

EMPLOYEE RETENTION CREDIT

IRS Processing Delays Are Resulting in Uncertainty and Are Harming and Frustrating Business Owners

WHY THIS IS A SERIOUS PROBLEM FOR TAXPAYERS

At the onset of the COVID-19 pandemic, Congress enacted the Employee Retention Credit (ERC) to support struggling businesses and exempt organizations impacted by government-imposed restrictions by providing a tax credit intended to keep employees on the payroll.¹ However, the ERC statutes are complicated and difficult to administer. Bad actors have taken advantage of this complexity by misleading some taxpayers to believe they are eligible for the credit. Thus, the IRS has been inundated with ERC claims and struggled to discern which were valid or invalid.

In the summer of 2023, the IRS drastically slowed ERC processing, culminating in a moratorium on processing new claims starting September 14, 2023. This moratorium continues to aggravate processing delays and cause harm and frustration for many business owners. To make matters worse, over the past four years, taxpayers have not received adequate information from the IRS about delays or the status of their ERC claims. Thousands of business owners have reached out to TAS and/or their congressional representatives for guidance on how to proceed. More than a year from the implementation of the moratorium, the IRS still has not processed many claims filed prior to September 14, 2023. Many businesses with legitimate ERC claims are depending on the funds to aid in their recovery from the pandemic. While waiting for the IRS to process these claims, businesses have been forced to close, experienced significant financial hardship, or taken out loans that continue to accrue interest.

¹ Henceforth, all references in this Most Serious Problem to businesses will necessarily include exempt organizations.

EXPLANATION OF THE PROBLEM

During the pandemic, Congress created significant tax benefits, including the ERC.² Congress intended this credit to provide financial assistance to businesses and exempt organizations impacted by government-imposed restrictions meant to stop the spread of the virus by incentivizing employers to keep employees on their payroll. This much-needed relief was significant for struggling businesses greatly impacted by the pandemic.

Unfortunately, when Congress delivers relief through the tax code, scammers, and bad actors all too often take advantage hoping to illegally obtain large refunds or promoter fees. Specifically, in the case of the ERC, bad actors and scammers targeted desperate business owners using aggressive advertising campaigns that provided inaccurate or incomplete information regarding their eligibility for the credit. To address this, the IRS drastically slowed its processing of these claims, culminating in a moratorium to give itself time to sort out the good claims from the bad. Since the IRS's implementation of the moratorium, the backlog of unprocessed ERC claims has grown. Also, IRS communications with affected businesses awaiting their ERC funds have been woefully inadequate. The IRS's failure to process ERC claims timely and provide taxpayers with regular updates has frustrated and burdened taxpayers and compromises their *rights to a fair and just tax system and to be informed*.³

Key issues include:

- *Lengthy processing times:* As of October 26, 2024, about 1.2 million claims remain unprocessed, leaving taxpayers without claim status updates or knowing what to expect going forward;⁴
- *Downstream consequences:* IRS delays in processing ERC claims have negative downstream consequences and force taxpayers to make difficult decisions. For example, a taxpayer may have to choose whether to amend their individual income tax return to account for an ERC refund not yet received;
- *Poor communication:* IRS disallowance notices issued prior to an examination are confusing and omit critical information;
- *Abandonment of standard exam procedures:* The IRS largely abandoned its standard procedures when reviewing ERC claims in favor of curtailed processes that do not provide taxpayers adequate opportunities to respond to the IRS while also running the risk of exceeding the time the IRS has to issue a refund;
- *Stolen check delays:* Some eligible businesses experienced additional delays when their ERC refund checks were stolen. These businesses had to wait months or longer for the IRS to conclude an investigation and issue a new check; and
- *Low participation in voluntary disclosure programs:* Taxpayer participation in the IRS's ERC disclosure programs has been low, and the IRS has not acted swiftly to approve taxpayer applications.

The Taxpayer Bill of Rights contains ten taxpayer rights, including the *rights to be informed, to pay no more than the correct amount of tax, and to challenge the IRS's position and be heard*. A taxpayer can only fully exercise these critical rights if the IRS clearly explains its position by being transparent and providing regular guidance and updates. Additionally, to ensure it protects taxpayer rights, the IRS must commit that all its employees – especially its Exam employees – are adequately trained and informed on the complex rules surrounding the ERC.

2 The acts include the Coronavirus Aid, Relief, and Economic Security Act (CARES) Act, Pub. L. No. 116-136, § 2301, 134 Stat. 281, 347-51 (2020); Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, Div. EE, Title II, §§ 206-207, 303, 134 Stat. 1181, 3059-65, 3075-79 (Div. EE is known as the Taxpayer Certainty and Disaster Tax Relief Act of 2020); American Rescue Plan Act of 2021 (ARPA), Pub. L. No. 117-2, § 9651, 135 Stat. 4, 176-82 (2021); Infrastructure Investment and Jobs Act, Pub. L. No. 117-58, § 80604, 135 Stat. 429, 1341 (2021). For this purpose, exempt organizations are those organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, educational, or other specified purposes that meet certain other requirements and are tax exempt under IRC § 501(c)(3).

3 See Taxpayer Bill of Rights (TBOR), <https://www.taxpayeradvocate.irs.gov/taxpayer-rights> (last visited Dec. 4, 2024). The rights contained in TBOR are also codified in IRC § 7803(a)(3).

4 IRS, Accounts Management (AM), Research, Analysis and Data (RAD) Reports, COVID Business Credits (week ending Oct. 26, 2024).

Background

During the height of the pandemic, many employers had to make significant changes to their operations because of public health orders designed to protect the public. To help employers absorb the financial impact of these orders and retain their employees, Congress created the ERC, which it amended throughout 2020 and 2021.⁵

Who Is Eligible for the Employee Retention Credit?

The rules governing eligibility for the ERC are complex and nuanced. Generally speaking, eligible employers who paid qualified wages between March 13, 2020, and December 31, 2021, can claim the ERC if their business or tax-exempt organization:

- Was fully or partially suspended by a government order due to the pandemic during 2020 or the first three calendar quarters of 2021, or
- Experienced the required decline in gross receipts during the eligibility periods during 2020 or the first three calendar quarters of 2021.

Additionally, employers may be eligible for the ERC if they are considered a recovery startup business. An employer must have started a recovery startup business by carrying on a new trade or business after February 15, 2020, and paid Form W-2 employees in the third or fourth quarters of 2021.⁶ And, if the business had 100 or more employees in 2019, taxpayers were only allowed to claim the credit for wages paid to employees who were not providing services in 2020.⁷ For the 2021 ERC, only employers with 500 or fewer employees in 2019 were allowed to claim the credit on wages paid to employees not providing services.⁸

Employers meeting these eligibility requirements might qualify for a credit of up to \$5,000 per employee in calendar year 2020.⁹ For 2021, Congress increased the credit to \$7,000 per employee for each eligible quarter, adding up to a maximum credit of \$21,000 per employee for most eligible employers in the first three calendar quarters of 2021.¹⁰ For the last two calendar quarters in 2021, the IRS limited recovery startup businesses to an aggregate credit of \$50,000 per quarter, potentially adding up to a total of \$100,000.¹¹

Initially, employers had to choose between claiming the ERC or receiving a loan under the Paycheck Protection Program (PPP).¹² Congress eventually changed the law and permitted eligible employers who received a PPP loan to also claim the ERC. However, employers cannot count the same wages both for seeking forgiveness of the PPP loan *and* calculating the ERC.¹³ This change allowed many more employers to qualify for the ERC but also increased confusion for many business owners and practitioners.

5 Initially, the law provided employers who qualified for the ERC a refundable credit against an employer's 6.2 percent share of Federal Insurance Contribution Act (FICA) taxes or Railroad Retirement Tax Act (RRTA) taxes. CARES Act, Pub. L. No. 116-136, § 2301, 134 Stat. 347 (2020). IRC §§ 3111(a) and 3221(a) impose FICA and RRTA taxes on employers. Most employers report this liability on Form 941, Employer's Quarterly Federal Tax Return.

