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Tax Alert

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Employee Retention Tax Credit—September 2024 Update

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The current status of the ERC and the next steps to assist your businesses.

What's the impact?

- For taxpayers that have made ERC claims and received Denial Letters, immediate action is required.
- Prior to the end of Chevron, IRS ERC guidance would have been given substantial deference.
- Taxpayers should reconsider their ERC posture post-Chevron.

There have been several recent, significant developments impacting the employee retention tax credit (ERC). First, an ERC promoter lost its effort to preliminarily enjoin the IRS from continuing the moratorium on ERC funding that started on September 14, 2023 (the Moratorium), see *Stenson Tamaddon, LLC v. United States Internal Revenue Service*, No. CV-24-01123-PHX-SPL (July 30, 2024) (Stenson). The lengthy decision in Stenson was highly critical of the Internal Revenue Service's (IRS) administration of the ERC and its Moratorium to date.

Shortly thereafter, possibly in response to *Stenson*, the IRS announced in I.R. 2024-203, on August 8, 2024 (the Announcement), a partial end to the Moratorium, and days later, on August 15, 2024, announced that it was rebooting the voluntary disclosure program. At the same time, the IRS has been sending out tens of thousands of denial letters in the form of Letter 105C (Denial Letter), which create yet more confusion about the ERC.

Whether your business has (1) applied for the ERC and is awaiting a refund, (2) already received an ERC refund, (3) received a Denial Letter, or (4) is still considering making an ERC claim before the April 15, 2025, deadline, this flurry of activity surrounding the tax program requires clarification.

While the unique circumstances of your business will best inform next steps, this Client Alert outlines the current status of the ERC to assist businesses as they navigate the remaining eight months before the end of the ERC and what options are available.

The Roadmap to April 15, 2025

DENIAL LETTERS

For taxpayers that have made ERC claims and received Denial Letters, immediate action is needed, as generally a reply is required within 30 days to preserve all appeal rights. Denial Letters are often not clear about the reasons for a denial or recourse available to the taxpayer. Indeed, the IRS admits in the Announcement that some Denial Letters do not even discuss the taxpayer's appeals rights. If you have received a Denial Letter, it is important to contact your tax counsel or accountant to determine the best course of action.

THE WHIPSAW EFFECT AND "PROTECTIVE CLAIMS"

The statute of limitations (SOL) on amending payroll tax returns (Form 941-X) for 2021 ends on April 15, 2025, and the ERC ends on the same date. Legislators attempted to end the ERC on January 31, 2024, as part of H.R. 7024, but this bill failed in a Senate roll call vote in early August 2024. While most think this is the final blow to H.R. 7024, the ERC portions of the bill enjoy bipartisan support and may be resuscitated in future legislation. These ERC provisions would have extended the SOL in favor of the IRS so it could audit ERC claims as far out as 2030.

The bill also would have fixed a technical problem with respect to the third and fourth quarter 2021 ERC claims, created when the American Rescue Plan Act extended the SOL to audit these quarters to five years (Section 3134(l)),[1] but did not extend the taxpayer's time to amend the associated income tax returns, which is three years. The problem arises because taxpayers claiming the ERC must reduce their wage deduction on their income tax returns by the amount

[1] All references to "Section" are to the Internal Revenue Code of 1986, as amended.

of the ERC refund, even before the taxpayer receives any ERC refund. This results in a whipsaw effect. Specifically, if the IRS successfully challenges the ERC refund after the taxpayer's SOL on refund claims expires, the taxpayer is left without its ERC refund and would be barred by the SOL from increasing its associated wage deduction. This would almost always (absent something like net operating losses or excess credits) put the taxpayer in a materially worse off position than if they never filed for the ERC in the first place. The resulting liability would be compounded by interest and penalties.

To insulate themselves, taxpayers should strongly consider filing "protective claims" prior to the expiration of the SOL on the income tax returns relating to ERC wages. The SOL is generally three years but depends on when the taxpayer filed and when taxes were paid (see, Section 6511(a), (b)). Therefore, this SOL could end sometime between April 2024 and October 2025. Because this determination is very fact specific, it is important to consult your tax attorney or accountant to make sure you meet this deadline and properly complete the "protective claim."

THE POST-CHEVRON WORLD

For taxpayers who have received a Denial Letter (or may receive one) or simply never heard from the IRS about their ERC claim, or for taxpayers still considering filing for the ERC prior to April 15, 2025, it is important to reevaluate whether your business qualifies for the ERC following the Supreme Court's Summer 2024 decisions ending Chevron deference to federal agency action: *Loper Bright Enterprises v. Raimondo; Relentless, Inc. v Dept. of Commerce; and Corner Post Inc. v. Board of Governors of the Federal Reserve System* (collectively, the "Post-Chevron Cases").

