What To Know About Employee Retention Credit Disclosures

By **Mark Loyd, Gregory Rhodes and Helen Cooper** (March 13, 2024)

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Eligible taxpayers hoping to address potentially erroneous employee retention credit claims have until midnight on March 22 to apply for the voluntary disclosure program.

The Internal Revenue Service introduced the voluntary disclosure program, or VDP, late last year as a lifeline to taxpayers that the IRS contends were hoodwinked by aggressive promoters.[1] The VDP is a settlement program that allows employers to repay 80% of the credit amount received.

In exchange for keeping 20% of the claimed credit, which will not be taxed as income, the taxpayer must cooperate with any requests for information from the IRS and sign a closing agreement.

Disclosure Pros and Cons

There are some distinct advantages to the VDP. First, VDP resolution will avoid an IRS audit. Likewise, if repayment is made by the date of the closing agreement, no interest or penalties will be charged.

The repayment amount does not include interest received by the taxpayer on employee retention credit, or ERC, funds.[2]

Plus, taxpayers who believe they were entitled to the credit for some tax periods, but not for others, can choose which tax periods to list on the VDP application. Further, VDP resolution eliminates the need to amend income tax returns to change wage expense deductions.[3]

However, there are some disadvantages to voluntary disclosure. Taxpayers who do not have the cash to make the repayment by the closing agreement date can apply for an installment arrangement, but interest and penalties will apply.[4] If the IRS does not accept an installment arrangement, then the taxpayer must find another way to finance participation in the program.

The VDP requires the taxpayer to admit they are not entitled to the credit. This may not be the best option for taxpayers who believe in the merit of their claim.

Background

The ERC is a refundable tax credit for businesses and tax-exempt organizations affected by the COVID-19 pandemic. The credit became successively more generous through additional legislation.

As originally passed into law with the CARES Act, the ERC provided a credit for wages paid in the first two quarters of 2020. Congress extended the ERC in the Taxpayer Certainty and Disaster Relief Act to include all of 2020 and the first two quarters of 2021. Then, the 2021 American Rescue Plan Act codified the ERC in Internal Revenue Code Section 3134, and extended the credit to include the third quarter of 2021, and the fourth quarter of 2021 for eligible startup businesses.

The credit was retroactively ended by the Infrastructure Investment and Jobs Act in November 2021.[5]

Despite its expiration in 2021, ERC claims are still being filed via amended tax returns. On March 20, 2023, the IRS listed ERC scams on its dirty dozen list of fraudulent tax schemes for 2023. According to an IRS press release, this was in response to "blatant attempts by promoters to con ineligible people to claim the credit."[6]

Beginning on Sept. 14, 2023, the IRS announced a moratorium on retroactive ERC claims. The moratorium was followed by the announcement of a process to withdraw pending claims and repay improper refunds. Then, on Dec. 21, 2023, the IRS launched the VDP.

Evaluating the Strength of an ERC Claim

Before applying for the VDP, taxpayers should carefully consider the strengths and weaknesses of their claim, as well as their perceived risk tolerance. It is important to review eligibility guidance to assess whether the taxpayer's facts fit within the ERC framework.

As a basic threshold, to be eligible for the ERC, a taxpayer must satisfy one of the following criteria:

- The suspension test: The taxpayer sustained a full or partial suspension of operations due to an order from an appropriate governmental authority limiting commerce, travel or group meetings because of Covid-19 during 2020 or the first three quarters of 2021;

- The gross receipts test: The taxpayer experienced a significant decline in gross receipts during 2020 or during the first three quarters of 2021; or

- The taxpayer qualified as a recovery startup business for the third or fourth quarters of 2021.[7]

Taxpayers who claimed the ERC should also assemble any documentation they have supporting eligibility for the credit.[8] For example, payroll records for the quarters in which the ERC is claimed may help substantiate the qualified wages used to calculate the credit.

Likewise, taxpayers who claimed the ERC based on the gross receipts test should keep work papers evidencing their calculation of the eligible employer's decline in gross receipts.

It is especially important for taxpayers claiming the credit based on the suspension test to gather relevant governmental Covid-19 orders demonstrating restrictions in place during the time period in which the ERC was claimed.