6 A recovery startup business is a business or organization that began carrying on a trade or business after February 15, 2020, and had average annual gross receipts of \$1 million or less for the three years preceding the quarter for which they are claiming the ERC. See IRS, Coronavirus FAQs, <https://www.irs.gov/coronavirus/frequently-asked-questions-about-the-employee-retention-credit#recovery> (last updated Dec. 2, 2024).

7 CARES Act, Pub. L. No. 116-136, § 2301(c)(3)(A), 134 Stat. 347 (2020).

8 CARES Act, Pub. L. No. 116-136, § 2301(c)(3)(A), 134 Stat. 347 (2020), as amended by Pub. L. No. 116-260, Div. EE, Title II, § 207(b) and (c), 134 Stat. 3062 (2020).

9 The ERC has been amended several times since Congress originally enacted it as part of the CARES Act. See IRS, Employee Retention Credit – 2020 vs 2021 Comparison Chart, <https://www.irs.gov/newsroom/employee-retention-credit-2020-vs-2021-comparison-chart> (last updated Jan. 30, 2024).

10 CARES Act, Pub. L. No. 116-136, § 2301(a) and (b), 134 Stat. 347 (2020), as amended by Pub. L. No. 116-260, Div. EE, Title II, § 207(b) and (c), 134 Stat. 3062 (2020); IRC § 3134(a) and (b), as enacted by ARPA, Pub. L. No. 117-2, § 9651, 135 Stat. 176 (2021).

11 IRC § 3134(b)(1)(B).

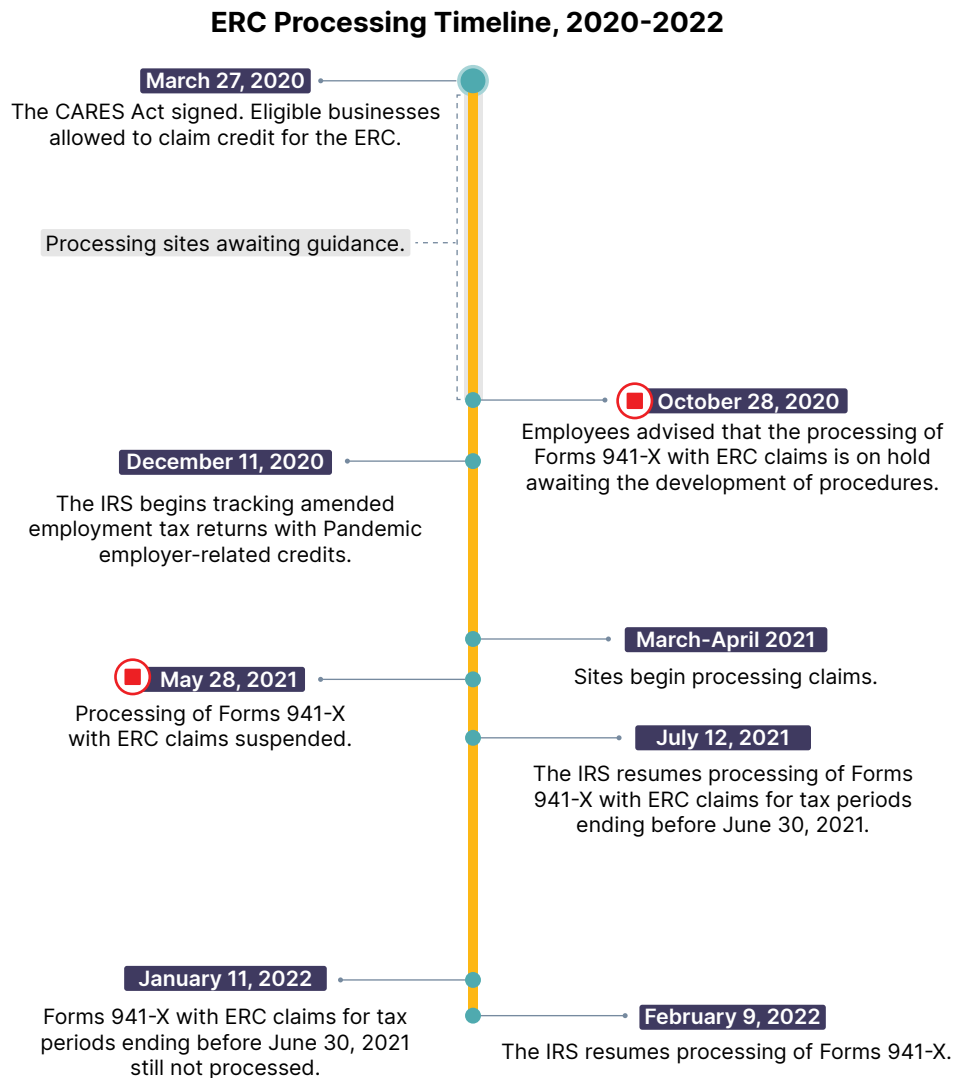
12 CARES Act, Pub. L. No. 116-136, §§ 1102, 2301(j), 134 Stat. 286, 350 (2020).

13 Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, Div. EE, § 206(c), 134 Stat. 3060 (2020).

The IRS Has Been Slow to Process Employee Retention Credit Claims, Leaving Taxpayers Without Claim Status Updates or Knowledge of What to Expect Going Forward

Even though Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act in March 2020, the IRS did not process its first ERC claims until around August 2020, and ERC claims processing did not really accelerate until around the first week of April 2021.¹⁴ Figure 2.1.1 illustrates the IRS’s stop-and-go processing of ERC claims.

FIGURE 2.1.1¹⁵



¹⁴ IRS, Compliance Data Warehouse (CDW), Business Master File (BMF), as of Sept. 2024.

¹⁵ Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2024-400-068, *Management Took Actions to Address Erroneous Employee Retention Credit Claims; However, Some Questionable Claims Still Need to Be Addressed* (2024), <https://www.tigta.gov/sites/default/files/reports/2024-11/2024400068fr.pdf>.

After the Stop-and-Go Processing Timeline

Once the IRS resumed processing ERC claims in February 2022, it really picked up the pace. For example, in 2022, it processed approximately three times as many claims as it processed in 2021. During the first eight months of 2023, the IRS processed almost as many claims as it processed in all of 2022. However, concerns about bad actors generating an increasing number of improper claims caused the IRS to bring the processing of ERC claims down to a trickle beginning the summer of 2023, then to a complete standstill. The potentially large amount of the credit along with its complexity attracted unscrupulous promoters taking advantage of the situation by aggressively advertising the ERC program to businesses in hopes of collecting large fees based upon the amount of the claims.¹⁶

The IRS announced on September 14, 2023, that it was imposing a moratorium on processing new ERC claims, and it pivoted from processing claims to using analytics to assess them. The IRS intended for the moratorium to provide it with time to conduct a risk scoring analysis to distinguish between valid and invalid claims.¹⁷ In its news release announcing the moratorium, the IRS indicated it suspected many of the claims were improper, stating:

The IRS believes many of the applications currently filed are likely ineligible, and tax professionals note anecdotally that they are seeing instances where 95 percent or more of claims coming in recent months are ineligible as promoters continue to aggressively push people to apply regardless of the rules.¹⁸

The IRS's lack of transparency coupled with it citing to "anecdotal information" in a news release has created the impression – quite possibly a misconception – that 95 percent of all pending ERC claims were fraudulent.¹⁹ It is unclear how the IRS could make this assertion since to establish fraud, the IRS must demonstrate an intentional violation of a known legal duty, which requires careful scrutiny of the case's facts and circumstances. An erroneous return is not necessarily fraudulent. The National Taxpayer Advocate acknowledges there may be some claims that do not qualify, and some may be fraudulent. For that reason, it is understandable why the IRS would believe it was appropriate to temporarily press the pause button on claims processing and take time to develop better methods to identify non-qualifying claims. But the IRS cannot make taxpayers wait indefinitely to receive their credits. It should accelerate the processing of ERC claims, and it should be transparent and provide details on its plans.

Nevertheless, the moratorium had an impact and caused a sharp decline in the number of new claims filed. It also negatively impacted the number of processed ERC claims in 2024.²⁰

¹⁶ IRS, CDW, BMF and Business Returns Transaction File (BRTF), as of Sept. 2024. For additional ERC processing data, see Figure 2.1.2.