We previously analyzed *Chevron* and the Post-Chevron Cases in a prior alert. Chevron imbued administrative agencies, such as the Department of Treasury (of which the IRS is a part), with considerable deference when interpreting and enforcing laws promulgated by Congress, such as the ERC (Section 3134). The Post-Chevron Cases ended this deference and consequently, taxpayers should carefully reconsider the IRS's prior interpretations of the ERC, especially given the ERC's genesis during the turbulent COVID-19 pandemic era.

The COVID-19 pandemic called for immediate action and did not afford legislators or Treasury with the time necessary to clearly define the ERC. The typical deliberative legislative process that produces legislative history explaining the intent of the statute was absent, and there was no time for Treasury to propose regulations with the normal notice and comment process for the public to raise questions and concerns regarding interpretations of the ERC. The little guidance the IRS provided regarding the ERC was done in a truncated period of time.

The IRS interpreted and is enforcing the ERC through several notices, the most significant of which is Notice 2021-20, issued in March 2021 (the Notice). The Notice is 102 pages and largely regurgitates the contents of the "Frequently Asked Questions" (FAQs) the IRS posted to its website beginning in 2020, which eventually grew to over 90 FAQs. The Notice, like the FAQs, were rushed, and in many cases take incredible liberties interpreting Section 3134, the ERC

statutory provision. Some of these interpretations favor taxpayers, but most do not. Many of the restrictive interpretations are not grounded in the statute itself or the spirit in which it was enacted—to make whole or compensate employers who retained employees during the COVID-19 pandemic, even though those employees may not have had any job to do because of operational restrictions caused by the pandemic. Moreover, the Notice itself is ambiguous and in some cases, very difficult to follow.

Prior to the Post-Chevron Cases, the IRS guidance, like the Notice, would have been given substantial deference. That is no longer the case. Courts are now required to interpret the Notice in accordance with the enabling statute, without any deference to the IRS's interpretation. To the extent that IRS guidance is contrary to the CARES Act or other legislation, taxpayers may no longer be bound to follow it when challenging the IRS on ERC-related claims.

THE END OF THE MORATORIUM

The *Stenson* court noted, and the IRS appears to agree, that the IRS can't simply stop processing claims forever and force taxpayers to file suit to get their ERC refunds. The Announcement only says that the IRS will start processing "high risk" (Denial Letters) and ***some*** "low risk" claims. The Announcement admits that it has already identified 50,000 such "low risk" claims and will begin making payments on these claims sometime in September or October 2024, and other "low risk" claims will be paid in fall 2024. It also appears that all of these "low risk" claims were filed ***before*** the Moratorium began, on September 14, 2023. This means that all of these "low risk" claimants will have waited ***at least*** one year before being paid. The Announcement goes on to say that "low risk" claims filed between September 14, 2023, and January 31, 2024, the proposed end-date for the ERC, which was rejected by Congress, will begin being processed next. One can presume these ERC claims will not be paid until after fall 2024, which means that these "low risk" claimants will also have waited a year or more for their ERC refunds. The fact that so many claimants that the IRS itself identifies as "low risk" have had to wait this long to receive ERC refunds is astonishing.

The Announcement doesn't address "medium risk" claims and one can only guess what "high risk" and "low risk" means. It appears that "high risk" claims are those that have the earmarks described in prior IRS announcements regarding "promoters" or "marketers" (Promoters) charging contingency fees for their services or claims by persons that were not running a business. Presumably the more of these earmarks, the higher the risk. Presumably the absence of any of these earmarks makes the claims "low risk" but it is hard to know. The Announcement says the IRS will start with the worst of the "high risk" and the best of the "low risk" and work toward the middle, and thus when the work is done, the "medium risk" will be known.

By statute, taxpayers can file a refund suit in federal court against the IRS to review ERC claims, but must wait six months before doing so (Sections 7422(a) and 6532(a)(1)). The IRS knows that

the vast majority (perhaps more than 99%) of these taxpayers are not going to pay the legal fees associated with filing such suits, so the IRS strategy, as described by the court in Stenson, is to stall. The strategy seems to be to starve the Promoters (like the plaintiff in Stenson) of fees and discourage businesses from filing ERC claims. The strategy seems to be working as the number of ERC claims has fallen precipitously over the past 12 months.

The question now is whether the Post-Chevron Cases will encourage more businesses to file ERC claims before the deadline of April 15, 2025.

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