

# Understanding ERC Claims and Options to Expedite Payments

by Barclay R. Taylor



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In this article, Taylor examines the employee retention credit, outlines alternatives for businesses unsure about the validity of their ERC claims, and explains options to expedite the payment of ERC funds.

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## I. Introduction

On March 12, 2020, the World Health Organization declared the COVID-19 outbreak a pandemic.<sup>1</sup> With the hope of mitigating the tough economic conditions that individuals and businesses were experiencing, Congress passed the 2020 Coronavirus Aid, Relief, and Economic Security Act.<sup>2</sup> A key provision of the CARES Act was the employee retention credit.<sup>3</sup>

The ERC encouraged businesses to retain, hire, and pay employees during the pandemic by offering a refundable federal payroll tax credit to eligible employers.<sup>4</sup> Unfortunately, many

<sup>1</sup> Tedros Adhanom Ghebreyesus, WHO Director-General's Opening Remarks at the Media Briefing on COVID-19 (Mar. 11, 2020).

<sup>2</sup> P.L. 116-136; Joint Committee on Taxation, "Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security Act," JCX-12R-20 (Apr. 23, 2020).

<sup>3</sup> The ERC was extended and modified by the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, section 207 of the Consolidated Appropriations Act, 2021; the American Rescue Plan Act of 2021, section 9651; and the Infrastructure Investment and Jobs Act.

<sup>4</sup> CARES Act.

businesses are still waiting to receive the funds from ERC claims filed months, or even years ago.

This article provides an overview of the ERC, outlines alternatives for businesses unsure about the validity of their ERC claims, and explains options to expedite the payment of ERC funds.

## II. Overview of the ERC

### A. Eligible Employer

Congress enacted the ERC to help businesses that were most vulnerable to harm during the COVID-19 pandemic, such as bars and restaurants, movie theaters, gyms, hair and nail salons, daycare facilities, manufacturing companies, and retail stores, to name a few. ERCs were available to both for-profit and nonprofit employers.<sup>5</sup>

To qualify as an eligible employer, a business must meet one of two tests. The first determines whether the business was "fully or partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes)" because of COVID-19 (that is, the government orders test).<sup>6</sup> This includes local, state, and federal governmental orders.<sup>7</sup> Some orders obviously qualify, such as a state governor's mandate that all nonessential businesses suspend operation, while others are less clear.

The second test determines whether a business experienced a "significant decline in gross receipts" during a relevant calendar quarter

<sup>5</sup> CARES Act, section 2301(c)(2)(C).

<sup>6</sup> CARES Act, section 2301(c)(2)(A).

<sup>7</sup> Notice 2021-20, 2021-11 IRB 922; IRS, "Frequently Asked Questions About the Employee Retention Credit" at Qualifying Government Orders, Q&A 1 (last visited Sept. 16, 2024).

(that is, the gross receipts test).<sup>8</sup> For 2020, eligibility begins in the quarter when the gross receipts were less than 50 percent of gross receipts for the same quarter in 2019, and ends on the first day of the quarter after the gross receipts were more than 80 percent of the same quarter in 2019.<sup>9</sup> For 2021, eligibility includes quarters in which gross receipts were less than 80 percent of the same quarter in 2019.<sup>10</sup>

The IRS later expanded the definition of an eligible employer to include recovery start-up businesses.<sup>11</sup> These are businesses that began operating a trade or business after February 15, 2020, and had average gross receipts of less than \$1 million during the three-year testing period.<sup>12</sup>

## B. Qualified Wages

The ERC is not a blanket provision for all wages paid by all employers during the pandemic. Determining which wages are “qualified wages” depends on (1) the average number of full-time employees of the eligible employer, and (2) the quarter in which the wages were paid.