¹⁷ IRS response to TAS information request (Sept. 23, 2024). As of August 30, 2023, the IRS had completed an initial risk assessment of approximately 1.1 million claims, and about 300,000 claims were awaiting this initial risk assessment.

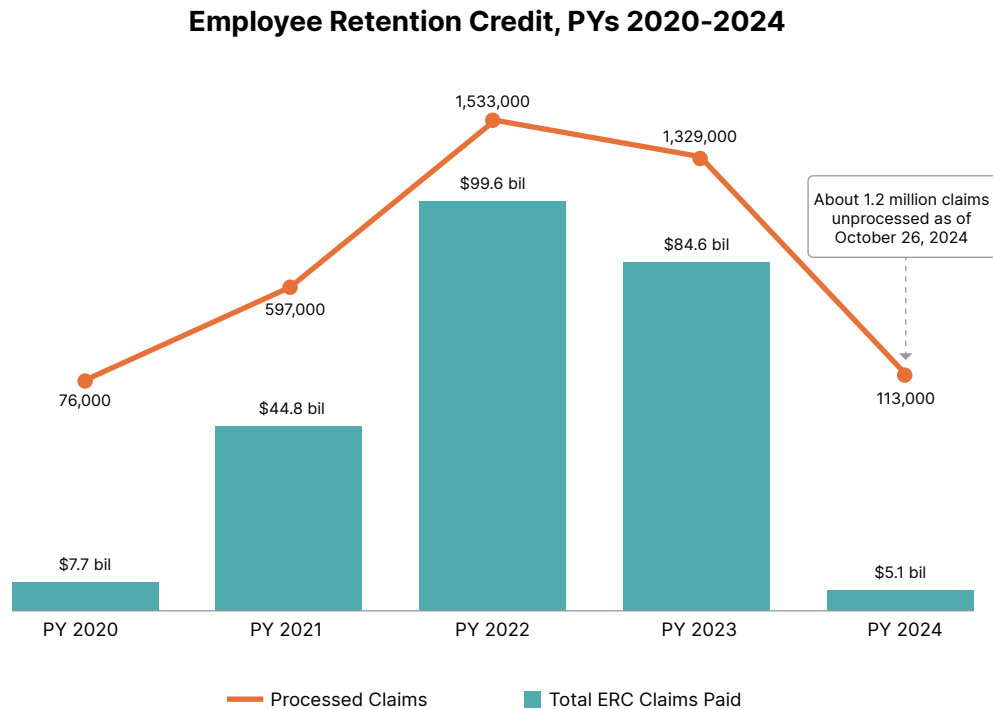
¹⁸ IRS News Release, IR-2023-169, To Protect Taxpayers From Scams, IRS Orders Immediate Stop to New Employee Retention Credit Processing Amid Surge of Questionable Claims; Concerns From Tax Pros (Sept. 14, 2023), <https://www.irs.gov/newsroom/to-protect-taxpayers-from-scams-irs-orders-immediate-stop-to-new-employee-retention-credit-processing-amid-surge-of-questionable-claims-concerns-from-tax-pros>.

¹⁹ Proposed Taxpayer Advocate Directive 2024-1: Accelerate the Processing of Backlogged Employee Retention Tax Credit Claims, Lift the Moratorium, and Provide Greater Public Transparency Regarding Processing Status (June 14, 2024).

²⁰ IRS, CDW, BMF and BRTF, as of Sept. 2024. See also IRS News Release IR-2023-169, To Protect Taxpayers From Scams, IRS Orders Immediate Stop to New Employee Retention Credit Processing Amid Surge of Questionable Claims; Concerns From Tax Pros (Sept. 14, 2023), <https://www.irs.gov/newsroom/to-protect-taxpayers-from-scams-irs-orders-immediate-stop-to-new-employee-retention-credit-processing-amid-surge-of-questionable-claims-concerns-from-tax-pros>. Some have questioned the legality of the IRS moratorium.

By the start of the moratorium in September 2023, the IRS had processed a total of approximately 3.6 million ERC claims.²¹ Since the implementation of the moratorium, the number of ERC claims processed has dropped to a trickle. Figure 2.1.2 illustrates the fluctuation in the IRS’s processing of ERC claims over the past several years and how processing came to a near standstill in 2024.

FIGURE 2.1.2²²



The slow processing of ERC claims has not only created financial hardship for businesses, but it has also cost the government fisc. The IRS has issued a total of about \$242 billion in ERC, as shown in Figure 2.1.2, and paid an estimated \$8.1 billion in interest.²³

21 IRS News Release, IR-2023-169, To Protect Taxpayers From Scams, IRS Orders Immediate Stop to New Employee Retention Credit Processing Amid Surge of Questionable Claims; Concerns From Tax Pros (Sept. 14, 2023), <https://www.irs.gov/newsroom/to-protect-taxpayers-from-scams-irs-orders-immediate-stop-to-new-employee-retention-credit-processing-amid-surge-of-questionable-claims-concerns-from-tax-pros>.

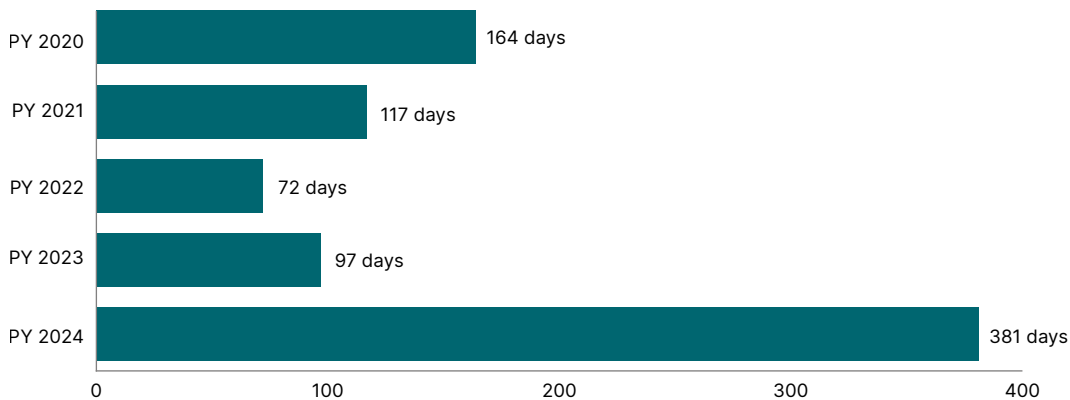
22 IRS, CDW, BMF and BRTF, as of Sept. 2024. ERC processed claims and credit amounts reflect claims that have not been reversed as of the end of September 2024. IRS, AM RAD Reports, COVID Business Credits (week ending Oct. 26, 2024). IRS News Release, IR-2023-40, IRS Issues Renewed Warning On Employee Retention Credit Claims; False Claims Generate Compliance Risk For People And Businesses Claiming Credit Improperly (Mar. 7, 2023), <https://www.irs.gov/newsroom/irs-issues-renewed-warning-on-employee-retention-credit-claims-false-claims-generate-compliance-risk-for-people-and-businesses-claiming-credit-improperly>.

23 The IRS paid \$6.4 billion in interest that accrued between the time the taxpayer filed an original Form 941 and when they filed a Form 941-X. The remaining \$1.7 billion accrued between the time the taxpayer filed a Form 941-X and when the IRS issued a refund on the claim, where the IRS took more than 45 days to issue the refund from when the claim was filed. Based on the IRS’s response to the TAS fact check, modifications were made to the interest calculations. However, due to time constraints, the IRS was not able to review the final interest calculations. IRS, CDW, BMF, as of Sept. 2024. See IRC § 6611(b). The IRS is required to pay interest on overpayments; however, under IRC § 6611(e)(2), interest will not accrue between the time a claim is filed to when a refund is issued if the refund is issued within 45 days of the claim being filed. See also Treas. Reg. § 301.6611-1.