Financial records that show employee hours and headcount by quarter, key performance indicators affected by a suspension in operations, or processes and procedures implemented in reaction to a government order can also be helpful in documenting the impact of government orders on the taxpayer's operations.

Controversy surrounding ERC claims is expected to continue for years to come, especially for claims that relied on the suspension test. This is because the suspension test relies on the facts and circumstances surrounding the specific claim, rather than a dollar threshold utilized by the gross receipts test.

Taxpayers that claimed the credit based on the suspension test criteria should expect that these claims will be more heavily scrutinized during an IRS audit.

Employers should prepare an audit-ready package that specifically identifies why they are eligible for the ERC. Understanding the eligibility criteria and how their business fits into that criteria can help the employer decide whether to apply for the VDP.

Employers with documentation and more reasoned arguments supporting eligibility may find themselves less inclined to participate in the program than taxpayers with claims that are less documented.

VDP Eligibility

Not all taxpayers who claimed the ERC are eligible for the VDP. To be eligible, the following criteria must be met:

- The ERC must have been claimed on an original or amended return and received;
- The taxpayer must believe it is not entitled to the credit;
- The taxpayer must not be currently under, or notified of, a pending criminal investigation;
- The taxpayer cannot be the subject of third-party information or an enforcement action related to ERC noncompliance;
- The taxpayer cannot have previously filed an amended employment tax return to reverse the ERC claim;
- The taxpayer cannot be under an employment tax exam for the applicable tax period; and

- The taxpayer cannot have received a prior notice and demand from the IRS for the claimed ERC's repayment.[9]

Taxpayers who are ineligible for voluntary disclosure may alternatively be eligible to withdraw their ERC claim. Those ineligible for both the VDP and the withdrawal program can amend their employment tax returns.

Applying for the VDP

Eligible taxpayers opting into the VDP need to file a Form 15434, "Application for the Employee Retention Credit (ERC) Voluntary Disclosure Program" and, if the credit was claimed in 2020, a Form SS-10, "Consent to Extend the Time to Assess Employment Taxes," which extends the statute of limitations.

If the taxpayer is represented by an authorized representative, then a Form 2848 power of attorney should be included with the application.

To be considered for an installment plan, the taxpayer should also include a Form 433-B business collection information statement with the application.

The application must be signed by an authorized person and uploaded using the IRS document upload tool by 11:59 PM on March 22. If a third party filed the employment tax returns at issue, then that third-party will need to apply for the VDP.[10]

After submission, the IRS will review the application and verify the applicant's eligibility. If the application is accepted, the IRS will adjust the taxpayer's tax account to reduce or eliminate the ERC amount.

If rejected, the IRS will send the taxpayer an explanatory letter with possible solutions.[11]

Whether to Participate

For taxpayers having valid second thoughts about their ERC claim, the VDP can be a good deal.

Resolution though the VDP allows a taxpayer to keep 20% of the funds they received, tax-free; avoids an IRS audit; and — for those that have the funds to make the payment — prevents the imposition of interest and penalties. As long as there was no willful or intentional misconduct, the IRS will treat program participants' ERC claims as if they had never been filed.

However, the program may not be right for everyone.

Taxpayers that believe in their ERC claim should consider whether the program is the right fit for them. Participation requires a large, upfront payment of the bulk of the ERC claim received. Repayment of a valid and substantiated ERC claim may not make sense in many instances. Moreover, participating taxpayers are required to sign a closing agreement and comply with further information requests.

The upcoming deadline for VDP participation leaves thoughtful taxpayers with much to consider.

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[1] IR-2023-169, Sept. 14, 2023.

[2] IRS, "Frequently asked questions about the Employee Retention Credit Voluntary Disclosure Program," last updated Feb. 14, 2024.

[3] Id.

[4] Id.

[5] Hale E. Sheppard, "ERC Enforcement Tactics: The IRS's Carrots and Sticks So Far," Tax Notes Federal, Feb. 12, 2024, p. 1017-1018.

[6] IR-2023-71, Oct. 13, 2023.

[7] Id.

[8] Brian Gardner, "Employee Retention Credit: It's Not All Fraud," Tax Notes Federal, Oct. 30, 2023, p. 824.

[9] "Frequently asked questions about the Employee Retention Credit Voluntary Disclosure Program," supra, FN 2.

[10] Id.

[11] Id.