

Services

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RENAN RODRIGUEZ

WASHINGTON:

202.378.2300

RENAN.RODRIGUEZ@

HUSCHBLACKWELL.COM

IRS Introduces Second Opportunity for ERC Claimants to Correct Errors

On August 15, 2024, the Internal Revenue Service (IRS) launched a second Employee Retention Credit (ERC) Voluntary Disclosure Program for employers to correct any mistakes related to their ERC claims. The ERC, introduced by the Coronavirus Aid, Relief, and Economic Security Act, was designed to help businesses and tax-exempt organizations that kept paying employees during the COVID-19 pandemic, even if they had to shut down or reduce operations due to government orders, saw a significant drop in revenue, or were recovery startups during the eligible periods. This new program provides participants another chance to fix any errors in such claims.

The IRS has found that the ERC has become quite complex and significantly vulnerable to fraud. This issue led the agency to stop processing ERC claims entirely on September 14, 2023. The IRS paused the voluntary disclosure program on March 22, 2024, to address the growing backlog of unprocessed claims. The recent announcement reflects the IRS's continued commitment to tackling ERC claims, especially as businesses have been growing frustrated with delays in receiving their benefits.

Eligibility

The Voluntary Disclosure Program is available to participants who have claimed the ERC for tax periods in 2021 and received a credit or refund before August 15, 2024, as long as:

1. The participant is not currently under criminal investigation or has not been notified that one is about to start;
2. The IRS has not been tipped off by a third party about the participant's noncompliance, nor has it gathered information on noncompliance through an enforcement action;

3. The participant is not currently being audited by the IRS for employment taxes related to the periods it intends to apply for in this program;
4. The participant has not been informed by the IRS that the ERC is being recaptured for the periods the participant is applying for[1]; and
5. The participant has not previously received a notice demanding repayment of all or part of the ERC claimed.

Third-party payers

Participants who claimed the ERC through a third-party payer—such as an agent under Section 3504 of the Internal Revenue Code, a professional employer organization, or a certified professional employer organization that filed the ERC claim under their own EIN instead of the participant's EIN—are eligible for the second ERC Voluntary Disclosure Program. However, the third-party payer will need to submit certain information reporting forms with the IRS.

Earlier this year, the IRS Office of Chief Counsel released legal memorandum AM 2024-001, concluding that third-party payers are liable, together with their clients, for underpayments of payroll taxes resulting from an improperly claimed ERC. Participants who used a third-party payer to file ERC claims on their behalf should refer to the language of the agreement entered into with the third-party payer to analyze whether language was inserted, such as a tax indemnity provision, that would impose responsibility on the participant to indemnify the third-party payer for penalties incurred as a result of the improper ERC claim.

Terms

Participants seeking to engage in the second round of the Voluntary Disclosure Program are subject to the IRS' following terms:

1. **Employment tax adjustments.** Participants will not be eligible for any ERC—neither refundable nor non-refundable—for the tax periods involved.
2. **Repayment.** Participants must return 85% of the claimed ERC, including both refundable and non-refundable amounts, to the U.S. Department of the Treasury.
3. **Interest.** A participant that pays the full 85% of the claimed ERC before finalizing the closing agreement will not be subject to interest underpayment. However, if the participant opts for an alternative payment arrangement like an installment agreement, interest may accrue from the start date of that agreement.

4. **U.S. federal income tax consequences.** The settlement eliminates any eligibility for the ERC, so participants are not required to adjust your wage expenses based on a previously claimed ERC. Participants who have not previously adjusted wage expenses will not be required to file amended returns or Administrative Adjustment Requests (AARs). Conversely, participants who have reduced wage expenses based on the ERC should not make further reductions in their amended returns or AARs. The settlement ensures that no additional income is recognized to participants from the resolution of the ERC obligation.
5. **Preparer/advisor information.** If a return preparer or advisor assisted with preparing the ERC claim, the participant must provide their name, address, phone number, and a description of their services.
6. **Penalties.** The IRS will not impose civil penalties for underpayment of employment tax related to the ERC if the participant repays 85% of the claimed ERC before signing the closing agreement.
7. **Closing agreement.** The participant will be required to sign a closing agreement.

What this means to you

The IRS will be closing the second ERC voluntary disclosure program on November 22, 2024. Interested participants should take proper action as soon as possible to ensure proper compliance with IRS information reporting requirements.

The IRS generally has three years to audit returns, including employment tax returns. Thus, the statute of limitation for the 2020 tax year will run in 2024 for most employers. Similarly, the statute for the 2021 tax year will run in 2025, except for ERC claims filed in Q3 of 2021 in which Congress has extended the statute to five years. ERC claims filed in Q3 of 2021 will run in 2027. Lastly, we note that even if the statute of limitations expires, the IRS has an additional two years from the issuance of any refund to seek its repayment in court if the IRS determines a refund was made in error. The two-year period can be extended up to five years if the government can show that the refund was induced by participant fraud or a misrepresentation of a material fact.

Contact us

If you or your company submitted ERC claims for the 2021 tax year and are concerned with the U.S. federal income tax consequences related to such claims or have any related ERC questions, we encourage you to reach out to Rey Rodriguez to ensure that your previous ERC claims comply with applicable U.S. federal tax laws.

[1] The IRS notifies an employer of ERC recapture by issuing a Letter 6577-C, *Employee Retention Credit (ERC) Recapture*.