Some good news: The IRS began processing ERC claims it identified ranging from very high to low risk. And on October 10, 2024, it announced it had 400,000 claims processed or ready to process that taxpayers had filed prior to January 31, 2024.²⁴ The 400,000 claims included 28,000 claims the IRS disallowed and 50,000 valid claims it had previously announced it was processing.²⁵ However, there are still over one million claims awaiting IRS processing, and it is unclear when these taxpayers can expect the IRS to act on their claims. All other businesses continue to wait without any guidance or information regarding the status of their claims. As the IRS exercises heightened caution with ERC processing, the average processing time has increased from under 120 days in processing years 2021-2023 to now more than a year, as shown in Figure 2.1.3.²⁶

FIGURE 2.1.3²⁷

Average Number of Days for Processing ERC Claims, PYs 2020-2024



As of October 26, 2024, about 98 percent of the slightly over one million unprocessed ERC claims were over 120 days old, compared to only about five percent that were more than 120 days old prior to the moratorium.²⁸

For the one million claims still awaiting IRS action, the IRS has provided little to no information on processing. Throughout the moratorium, it has not provided the public with regular updates on its progress evaluating claims or with any estimate of when it expects to resume normal processing. Another challenge facing these businesses is the inability to check the status of their claim. In fact, IRS procedures instruct employees to inform taxpayers who call inquiring about the status of their Forms 941 or 941-X that “...we cannot provide any additional information at this time as to the status or timeframe for processing their form.”²⁹ This leaves taxpayers wondering when – if ever – the IRS will process their claim. Unfortunately, the IRS has stated that it has no intention of providing regular, real-time updates to taxpayers regarding their claims.³⁰

24 Telephone conversation with Director, IRS Campus Examination (Oct. 30, 2024). Processed claims are either allowed, partially allowed, disallowed, partially disallowed, or assigned for a future audit.
 25 IRS News Release, IR-2024-203, IRS Moves Forward With Employee Retention Credit Claims: Agency Accelerates Work On Complex Credit As More Payments Move Into Processing; Vigilance, Monitoring Continues on Potentially Improper Claims (Aug. 8, 2024), <https://www.irs.gov/newsroom/irs-moves-forward-with-employee-retention-credit-claims-agency-accelerates-work-on-complex-credit-as-more-payments-move-into-processing-vigilance-monitoring-continues-on-potentially-improper-claims>.
 26 A *processing year* is based on the cycle when the transaction posts to the IRS Master File.
 27 IRS, CDW, BMF, as of Sept. 2024.
 28 IRS, AM RAD Report, COVID Business Credits (week ending Oct. 26, 2024).
 29 Internal Revenue Manual (IRM) 21.7.2.7.2(5), Employee Retention Credit (ERC) (Feb. 28, 2024), https://www.irs.gov/irm/part21/irm_21-007-002r.
 30 IRS response to TAS information request (Sept. 23, 2024).

Not surprisingly, the processing delays and IRS's lack of transparency regarding claims has led to an influx of TAS cases from taxpayers seeking assistance with their pending ERC claims. Prior to the October 26, 2024, announcement, the IRS provided status updates at TAS's request showing that it had processed fewer than 25 percent of TAS taxpayers' claims. As of November 26, 2024, the IRS advised TAS it had worked approximately 10,500 of 26,000 taxpayer claims from TAS taxpayers – just about 40 percent of the outstanding inventory.³¹ However, a number of the remaining TAS cases include refund claims filed after the January 31, 2024, revised moratorium date.

IRS Delays in Processing Claims Create Negative Downstream Consequences and Force Taxpayers to Make Difficult Decisions

As a general rule, the tax system favors parity. For purposes of the ERC, this means taxpayers filing claims for ERC are not entitled to claim a wage deduction on their individual or business income tax returns if they claimed the ERC on their original or amended employment tax returns, such as Forms 941 or 941-X.³² Congress apparently viewed a taxpayer's receipt of an ERC and deduction for wage expenses to be an unwarranted double benefit. The law required taxpayers who were retroactively claiming the ERC by amending their employment tax returns to also make a corresponding adjustment on their individual or business income tax returns, removing any wage deductions for the corresponding amount of ERC claimed.³³ In other words, no double-dipping – taxpayers cannot claim the ERC for the amount of wages claimed as a wage deduction on either their individual or business income tax returns.

Many business owners and practitioners are hesitant to reduce their wage deduction until the IRS acts upon their ERC claim. This is a reasonable approach because the IRS still has a backlog of ERC claims, and taxpayers have a limited timeframe to amend their individual and business income tax returns and claim the wage deductions if the IRS ultimately denies their ERC claim.³⁴ Thus, taxpayers are concerned that by the time the IRS reviews their ERC claim and potentially disallows it, the taxpayer could be time-barred from amending their individual or business income tax returns where they could have claimed a wage deduction. This could result in the taxpayer paying more income tax than what they truly owed, compromising the taxpayer *right to pay no more than the correct amount of tax*.³⁵

However, it is also a matter of fairness that in situations where the IRS has finally allowed the ERC, taxpayers must amend their individual or business income tax return to remove the wage deduction. Otherwise, these taxpayers would doubly benefit, which Congress did not grant and negatively impacts the government fisc. It is critical the IRS fairly administer the tax code; therefore, it should send these taxpayers a notice reminding them they must amend their individual or business income tax return to remove the previously claimed wage deduction now that the IRS has allowed their ERC claim. The IRS should treat taxpayers consistently and not place those businesses that followed the law and made the required corresponding adjustments at a competitive disadvantage to businesses that did not make the corresponding adjustments.

31 IRS response to TAS fact check (Nov. 26, 2024).

32 Congress imposed limitations on wage expenses for income tax purposes by enacting in the ERC statutes a provision applying rules similar to the rules in IRC § 280C(a). See CARES Act, Pub. L. No. 116-136, § 2301(e), 134 Stat. 349 (2020); IRC § 3134(e). Generally, most taxpayers claim wage expense as a deduction on their income tax returns. See IRC § 162.

33 IRS, Coronavirus, Frequently Asked Questions About the Employee Retention Credit, <https://www.irs.gov/coronavirus/frequently-asked-questions-about-the-employee-retention-credit> (last updated Dec. 2, 2024). Taxpayers in certain circumstances may reduce the prior amount capitalized (and make any resulting adjustment, such as reducing a depreciation deduction) rather than reducing the prior wage deduction. See, e.g., CARES Act, Pub. L. No. 116-136, § 2301(e), 134 Stat. 349 (2020); IRC § 3134(e).

34 IRC § 6511(a).

35 See Taxpayer Bill of Rights (TBOR), <https://www.taxpayeradvocate.irs.gov/taxpayer-rights> (last visited Dec. 4, 2024). The rights contained in TBOR are also codified in IRC § 7803(a)(3).

Taxpayers who appropriately reduced their wage deduction on their individual or business income tax returns by the amount of ERC claimed are now in a difficult position if they are still waiting for the IRS to process their ERC claim.³⁶ For example, if a taxpayer amended their income tax return in January 2023 by reducing the amount of their wage deduction by the amount of the ERC credit claimed, thus generating a liability that they were unable to pay, they have been accruing interest and penalties on their income tax liability for almost two years while awaiting their ERC refund. Many taxpayers who are already financially strapped may have been relying on the ERC refund to pay their increased income tax liability. Further, if this business receives a claim disallowance in January 2025, taxpayers are concerned that there may be no remedy for them to amend their individual or business income tax returns and remove the IRC § 280C adjustment (*i.e.*, amending the income tax return to claim a deduction for wages paid), since the refund statute will have expired for most tax year (TY) 2020 individual or business income tax returns, and the 2021 individual or business income tax returns will expire in 2025.³⁷

