IRS Presses Pause on Processing New ERC Claims

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On September 14, the IRS announced that it would stop processing new claims for the Employee Retention Credit (ERC) through at least December 31, 2023, citing serious concerns about "aggressive promoters" that it says are pushing employers to make questionable and even fraudulent claims to the ERC. The IRS also extended its processing time for existing claims from 90 to 180 days and hinted at forthcoming relief provisions for taxpayers who were victims of unscrupulous ERC promoters and made false claims to credits. Finally, the IRS emphasized that it continues to pursue "thousands" of civil audits and "hundreds" of criminal investigations against both promoters and employers that made false claims to the ERC and is devoting additional resources to these efforts.

ERC Background

Congress passed the ERC to jumpstart the economy during the COVID-19 pandemic and get cash into the hands of businesses immediately. Employers qualify for the ERC if they experienced any of the following during 2020 or 2021:

- **Suspension of Operations Due to Governmental Order:** Sustained a full or partial suspension of operations due to orders from an appropriate governmental authority limiting commerce, travel or group meetings because of COVID-19 during 2020 or the first three quarters of 2021;
- **Decline in Gross Receipts:** Experienced a significant decline in gross receipts during 2020 or a decline in gross receipts during the first three quarters of 2021; or
- **Recovery Startup Business:** Qualified as a recovery startup business for the third or fourth quarters of 2021.

Because the ERC is a refundable tax credit, employers may qualify to claim the ERC even now, when the most immediate effects of the pandemic have largely passed. However, many ERC promoters have arisen during and following the end of the pandemic, highlighting the

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availability of the ERC to businesses and charging large contingency fees (25% to 40%) for helping the employer make an ERC claim.

Claims to the ERC under the Suspension of Operations Test

While the legal tests for "significant decline in gross receipts" and "decline in gross receipts" are straightforward mathematical tests, ERC promoters have tested the limits of what constitutes a "**full or partial suspension of operations"** pursuant to a governmental order. IRS guidance defines what a "full or partial suspension" means, in addition to a proper "governmental order." However, many ERC claims have stretched this guidance far past any reasonable limit.

As one example, IRS guidance does allow for employers to "step into the shoes of a supplier" for purposes of this test. *See* IRS Notice 2021-20, Q&A 12. For example, if an employer located in Kentucky had one single supplier located in New York City, and that one supplier had its operations completely suspended due to a New York City governmental order, that might give rise to a proper ERC claim even if the employer was not subject to a similar governmental order in Kentucky. However, the IRS Chief Counsel recently issued guidance providing that *general* supply chain shortages due not qualify as a "full or partial suspension of operations", where for example, the employer merely had to purchase replacement goods at a higher price or had to use supplies that the employer had held in reserve.

Indeed, the IRS announcement states that "[t]he IRS believes many of the applications currently filed are likely ineligible, and tax professionals note anecdotally that they are seeing instances where **95% or more of claims** coming in recent months are ineligible as promoters continue to aggressively push people to apply regardless of the rules."

New IRS Policy on ERC Claims

Given this state of affairs, the IRS has simply decided to stop processing **new** claims for the ERC. This policy is effective immediately, through at least December 31, 2023. While **existing**

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claims will continue to be processed, the processing time has been extended to 180 days such that the IRS has more time to scrutinize each claim.

It is important to note that the IRS has **not** banned or limited the **submission** of new ERC claims. Rather, these claims will be held in reserve while the IRS gets through the claims currently pending. Indeed, employers with valid and vetted ERC claims that have not been submitted to the IRS are well advised to submit those claims in a timely fashion. In general, the statute of limitations to file ERC claims with respect to quarters in 2020 expires on April 15, 2024.

Finally, the IRS highlighted a few initiatives for employers: (1) a special withdrawal option for pending claims, and (2) an ERC settlement program.

First, the IRS is finalizing a "special withdrawal option" for employers who have submitted an ERC, but the IRS has not yet processed it or paid the ERC. This appears to be a "mulligan" option for employers who may have submitted a dubious claim, and now wish to withdraw it. The IRS estimates that approximately 600,000 employers are in this situation. However, the IRS makes it clear that an employer's withdrawal of a willfully filed fraudulent claim "will not exempt them from potential criminal investigation and prosecution."

Second, this fall the IRS will be rolling out a general ERC settlement program for employers who received improper ERC payments. This program will "allow the business to avoid penalties and future compliance action" and may also address the problem of repaying the portion of the ERC that a promoter took as its contingency fee. It remains to be seen whether this program will involve IRS Criminal Investigations or otherwise allow employers to be relieved of any potential criminal liability.

Ultimately, the IRS has emphasized its commitment to pursuing fraudulent ERC claims in both civil and criminal investigations. Indeed, earlier this summer, a New Jersey tax preparer was arrested and indicted for allegedly filing over $124 million in fraudulent ERC claims. Employers should therefore take the IRS's announcement seriously; in our view, fraudulent ERC and employment tax claims are currently the highest priority for IRS civil and criminal

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enforcement.

Employers should seek the advice of counsel: (1) when preparing any ERC claim, particularly under the Suspension of Operations test; (2) when considering whether to use any of the IRS's forthcoming settlement initiatives; or (3) after receiving an IRS notice regarding an audit or criminal investigation regarding an ERC claim. Additionally, if an employer has a pending claim with the IRS, counsel should investigate whether the claim meets the required tests.

For more information about these developments, please contact the author or any attorney in Frost Brown Todd's Tax practice group.

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