Qualified wages for a small eligible employer are wages paid to any employee during an applicable quarter.<sup>13</sup> For a large eligible employer, qualified wages are only those wages paid to employees who were not providing services during the applicable quarter.<sup>14</sup> A small eligible employer for 2020 was an entity with an average of 100 or fewer full-time employees during 2019.<sup>15</sup>

To expand help to more small businesses for 2021, the threshold was raised to 500 full-time employees.<sup>16</sup>

Only wages paid in certain quarters are eligible for the ERC. For employers that meet the government orders test or the gross receipts test, qualified wages apply to wages paid between March 13, 2020, and September 30, 2021.<sup>17</sup>

## C. Amount of Credit

Wages eligible for ERCs are measured on a quarter-by-quarter basis. For 2020, eligible employers were able to claim an ERC equal to 50 percent of qualified wages paid per calendar quarter.<sup>18</sup> The cumulative qualified wage limitation for all three quarters of 2020 was \$10,000 per employee.<sup>19</sup> This means that the maximum ERC for 2020 was \$5,000 per employee.

For 2021, eligible employers were able to claim an ERC equal to 70 percent of qualified wages per calendar quarter.<sup>20</sup> The qualified wage limitation for 2021 was \$10,000 for each employee per quarter, not per year. Because this applied to the first three quarters for employers that met the government orders test or the gross receipts test, the ERC limitation for 2021 was \$7,000 per employee per quarter.<sup>21</sup> In other words, most eligible employers could claim a maximum of \$21,000 per employee for 2021.<sup>22</sup>

## D. Tax Return Reporting

Businesses that claimed ERCs were required to report the claim on the original Form 941, “Employer’s Quarterly Federal Tax Return,” or

<sup>8</sup> CARES Act, section 2301(c)(2)(B); Taxpayer Certainty and Disaster Tax Relief Act of 2020; Notice 2021-23, 2021-16 IRB 1113.

<sup>9</sup> CARES Act, section 2301(c)(2)(B). Under Notice 2021-23, a business that was not in existence in 2019 can substitute “2019” for “2020.”

<sup>10</sup> Notice 2021-23. This notice also provides an alternative quarter election rule for 2021.

<sup>11</sup> Notice 2021-49, 2021-34 IRB 316; Notice 2021-65, 2021-51 IRB 880.

<sup>12</sup> Notice 2021-49; Notice 2021-65.

<sup>13</sup> CARES Act, section 2301(c)(3)(A)(ii). Note that there are exceptions related to payments for qualified health plan expenses, Paycheck Protection Program loans, and other tax credits. Further, there are exceptions regarding wages of certain owners, constructive owners, and related individuals. These and other exceptions are outside the scope of this article.

<sup>14</sup> CARES Act, section 2301(c)(3)(A)(i).

<sup>15</sup> *Id.*

<sup>16</sup> Notice 2021-23.

<sup>17</sup> CARES Act, section 2301(m); Notice 2021-23; Notice 2021-49; Notice 2021-65. Recovery start-up businesses can extend the window to wages paid through December 31, 2021.

<sup>18</sup> CARES Act, section 2301(a).

<sup>19</sup> CARES Act, section 2301(b)(1).

<sup>20</sup> Taxpayer Certainty and Disaster Tax Relief Act of 2020; Notice 2021-20; Notice 2021-23; Notice 2021-49; Notice 2021-65.

<sup>21</sup> Taxpayer Certainty and Disaster Tax Relief Act of 2020; Notice 2021-20; Notice 2021-23; Notice 2021-49; Notice 2021-65.

<sup>22</sup> Under Notice 2021-49, recovery start-up businesses can claim ERCs for wages through December 2021, but the refund is capped at \$50,000 per quarter for each of 2021, Q3 and Q4.

file a Form 941-X, “Adjusted Employer’s Quarterly Federal Tax Return or Claim for Refund,” for each applicable period.<sup>23</sup> The IRS did not initially require businesses to provide supporting documentation about eligibility for their ERC claims.