Some have suggested administrative remedies to this problem to put all ERC recipients on par with each other. One such remedy would be to allow taxpayers to make any necessary adjustments on their individual or business income tax returns for the same year they either receive the ERC refund or the IRS disallows the claim.³⁸ For example, if taxpayers receive their ERC refund in TY 2025 and cannot adjust their income tax return for the years they claimed the ERC (2020 or 2021) because the period for amending the income tax return has expired, they would remedy this by reducing their wage deduction by the appropriate amount on their 2025 income tax return. Conversely, if the tax years remain the same as in the previous example but the IRS disallowed the ERC claim, and the taxpayer can no longer claim the wage deduction on the earlier income tax return they claimed the ERC because the period for amending the income tax return has expired, the IRS should allow taxpayers to take this deduction on their 2025 income tax return or the year of the resolution of the disallowance.³⁹ The IRS allowing these adjustments on the taxpayer's 2025 income tax return will rectify the incorrect claim or omission on the prior income tax return as a result of the outcome of the taxpayer's ERC claim, which will result in either a reduction or increase in the taxpayer's income tax liability and possibly create a larger income tax refund for the taxpayer – or a balance due to the IRS.⁴⁰

IRS Notices Are Confusing and Omit Critical Information

Although the IRS had almost a year from the issuance of the moratorium to perfect both its ERC processes and notices, when it finally issued post-moratorium notices, they were unclear and contained errors. In the summer of 2024, the IRS issued nearly 28,000 notices of ERC disallowance, which contained several significant problems, such as:

- Omitting information about the taxpayer right to seek review by the Independent Office of Appeals (Appeals), a U.S. district court, or the U.S. Court of Federal Claims;⁴¹
- Including inaccurate or vague explanations about why the IRS disallowed the claim;⁴² and

36 See CARES Act, Pub. L. No. 116-136, § 2301, 134 Stat. at 347-51; IRC § 3134(e); IRS Notice 2021-49, 2021-34 I.R.B. 316, Guidance on the Employee Retention Credit under Section 3134 of the Code and on Miscellaneous Issues Related to the Employee Retention Credit, <https://www.irs.gov/pub/irs-drop/n-21-49.pdf>.

37 IRC §§ 6511, 280C. Under IRC § 6511, taxpayers have three years from the due date of the original return or three years from the date they filed the return if they filed it after the due date to amend the original return. Additionally, taxpayers have two years from the time they paid the tax to file a claim for refund under IRC § 6511(a). The applicable time period for filing the claim is whichever time period is later. The IRC § 280C deduction allows a business to take a deduction for wages and salaries paid to employees.

38 See Matt Kelley, *The 280C(a) Timing Conundrum and the IRS Solution*, LINKEDIN BLOG (Oct. 1, 2024).

39 See *id.*

40 See *id.*

41 See TBOR, <https://www.taxpayeradvocate.irs.gov/taxpayer-rights> (last visited Dec. 4, 2024). The rights contained in the TBOR are also codified at IRC § 7803(a)(3).

42 IRS News Release, IR-2024-203, IRS Moves Forward With Employee Retention Credit Claims: Agency Accelerates Work on Complex Credit as More Payments Move Into Processing; Vigilance, Monitoring Continues on Potentially Improper Claims (Aug. 8, 2024), <https://www.irs.gov/newsroom/irs-moves-forward-with-employee-retention-credit-claims-agency-accelerates-work-on-complex-credit-as-more-payments-move-into-processing-vigilance-monitoring-continues-on-potentially-improper-claims>.

- Failing to inform the taxpayer that the IRS would subject the responses to an exam-like review prior to sending the matter to Appeals.

As a result of these omissions and inaccuracies, taxpayers and practitioners questioned whether they could seek assistance from Appeals or if they would have to litigate the matter. The incorrect or vague explanations also left taxpayers and practitioners wondering what information they should submit to the IRS. For example, if the notice explained that the IRS could not verify the existence of the business, should the taxpayer or practitioner only provide information to show the business existed during the specified time period for which the IRS disallowed the claim, or should they also provide supporting documentation for the claim more broadly, including all of the quarters, even if the IRS has not disallowed the related quarters? Or should the business only address what they believe the IRS is disallowing?

It was not until Friday, September 20, 2024 – more than a month after the IRS sent notices to taxpayers disallowing the ERC claims – that it addressed the omissions made in the notices of claim disallowance and provided taxpayers with more in-depth information on how to dispute the disallowance.⁴³ The IRS requested that in addition to providing documentation to support the reason for the disallowance in the notice that the taxpayer provide documentation supporting **at least one** of three specific eligibility factors **for each quarter** they had claimed the ERC.⁴⁴ Many taxpayers and practitioners felt pressured to meet the 30-day time period to request an appeal of a notice of claim disallowance and had already responded to the notices prior to the IRS releasing this information. This left taxpayers and practitioners wondering if they should supplement their response by proactively sending in the additional information that the IRS was now requesting via its webpage or if they should wait for the IRS to formally request these additional documents.⁴⁵

Both taxpayers and the IRS would benefit from the IRS providing taxpayers with clear information from the start, preserving the taxpayer *right to be informed*, rather than supplementing notices via webpages.⁴⁶ In addition to unclear notices, TAS has heard complaints that some of the notices sent by the IRS are inaccurate. For example, TAS has heard on more than one occasion that the notices incorrectly state that the taxpayer erroneously calculated the gross receipts test or that the claim filed by the taxpayer was untimely.⁴⁷

Another example of notices that omitted critical information is in the ERC recapture notices.⁴⁸ The IRS issued regulations allowing it to recapture wrongly paid or applied ERC claims through erroneous refund procedures.⁴⁹ On August 15, 2024, the IRS announced it intended to mail up to 30,000 new letters to taxpayers reversing or recapturing potentially more than \$1 billion in ERC claims.⁵⁰ Unfortunately, the recapture notices did not inform taxpayers of their administrative appeal rights, such as their right to a

43 IRS, Understanding Letter 105-C, Disallowance of the Employee Retention Credit, <https://www.irs.gov/coronavirus/understanding-letter-105-c-disallowance-of-the-employee-retention-credit> (last updated Dec. 2, 2024).

44 *See id.*

45 *See id.*

46 *See* TBOR, <https://www.taxpayeradvocate.irs.gov/taxpayer-rights> (last visited Dec. 4, 2024). The rights contained in the TBOR are also codified at IRC § 7803(a)(3).

47 Conversations with outside stakeholders (June 4, 2024; Sept. 5, 2024; Sept. 17, 2024; Oct. 31, 2024). IRS errors in notices of claim disallowance create frustration for the taxpayer, ultimately forcing them to spend more time and/or money to resolve their problem and creating rework for the IRS. Additionally, to correct the problem, taxpayers may be forced to file a refund suit in a U.S. district court or the U.S. Court of Federal Claims, ultimately creating unnecessary work for the U.S. Department of Justice.

48 IRS Letter 6577-C, Employee Retention Credit Recapture.

49 Treas. Reg. § 31.3111-6. The IRS's recapture authority is the one clear instance in which it could assert penalties against the taxpayer for wrongly claiming the ERC. These include failure-to-pay penalties under IRC § 6651(a)(2) and failure-to-deposit penalties under IRC § 6656. *See also* Telephone conversation with Director, IRS Campus Examination (Oct. 30, 2024).

50 IRS News Release, IR-2024-212, IRS Reopens Voluntary Disclosure Program To Help Businesses With Problematic Employee Retention Credit Claims; Sending Up To 30,000 Letters To Address More Than \$1 Billion in Errant Claims, (Aug. 15, 2024), <https://www.irs.gov/newsroom/irs-reopens-voluntary-disclosure-program-to-help-businesses-with-problematic-employee-retention-credit-claims-sending-up-to-30000-letters-to-address-more-than-1-billion-in-errant-claims>.

Collection Due Process hearing or the Collection Appeals Program.⁵¹ The IRS failed to observe the taxpayer *right to challenge the IRS's position and be heard* by omitting information on these Appeals programs in its recapture notices.

The IRS Has Largely Abandoned Its Standard Exam Procedures in Favor of Compressed Review Processes That in Some Circumstances Risk Running Up Against the Time Period in Which It Can Issue a Refund

The IRS has primarily relied on three processes to review ERC claims, including:

- *Standard audits:* For fiscal year (FY) 2024, the IRS selected 2,300 ERC claims for field audits, and IRS Campus Examination (Exam) closed about 1,400 of these claims.⁵²
- *Streamlined audits:* The IRS developed a streamlined correspondence audit process for ERC claims and selected 1,375 claims for the new compliance workstream, as of September 30, 2024.⁵³
- *Reverse audit-like process:* In the summer of 2024, the IRS issued about 28,000 notices of claim disallowance after running ERC claims through its risk scoring model analysis. When taxpayers respond to these notices, the IRS will conduct an audit-like review process prior to sending the case to Appeals.

