforcement created in 2020. Today's webinar spent some time explaining the structure of this office, which is split into 48 field offices, the DC headquarters, and a policy shop that includes a data analytics team and an Emerging Threats Mitigation Team. They have been alert to the possibility of fraudulent ERC claims since the beginning, and manually reviewed forms (Form 7200) when they first started coming in. A "fabricated entities project" (apparently informal, since it is not on the IRS website) formed to identify fake companies that claimed the ERC.

The presenter walked through the history of the ERC, with the help of some slides I will attach to this memo.

- The **CARES Act** created the ERC in 2020 as a fully refundable credit available to employers against employment taxes, to incentivize companies that had had to shut down to keep employees on their payrolls. The first iteration of the ERC ran from March 13, 2020 through December 31, 2020, and covered all four quarters of the year.
    - Employers eligible for the ERC included employers carrying on a trade or business, tax-exempt employers, and tribal entities (government and non-government) carrying on a trade or business.
    - Employers were eligible if they fully or partially suspended operations due to a government order or if their gross receipts in the quarter declined to less than 50% of their 2019 level.
    - Small employers (100 employees or fewer) could apply for ERCs for "qualified wages" (payments to employees subject to FICA, plus qualified health plan costs) of up to $10,000 per employee, for wages to any employee. The tax credit was 50%, so employers could get a maximum of $5,000 per employee for March 13, 2020 through December 31, 2020.
    - Large employers (more than 100 employees) could apply for ERCs for "qualified wages" (payments to employees subject to FICA, plus qualified health plan costs) of up to $10,000 per employee, only for

wages paid to an employee for a time when they were not providing services. The tax credit was 50%, so employers could get a maximum of $5,000 per employee for March 13, 2020 through December 31, 2020.

- The **Relief Act** extended the ERC to quarters 1 and 2 of 2021, but made some changes.
  - Certain governmental employers (schools and healthcare facilities) became eligible for the ERC.
  - Employers were eligible if they fully or partially suspended operations due to a government order or if their gross receipts in the quarter declined to less than 80% of their 2019 level.
  - The limit for "small employer" rose to 500 employees or fewer; "large employers" were those with more than 500 employees.
  - The tax credit rose to 70% of up to $10,000 per employee per quarter, so up to $7,000 per employee per quarter.
- The **American Rescue Plan Act** extended the ERC to quarters 3 and 4 of 2021, and made further changes.
  - "Recovery Startup Businesses" became eligible for the ERC. A "recovery startup business" was one that (1) was not otherwise an eligible employer; (2) began carrying on a trade or business after Feb. 15, 2020; and (3) had average annual gross receipts for the three tax years preceding the quarter in which it claimed the credit of no more than $1 million.
- The **Infrastructure Investment and Jobs Act** set new limits on the ERC for the fourth quarter of 2021.

The various laws imposed limits to try to keep businesses from double dipping:

- Employers who received PPP loans could claim ERC only to the extent that their PPP loans were not forgiven in the covered period.
- Wages used for these tax credits could not be claimed for the ERC:
  - Credit for Sick Leave and Family Leave Wages
  - Research & Development Payroll Tax Credit
  - Work Opportunity Tax Credit
  - Indian Employment Credit
  - Grants for Shuttered Venue Operators and Restaurant Revitalization (Q3 and Q4 2021 only)
  - Credit for Employees who are Active Duty Members of the Uniformed Services

- Wages claimed for the ERC could not be deducted on the employer's income tax return.
- Close relatives of employers were not eligible for the ERC, including:
  - Children or descendants of children
  - Brothers, sisters, stepbrothers, stepsisters
  - Fathers, mothers, or other ancestors (e.g., grandparents)
  - Stepfathers or stepmothers
  - Nieces or nephews
  - Aunts or uncles
  - Sons-in-law, daughters-in-law, brothers-in-law, or sisters-in-law
  - Anyone who lives with the employer other than the employer's spouse

The IRS has been treating excessive tax credits as underpayments, unless they have reason to suspect fraud. Noncompliance with the ERC has a statute of limitations of five years, but fraud has no statute of limitations, and the IRS will claw back what it can. The presenter said the IRS had been receiving an influx of amended returns from businesses that got questionable advice.

ERC fraud has fallen into three broad categories: fictitious businesses, identity theft, and inflated or false ERC claims. The IRS is encouraging people to report fraud or fraudulent promotions. Form 3949-A is the form to report suspected tax law violations, and Form 14242 is the form to report abusive tax promotions or preparers.

The presentation ended with a fairly stern admonishment about tax preparers' know-your-client obligations under Circular 230.