To avoid getting a double benefit from the same funds, businesses were required to reduce the wage expense deduction by the amount of the ERC by filing an amended income tax return (such as Form 1120, “U.S. Corporation Income Tax Return”; Form 1120-S, “U.S. Income Tax Return for an S Corporation”; or Form 1065, “U.S. Return of Partnership Income”) for the relevant year.<sup>24</sup>

### E. Refundable Payroll Tax Credit

Because the ERC is a refundable federal payroll tax credit, a business can claim an ERC that exceeds its employment tax liability for the year.<sup>25</sup> Any excess credit amount is treated as an overpayment and the business is entitled to a refund.<sup>26</sup> Many businesses have already received substantial refund checks from Treasury. Unfortunately, hundreds of thousands of ERC claims likely remain unreviewed and unpaid.

## III. Administration of the ERC

Because of the uncertainty many businesses faced during the pandemic, and consistent with congressional intent in enacting the CARES Act, the IRS made a concerted effort to distribute ERC funds to those in need as quickly as possible. The ERC proved to be a lifesaver for many businesses early on. However, this initial urgency caused the IRS to distribute ERC funds to some businesses that might not have met the qualifications. With billions of dollars at stake, amid growing concerns from the agency of fraud and abuse, the IRS enacted several programs to shake out some of the bad claims.

## A. Moratorium on Processing Claims

The IRS issued a moratorium on processing claims starting September 14, 2023.<sup>27</sup> Businesses could continue to submit ERC claims, but the IRS would not be reviewing or processing those claims until the moratorium was lifted.<sup>28</sup> Although the IRS explained that the purpose was to guard against paying fraudulent ERC claims,<sup>29</sup> the moratorium applied to all new ERC submissions. This blanket decision to stop processing claims left hundreds of thousands of businesses in the dark about whether and when they would receive ERC funds.

According to IRS officials, during the first three-and-a-half years of the ERC program, approximately 15 percent of ERC claims were submitted in the 90 days leading up to the moratorium.<sup>30</sup> At one point, the IRS indicated that it had an inventory of 1.4 million unprocessed ERC claims.<sup>31</sup> Reports show that the IRS used data from these unprocessed ERC claims to categorize claims into different “risk groups.”<sup>32</sup>

After nine months, in June 2024, the IRS lifted the moratorium, announcing that it would (1) begin processing claims again, starting with “lower-risk” claims, and (2) start sending tens of thousands of denial letters to unprocessed “high-risk” claims.<sup>33</sup> Because the IRS is hopeful that legislation<sup>34</sup> will retroactively adjust the ERC deadline to January 31, 2024, the agency announced it would begin processing ERC claims submitted between September 14, 2023, and January 31, 2024.<sup>35</sup>

## B. ERC Withdrawal Program

In October 2023, the IRS announced a program under which businesses could withdraw

<sup>23</sup> IRS, “Employee Retention Credit” (last visited Sept. 12, 2024).

<sup>24</sup> Notice 2021-20, Section III.L, Q&A 60.

<sup>25</sup> CARES Act, section 2301(b)(3).

<sup>26</sup> Section 6402(a); section 6413(b).

<sup>27</sup> IR-2023-169.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> Lauren Loricchio, “Sunset for ERC Withdrawal Initiative to Be Determined,” *Tax Notes Federal*, Nov. 6, 2023, p. 1093.

<sup>31</sup> IR-2024-169.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> Tax Relief for American Families and Workers Act of 2024 (H.R. 7024).

<sup>35</sup> IR-2024-203.

ERC claims that might be improper (the ERC withdrawal program).<sup>36</sup> Businesses are eligible for the ERC withdrawal program if they meet the following criteria:

- they made the ERC claim on an adjusted employment tax return (Form 941-X, Form 943-X, “Adjusted Employer’s Annual Federal Tax Return for Agricultural Employees or Claim for Refund,” Form 944-X, “Adjusted Employer’s Annual Federal Tax Return or Claim for Refund,” or Form CT-1X, “Adjusted Employer’s Annual Railroad Retirement Tax Return or Claim for Refund”);
- they filed the adjusted return only to claim the ERC, without any other adjustment;
- they want to withdraw the entire amount of ERC claimed; and
- the IRS has not paid the claim or if it did, the business has not cashed or deposited the refund check.<sup>37</sup>