Standard audits: When the IRS reviews an ERC claim as part of a field examination, Exam issues a notice of claim disallowance only after it considers the facts and circumstances of the case as well as documentation and substantiation provided by the taxpayer. If the taxpayer and IRS cannot reach an agreement, the taxpayer will receive a 30-day letter advising them of their right to respond to the notice by requesting an administrative appeals hearing.⁵⁴ Upon receiving this request, Exam refers the case to Appeals, but typically it does not issue a formal claim disallowance notice at this stage.⁵⁵

Streamlined audits: The IRS developed a new ERC streamlined audit process in which the IRS sends the taxpayer a letter and a request for information. Taxpayers who do not respond and/or do not provide adequate information receive Letter 105C, Notice of Claim Disallowance. This deviates from a standard employment tax examination where the taxpayer receives a report that includes an explanation of adjustments.

This streamlined correspondence audit skips the standard administrative steps and the IRS issues the taxpayer Letter 105C, Claim Disallowance, or Letter 106C, Partial Claim Disallowance, immediately after the taxpayer responds to the information request. The IRS only sends a formal notice of claim disallowance when the taxpayer does not execute their right to appeal or once the Appeals process is complete and Appeals has determined that the IRS should disallow the claim. The streamlined correspondence audit skips several steps, most notably providing the taxpayer the right to have Appeals weigh in prior to issuing a formal claim disallowance notice.⁵⁶

51 IRS Letter 6577C, Employee Retention Credit Recapture. See also Tom Cullinan, *Proposed Regs on Erroneous ERC Refunds Won't Fly, Firm Warns*, TAX NOTES, Aug. 15, 2024, <https://www.taxnotes.com/research/federal/other-documents/public-comments-regulations/proposed-regs-erroneous-erc-refunds-wont-fly-firm-warns/714pf>.

52 IRS response to TAS information request (Oct. 24, 2024). Of the 2,300 claims selected for examination, about 600 were in the Small Business/Self-Employed (SB/SE) Division and roughly 1,700 were in the Tax Exempt/Government Entities (TE/GE) Division. Of the 2,300 claims, Exam closed approximately 1,400, SB/SE closed about 1,000, and TE/GE closed roughly 400.

53 Telephone conversation with Director, IRS Campus Examination (Oct. 30, 2024). See also IRS response to TAS information request (Oct. 24, 2024).

54 These letters give a taxpayer 30 days from the date of the letter to provide the requested information or request a conference with the IRS Independent Office of Appeals if the taxpayer disagrees with the proposed changes to their tax return.

55 IRM 4.23.22.6, 30-Day Letters: Unagreed Case Procedures (May 16, 2018), https://www.irs.gov/irm/part4/irm_04-023-022; IRM 4.23.10.10.11, Explanation of Adjustments: Form 886-A, Form 5701, and Employment Tax Lead Sheet (ETLS) Copies (June 1, 2023), https://www.irs.gov/irm/part4/irm_04-023-010.

56 IRM 4.10.11.2.2.2(1), Claims for Refund – Letters (Sept. 29, 2022), https://www.irs.gov/irm/part4/irm_04-010-011; and IRM 8.7.7.5(7), Closing Refund Claim Cases (No Additional Tax) (Dec. 17, 2019), https://www.irs.gov/irm/part8/irm_08-007-007.

Reverse audit-like process: The IRS deviated from its standard exam process for the majority of ERC claims reviewed in favor of a more hands-off approach in the new ERC streamlined audit process and recent ERC disallowance notice process. The IRS issued 28,000 ERC notices disallowing the ERC to taxpayers before anyone in the IRS requested supporting documentation, laid eyes on the case, or considered the specific facts and circumstances. It ran these cases through its risk scoring model analysis and deemed them “improper claims.”⁵⁷

Although this hands-off approach may have been easier for the IRS up front, it has led to several problems for both the IRS and taxpayers later in the review process. First, the automatic process the IRS used to issue these notices of disallowance seems flawed, as a number of taxpayers report receiving notices of claim disallowance they believe are clearly erroneous. Second, the IRS issuance of these notices of claim disallowance prior to conducting any meaningful review (*i.e.*, requesting information from the taxpayer to verify the validity of the claim) created administrative problems.

Since the IRS had not requested or reviewed any taxpayer documentation, under its own procedures the case could not go directly to Appeals. Appeals is not a finder of fact and cannot consider or review documentation that an Exam employee has not first reviewed.⁵⁸ Therefore, the IRS had to develop a new review process which would not be considered a formal examination, but rather something similar. This review process allowed the IRS to consider information provided by the taxpayer in response to the ERC notices of claim disallowance issued by the risk scoring model analysis. The new review process also provided the IRS with the opportunity to review and consider the taxpayer’s information prior to sending the taxpayer’s response to Appeals.⁵⁹

In essence, the IRS is subjecting these taxpayers to a reverse audit of sorts. It first issues notices of claim disallowance to taxpayers and then asks them to substantiate their claim if they disagree with the notice, when it will conduct a review of such documents.⁶⁰ This is a reverse process because taxpayers usually attempt to substantiate their claim during an examination, and the IRS issues a notice of claim disallowance only if it remains unpersuaded that the taxpayer qualifies for the claimed credit or deduction. In the reverse audit, the IRS has disallowed the claim, and taxpayers will need to provide support after receiving the claim disallowance. If the IRS employee agrees with the support provided, they will allow some or all of the credit.

If the IRS employee fully allows the credit, there is no reason for the case to be forwarded to Appeals, even if the taxpayer requested an Appeals conference. If the business did not request an appeal and the IRS disagrees with the response, the IRS will not forward the case to Appeals. Instead, it will send Letter 916-C, Claim Incomplete for Processing; No Consideration, stating that the disallowance stands. Although the notice of claim disallowance only instructs taxpayers on their right to request an appeal, and not that they can submit information to the IRS for review, it is unclear how many taxpayers would actually elect this review option.

In some cases, after reviewing the taxpayer’s arguments, the IRS may issue Letter 3064-C, Special Letter, to the taxpayer requesting additional information. More commonly, if a business requests an appeal and the IRS employee disagrees with the taxpayer’s position, the IRS will forward the file directly to Appeals and send

57 IRS News Release, IR-2024-212, IRS Reopens Voluntary Disclosure Program to Help Businesses With Problematic Employee Retention Credit Claims; Sending Up to 30,000 Letters to Address More Than \$1 Billion in Errant Claims (Aug. 15, 2024), <https://www.irs.gov/newsroom/irs-reopens-voluntary-disclosure-program-to-help-businesses-with-problematic-employee-retention-credit-claims-sending-up-to-30000-letters-to-address-more-than-1-billion-in-errant-claims>.

58 For ERC claims, the IRS is considering any appeal request made within the two-year period for filing suit under IRC § 6532, which begins from the date listed on the notice of claim disallowance. IRS response to TAS information request (Sept. 23, 2024).

59 Erin M. Collins, Notice of Claim Disallowance: Don’t Make This Mistake, NATIONAL TAXPAYER ADVOCATE BLOG (Apr. 6, 2022), <https://www.taxpayeradvocate.irs.gov/news/nta-blog/nta-blog-notice-of-claim-disallowance-dont-make-this-mistake/2022/04>.

60 IRS, Understanding Letter 105-C, Disallowance of the Employee Retention Credit, <https://www.irs.gov/coronavirus/understanding-letter-105-c-disallowance-of-the-employee-retention-credit> (last updated Dec. 2, 2024). The IRS guidance instructed taxpayers to provide detailed written explanations regarding how government orders resulted in the suspension of their business, along with a written explanation as to why the taxpayer believes they are entitled to the ERC, a description of the taxpayer’s trade or business, copies of worksheets showing how they computed the ERC, etc. Additionally, the IRS asked taxpayers who claimed the ERC due to either a decline in gross receipts or as a recovery startup business to provide other documentation to substantiate their claim.

