

## The Employee Retention Credit: New IRS Initiatives Raise Legal Considerations for Employers

11.08.2023 | Employee Benefits and Tax Disputes & Tax Litigation Alert

In this client alert, we discuss some considerations for employers in light of recent IRS initiatives concerning the Employee Retention Credit (“ERC”). Although the initiatives are primarily procedural, an employer’s decision about whether to proceed with or withdraw an ERC claim requires both legal and factual analysis.

### Background

The ERC was initially enacted in March 2020 as part of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) to provide eligible employers with a refundable tax credit against applicable employment taxes during qualifying periods between March 13, 2020 and December 31, 2021.[1] It has subsequently been amended in three separate pieces of legislation.[2] The result is a complex law with shifting eligibility criteria.

Although the ERC eligibility period ended no later than December 31, 2021, amended employment tax returns may generally be filed within three years of the date the initial return was filed. Forms for a calendar year are considered filed on April 15 of the succeeding calendar year if filed before that date. This means that amended returns for calendar year 2020 may generally be filed through April 15, 2024, and through April 15, 2025 for calendar year 2021.

Many employers who timely filed their 2020 and 2021 employment tax returns did not claim the ERC on the initial returns. Reasons could include lack of familiarity with the credit, uncertainty about eligibility, and workforce demands during the initial period of the pandemic. Regardless, the IRS has recently seen an influx of amended returns claiming the ERC, with approximately 15% of all claims being filed between mid-June and mid-September 2023.

Some employers have sought advice from attorneys and CPAs when determining their eligibility for the ERC. Others have relied on marketers advertising large refunds, often on contingency, with insufficient attention to the required eligibility determinations. This has led to IRS concerns with potential abuse of the credit, ranging from fraudulently claiming the credit for nonexistent businesses to unsupported or aggressive claims on the part of legitimate businesses.

### Recent IRS Initiatives: Processing Moratorium and Withdrawal Options

On September 14, 2023, the IRS announced a moratorium on processing new ERC claims through at least the end of 2023. Claims received prior to the moratorium will continue to be processed, but with stricter compliance reviews and a corresponding extension of the standard processing goal from 90 days to 180 days, and even longer if a claim faces further review or audit. Stated IRS goals include both protecting against fraud and protecting businesses from penalties resulting from bad claims.

On October 19, 2023, the IRS announced the details of a withdrawal process for certain employers that filed an ERC claim but have not yet received a refund to withdraw their submission and thereby avoid future repayment, interest and penalties. Employers are eligible to use the process if (1) they claimed the ERC on an adjusted employment return, (2) they filed the adjusted return only to claim the ERC, and made no other

adjustments, (3) they want to withdraw the entire amount of their ERC claim, and (4) either the IRS has not paid their claim, or the claim has been paid but they have not cashed or deposited the refund check.

The specifics of the process depend on factors such as whether the employer used a professional payroll company and whether the employer has been notified that it is under audit. Also, employers that are not eligible to use the process may be able to file an amended employment tax return using the existing amendment procedures.

The IRS is also working on guidance for employers who have already received the ERC payment but were misled into making the claim. That guidance is expected later this fall.

### Considerations for Employers

Employers with pending ERC claims must decide whether to proceed or withdraw, and whether they have any legal recourse in the face of extended processing times. Employers who have yet to submit a claim must decide whether to do so in an environment in which the IRS has explicitly warned taxpayers to use extreme caution before applying for the ERC due to aggressive maneuvers by marketers and scammers. With that caveat duly acknowledged, employers should not forgo applying without first objectively assessing the merits of their claim.

While the decisions are procedural, legal and factual considerations will play a significant role for most employers. These include:

1. What specific ERC rule(s) am I using to determine eligibility?
2. Does the applicable rule vary from quarter to quarter?
3. Is there IRS guidance on the application of the rule to facts like mine?
4. If not, what legal rationale supports my position?
5. What factual support can I provide for my position?

IRS guidance may provide some assistance with these questions. In addition to a series of FAQs on its website,[3] the IRS has issued three Notices addressing various aspects of the ERC such as the definition of qualified wages, what constitutes a full or partial suspension of operations, and the interaction of the ERC with the Paycheck Protection Program.[4] The IRS has also issued a Revenue Procedure providing a safe harbor for certain exclusions from gross receipts for purposes of determining ERC eligibility[5]; a Generic Legal Advice Memorandum (“GLAM”) addressing full or partial suspension of operations in the context of a supply chain disruption[6]; and a GLAM which clarifies the status of Occupational Safety and Health Administration (“OSHA”) communications as government orders for purposes of the ERC.[7]

However, IRS guidance can prove insufficient, given the interplay of the complexity of the ERC and the diversity of employer fact patterns. Statutory requirements such as employer aggregation receive only cursory attention in the guidance, leaving unanswered many questions essential to an eligibility determination. Further, although the IRS will generally be bound by its guidance and taxpayers may generally rely on it,[8] it may be possible to prevail with a position regarding ERC eligibility that is not supported or addressed in the guidance. For these reasons, legal advice can assist employers in deciding how to proceed with their ERC claims in the wake of the processing moratorium and the new withdrawal options. Caplin & Drysdale’s Tax Disputes & Tax

Litigation and Employee Benefits attorneys are available to provide such counsel.

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[1] Availability in the fourth quarter of 2021 is limited to ‘recovery startup’ businesses.

[2] The Taxpayer Certainty and Disaster Relief Act of 2020, the American Rescue Plan Act of 2021, and the Infrastructure Investment and Jobs Act of 2021.

[3] *Available at* <https://www.irs.gov/coronavirus/frequently-asked-questions-about-the-employee-retention-credit> (last visited Nov. 7, 2023).

[4] See IRS Notice 2021-20, 2021-23, 2021-49.

[5] Rev. Proc. 2021-33.

[6] *Available at* <https://www.irs.gov/pub/lanoa/am-2023-005-508v.pdf> (last visited Nov. 7, 2023).

[7] *Available at* <https://www.irs.gov/pub/lanoa/am-2023-007.pdf> (last visited Nov. 7, 2023).

[8] Rev. Rul. 87-138, 90-91. FAQs and GLAMs may not be used or cited as precedent.

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