Letter 86-C.⁶¹ If Appeals agrees that the IRS should disallow the taxpayer's credit, the taxpayer will still have the right to dispute the IRS's disallowance by filing suit in a U.S. district court or the U.S. Court of Federal Claims, but they must do so within two years of receiving Letter 105-C.⁶²

The National Taxpayer Advocate believes that when a taxpayer responds to the ERC streamline audit document request or reverse audit claim disallowance notice by providing information requested by the IRS, the IRS should respond to the taxpayer in a manner that more closely mirrors an examination report that provides taxpayers with a clear understanding of its conclusions. For claim disallowance responses, the IRS should also offer taxpayers 30 days to respond with additional documentation prior to sending the case to Appeals. Taxpayers can avoid a time-consuming back-and-forth between the IRS and Appeals if they can provide the documentation. The National Taxpayer Advocate is concerned that the potential volume of ERC cases referred to Appeals as well as the increased workload will cause further delays for taxpayers with cases under review and consideration.

Along with the reverse exam process providing taxpayers with fewer opportunities to dispute the IRS's conclusion, putting Exam's review after the IRS sends the notices of disallowance elongates the time it takes a taxpayer's claim to get to Appeals. An appeal is already a lengthy process, as it can take months before Appeals assigns an officer to the case; it also can take five months or more from the issuance of Letter 86C to hold an initial Appeals conference.⁶³

This drawn-out process is especially concerning because the IRS's issuance of a notice of disallowance begins the running of a two-year period during which the IRS must issue any refund. Specifically, the two-year timeframe in which the taxpayer can either file suit or the IRS can issue a refund begins from the date on the notice of claim disallowance.⁶⁴ Under the law, any refund the IRS issues after this two-year time period is considered erroneous.⁶⁵ The taxpayer can extend the two-year time period under IRC § 6532 for the IRS to issue a refund only when they submit Form 907, which requires both the IRS and taxpayer to agree and sign.⁶⁶

The IRS could address this lengthy review process by sending taxpayers a letter prior to the official notice of claim disallowance informing them that it is inclined to disallow their claim. The letter could provide taxpayers an opportunity to send the IRS necessary documentation to support the claim and request an Appeals hearing. If the taxpayer does not respond, the IRS can move forward and issue the official notice of claim disallowance. If the taxpayer responds to the notice and sends in documentation to support the claim, the IRS will not issue a notice of claim disallowance until an Exam employee has reviewed the taxpayer's information and Appeals has reviewed the IRS's decision. Only after that process should the IRS issue an official notice of claim disallowance, which would essentially move the entire claim review process before the two-year clock starts. The IRS could easily do this by substituting an initial letter for the notices of claim disallowance requesting additional information and reserving the IRS's issuance of a notice of claim disallowance until after Exam and Appeals complete their reviews.

61 IRS, Coronavirus, Frequently Asked Questions About the Employee Retention Credit, <https://www.irs.gov/coronavirus/frequently-asked-questions-about-the-employee-retention-credit> (last updated Dec. 2, 2024). IRS Letter 86-C is an interim letter notifying a taxpayer when the IRS transfers their case to another office or function. Currently this webpage is the only formal guidance the IRS has provided on these procedures, as it has not yet developed IRMs that formally spell out this process for either taxpayers or IRS employees.

62 IRC § 6532(a)(2); Erin M. Collins, Notice of Claim Disallowance: Don't Make This Mistake, NATIONAL TAXPAYER ADVOCATE BLOG (Apr. 6, 2022), <https://www.taxpayeradvocate.irs.gov/news/nta-blog/nta-blog-notice-of-claim-disallowance-dont-make-this-mistake/2022/04>.

63 IRS response to TAS information request (Sept. 7, 2023).

64 IRC § 6532. Taxpayers have two years from the date on the notice of claim disallowance to file a refund suit in either a U.S. district court or the U.S. Court of Federal Claims. The IRS must issue a refund within this two-year period as any refund that falls outside of this period is considered "erroneous" under IRC § 6514.

65 IRC § 6514.

66 IRC § 6532(a)(2). See also Erin M. Collins, Notice of Claim Disallowance: Don't Make This Mistake, NATIONAL TAXPAYER ADVOCATE BLOG (Apr. 6, 2022), <https://www.taxpayeradvocate.irs.gov/news/nta-blog/nta-blog-notice-of-claim-disallowance-dont-make-this-mistake/2022/04>.

Another process the IRS should consider to reduce the amount of time it takes to review these claims is the Appeals Fast Track Settlement (FTS) option. FTS is a voluntary mediation process available to taxpayers when the IRS conducts an examination, but issues remain unresolved. Although Appeals has said it will consider an FTS application and determine how to move forward with such a request in accordance with established procedures, Small Business/Self-Employed (SB/SE) Field Compliance is the gatekeeper of offering such an option to taxpayers, and it is unclear if or when it will make this option available for ERC cases.⁶⁷ In fact, during a recent conference, an Appeals official stated that SB/SE believes the majority of cases where the IRS sent a notice of claim disallowance are bad claims. Specifically, the Appeals official indicated that it is SB/SE's view that the IRS's algorithms for selection "are so good that they don't want to compromise them in their cases. They're only taking to Exam the rotten apples of the ERC cases . . . and basically if you're not going to compromise, there's nothing to do in ERC" cases.⁶⁸ It is interesting that the IRS believes that its algorithms are so good, considering the number of issues taxpayers and practitioners have raised regarding problems with the notices of claim disallowance.

It is unlikely that FTS will be available for the ERC streamline audits and the ERC disallowances since there is no point prior to the IRS issuing the disallowance notice for the taxpayer to request FTS. Further, it is uncertain if the IRS considers the examiner review of the claim as a Compliance function or as something that falls short of this FTS requirement, even though it is not an official audit that would meet the eligibility requirements of FTS. When taxpayers respond to the notice of claim disallowance, an examiner first reviews their documents and protests but does not subject the taxpayer to an official exam. Any effort on the IRS's part to deem these cases ineligible based on an Exam-like process it created would be unfair and carry the risk of appearing as if it intentionally disqualified these taxpayers for FTS.

ERC cases seem tailor-made for the FTS option (*i.e.*, rules surrounding ERC are notoriously complex and contain many gray areas) where a mediator can consider the unique facts and circumstances along with the hazards of litigation. The IRS should ensure that taxpayers whose ERC claims it has disallowed receive the option to participate in FTS.⁶⁹

Eligible Businesses Experienced Additional Delays When Their Employee Retention Credit Refund Checks Were Stolen

A number of eligible businesses relying on the ERC have faced additional delays and frustrations when they reported not receiving their checks, even though IRS systems show the checks were issued. As of September 30, 2024, over 21,000 taxpayers reported to the IRS that they had not received their ERC checks.⁷⁰ It is likely that many taxpayers did not receive these checks because they were destroyed, stolen, or sent to the wrong address.⁷¹

67 Rev. Proc. 2017-25, 2017-14 I.R.B. 1039; IRS response to TAS information request (Sept. 24, 2024); Lauren Loricchio, *Appeals Open to Using Mediation for ERC Cases*, TAX NOTES, Nov. 18, 2024, <https://www.taxnotes.com/tax-notes-federal/tax-system-administration/appeals-open-using-mediation-erc-cases/2024/11/18/7n86n>; IRS, Fast Track, <https://www.irs.gov/appeals/fast-track> (last updated July 15, 2024).

68 Lauren Loricchio, *Appeals Open to Using Mediation for ERC Cases*, TAX NOTES, Nov. 18, 2024, <https://www.taxnotes.com/tax-notes-federal/tax-system-administration/appeals-open-using-mediation-erc-cases/2024/11/18/7n86n>.

69 Others have suggested the IRS create a new forum in which taxpayers can have their claim for refund considered in a hearing-like setting. The recommendation is for the IRS to create an "opt-in hearing program" that would allow taxpayers an opportunity for an administrative hearing to establish their eligibility for their previously submitted refund claim. James Creech, *Proposed Changes to Improve Refund Claim Processing*, TAX NOTES, Oct. 9, 2024, <https://www.taxnotes.com/tax-notes-federal/litigation-and-appeals/proposed-changes-improve-refund-claim-processing/2024/10/14/7lspw>.

70 IRS, CDW, BMF, as of Sept. 2024. Upon receiving a taxpayer complaint that their ERC check was not received, the IRS then posts Transaction Code 971, Action Code 011, Nonreceipt of Refund Check, to the taxpayer's IRS account. This indicates the check could have been stolen, lost, or destroyed.

71 U.S. Dep't of Justice, U.S. Attorney's Off., E.D.N.Y., Press Release, *Two Former Postal Workers Charged With Stealing U.S. Treasury Checks Valued at More than \$4 Million From Kennedy Airport Mail Facility* (July 10, 2024), <https://www.justice.gov/usao-edny/pr/two-former-postal-workers-charged-stealing-us-treasury-checks-valued-more-4-million>.

When taxpayers believe someone has stolen their ERC refund check, they need to contact the IRS to investigate. If the IRS determines it issued the check, it sends the taxpayer Form 3911, Taxpayer Statement Regarding Refund, with instructions on how to request that the Bureau of the Fiscal Service (BFS) investigate to determine whether anyone ever deposited the check and into what account; these investigations can take up to nine months. For taxpayers who reported their ERC checks stolen in calendar year 2024, the average time until the IRS issued a new check was about nine weeks from the time the taxpayer filed Form 3911, further delaying an already protracted process.⁷²

When BFS resolves the missing check issue, the IRS again issues a paper check. Under its procedures, the taxpayer cannot request that the IRS electronically deposit the second refund to their account. It will only issue a paper check each time because IRS automated processes require a manual override to issue the funds into the taxpayer's account electronically. The IRS should work with BFS to provide taxpayers an option to elect to deposit funds electronically in lieu of a replacement paper check.

Taxpayer Participation in the IRS's Employee Retention Credit Disclosure Programs Has Been Low

After it announced the moratorium, the IRS offered several disclosure programs for improper ERC claims. First, on October 19, 2023, it announced a withdrawal process for unprocessed ERC claims.⁷³ As of September 30, 2024, the IRS had received 11,832 withdrawal requests.⁷⁴ As of September 30, 2024, the IRS had closed 10,873 withdrawal requests, with 959 still awaiting processing.⁷⁵

Second, on December 21, 2023, the IRS announced it would open a voluntary disclosure program (VDP) for taxpayers who received their claimed refund but subsequently determined their ERC claim was invalid.⁷⁶ Under this VDP, the IRS required taxpayers to pay back 80 percent of the credit with no penalties or interest on the repaid amount.⁷⁷ The VDP closed on March 22, 2024, and the IRS received 2,609 applications for the program prior to this date; yet as of September 30, 2024, it has only executed closing agreements for 782 of these submissions.⁷⁸ On August 15, 2024, the IRS announced a second VDP that requires taxpayers to pay back 85 percent of the credit.⁷⁹ As of September 30, 2024, for the second round of the ERC VDP, which expired on November 22, 2024, the IRS had received just 48 applications.⁸⁰

72 IRS, CDW, BMF, as of Sept. 2024.

73 IRS News Release, IR-2023-193, IRS Announces Withdrawal Process for Employee Retention Credit Claims; Special Initiative Aimed at Helping Businesses Concerned About an Ineligible Claim Amid Aggressive Marketing, Scams (Oct. 19, 2023), <https://www.irs.gov/newsroom/irs-announces-withdrawal-process-for-employee-retention-credit-claims-special-initiative-aimed-at-helping-businesses-concerned-about-an-ineligible-claim-amid-aggressive-marketing-scams>.

74 IRS response to TAS information request (Oct. 24, 2024). These withdrawal requests represented multiple filing quarters. Unfortunately, the IRS was unable to provide TAS with the average time for processing taxpayers' withdrawal requests.

75 IRS response to TAS information request (Oct. 24, 2024).

76 IRS News Release, IR-2023-247, IRS: New Voluntary Disclosure Program Lets Employers Who Received Questionable Employee Retention Credits Pay Them Back At Discounted Rate; Interested Taxpayers Must Apply By March 22 (Dec. 21, 2023), <https://www.irs.gov/newsroom/irs-new-voluntary-disclosure-program-lets-employers-who-received-questionable-employee-retention-credits-pay-them-back-at-discounted-rate-interested-taxpayers-must-apply-by-march-22>.

77 See *id.* ("Those that the IRS accepts into the [voluntary disclosure] program will need to repay only 80 percent of the credit they received.")

78 IRS response to TAS information request (Oct. 24, 2024).

79 IRS News Release, IR-2024-212, IRS Reopens Voluntary Disclosure Program to Help Businesses With Problematic Employee Retention Credit Claims; Sending Up to 30,000 Letters to Address More Than \$1 Billion in Errant Claims (Aug. 15, 2024), <https://www.irs.gov/newsroom/irs-reopens-voluntary-disclosure-program-to-help-businesses-with-problematic-employee-retention-credit-claims-sending-up-to-30000-letters-to-address-more-than-1-billion-in-errant-claims>.

80 IRS response to TAS information request (Oct. 24, 2024); IRS Tax Tip 2024-78, Second ERC Voluntary Disclosure Program for Improper Claims is Open Through Nov. 22 (Sept. 23, 2024), <https://www.irs.gov/newsroom/second-erc-voluntary-disclosure-program-for-improper-claims-is-open-through-nov-22>.

CONCLUSION AND RECOMMENDATIONS

The ERC was meant to be a lifeline for businesses and nonprofits battered by the pandemic. Instead, for many it has become a source of confusion and hardship. Due to the IRS's delays, inefficiency, and lack of clarity, countless eligible businesses are still awaiting relief. While administering the ERC is no small task, the IRS's missteps – including lengthy delays, limited guidance and communication, unclear notices, and non-standard examination processes – have prolonged businesses' hardships unnecessarily. Many employers have been left without the funds they need to stay afloat, pay employees, or plan for the future.

This issue is not just about processing claims – it is about fulfilling a promise to American businesses and communities while protecting against fraud. The IRS must prioritize taxpayer needs, streamline claim processing, handle disputes fairly and promptly, and deliver the relief Congress intended. The time for action is *now*. Businesses can't wait any longer.

Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. *Provide transparent training and guidance:* Ensure it provides internal subject matter training and guidance to all IRS employees working on processing, conducting an audit, or in Appeals considering an ERC claim, and post IRS training materials online on IRS.gov within 30 days of issuance to the employees.
2. *Expedite claim processing:* Process all ERC claims filed before January 31, 2024, by April 30, 2025, and claims pending for over six months by July 31, 2025. Processing includes paying the claim, denying the claim, or notifying the taxpayer that the claim is under audit.
3. *Prioritize economic hardship cases:* Process claims from businesses in financial hardship first and then process the remaining claims in the order received.
4. *Lift the moratorium:* Resume processing post-January 31, 2024, claims and process future claims within six months of receipt.
5. *Enhance communication:* Provide regular updates on IRS.gov on the processing of outstanding ERC claims and include specific anticipated timeframes.
6. *Provide clear disallowance explanation:* Provide a detailed factual and legal explanation in Letter 86C as to why the ERC claim disallowance is being upheld and provide the taxpayer more time to submit additional information before referring the case to Appeals.
7. *Request supporting documentation proactively:* When taxpayers have not been subject to an exam, issue a letter allowing taxpayers to send in documentation and seek an appeal prior to the notice of claim disallowance being issued for the ERC.
8. *Track and extend statutes:* In Appeals, track the two-year IRC § 6532 statute cases on ERC claims in inventory and notify taxpayers of this pending statute expiration six months prior to the two-year deadline. Also, provide taxpayers an explanation of the impact of the expiration of the statutory period to file suit and the option of executing Form 907 to extend the statute.
9. *Offer Fast Track:* Allow ERC taxpayers to utilize the Fast Track process.
10. *Enable direct deposit for replacement checks:* Partner with BFS to provide taxpayers an option to elect to have funds deposited electronically in lieu of receiving a replacement paper check.

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