Unlike many other IRS programs, the ERC withdrawal program is open to taxpayers regardless of whether they are subject to an IRS examination.<sup>38</sup> In fact, a batch of information document requests from January 2024 included the following language:

If, while preparing your response to this IDR [information document request], you determine that you’re not entitled to the ERC claimed, let us know if you want to withdraw your claim for ERC. We’ll provide you with specific instructions on how to withdraw your claim.<sup>39</sup>

### C. First ERC Voluntary Disclosure Program

On December 21, 2023, the IRS announced the ERC voluntary disclosure program (first ERC VDP).<sup>40</sup> Employers that claimed ERCs and later determined they were not eligible for the credits

were able to resolve improper claims on a favorable basis.<sup>41</sup> To qualify for this program, employers had to repay 80 percent of the claimed ERC amount and sign a closing agreement with the IRS.<sup>42</sup>

Eligibility terms for participants in the first ERC VDP were as follows:

- they could not be under criminal investigation and could not have been notified that the IRS intended to commence a criminal investigation;
- the IRS had not received information from a third party alerting the agency about their noncompliance, nor had the IRS acquired information directly related to the noncompliance from an enforcement action;
- they were not under an employment tax examination by the IRS for any tax periods for which they were applying for the ERC VDP; and
- they had not previously received notice and demand for repayment of all or part of claimed ERCs.<sup>43</sup>

To participate, businesses had to (1) formally apply by completing a special form, (2) cooperate with the IRS by providing additional information requested, (3) repay 80 percent of the ERC funds received, and (4) sign a closing agreement.<sup>44</sup> Businesses making full payment of the 80 percent would not be subject to penalties or interest.<sup>45</sup> The first ERC VDP closed on March 22, 2024.<sup>46</sup>

In concert with the first ERC VDP, the IRS announced that it was in the process of sending 20,000 denial letters to businesses that claimed ERCs.<sup>47</sup> This was the start of a big push by the IRS to begin auditing ERC claims.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*; Announcement 2024-3, 2024-2 IRB 364. Special rules applied to third-party payers, such as professional employer organizations and payroll agents.

<sup>44</sup> IR-2023-247; Announcement 2024-3.

<sup>45</sup> IR-2023-247; Announcement 2024-3. Additionally, businesses were not required to file amended returns or administrative adjustment requests.

<sup>46</sup> IR-2023-247; Announcement 2024-3.

<sup>47</sup> IR-2023-247; Announcement 2024-3.

<sup>36</sup> FS-2023-24.

<sup>37</sup> *Id.*

<sup>38</sup> IR-2023-193.

<sup>39</sup> Information Release IDR dated Jan. 17, 2024, on file with the author.

<sup>40</sup> IR-2023-247.



## D. Second ERC VDP

On August 15, 2024, the IRS announced a second ERC VDP, allowing businesses to disclose improper ERC claims by November 22, 2024.<sup>48</sup> The second ERC VDP was similar to the first except that businesses now had to repay 85 percent of the ERC funds received instead of 80 percent. To nudge those on the fence about participating, the IRS announced that it was sending 30,000 new letters to recapture more than \$1 billion in “improper” ERC claims.<sup>49</sup> More importantly, the IRS indicated that the second ERC VDP would be the final opportunity for businesses to make a voluntary disclosure.<sup>50</sup>

### IV. Warning Signs for Improper Claims

The IRS announced several warning signs that would serve as red flags for potentially improper ERC claims:

- claiming too many quarters;
- relying on nonqualifying government orders;
- having too many employees and wrong calculations;
- citing supply-chain issues;
- claiming the ERC for too much of a tax period;
- not paying wages or not existing as a business during the eligibility period;
- promoters saying there’s nothing to lose;
- essential business operating fully without a decline in gross receipts during the pandemic;
- being unable to substantiate how a government order fully or partially suspended business operations;
- reporting family members’ wages as qualified wages;
- using wages already used for Paycheck Protection Program loan forgiveness; and
- large employers claiming wages for employees who provided services.<sup>51</sup>

<sup>48</sup> IR-2024-212.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> IR-2024-39; IR-2024-198.

It is important to note that these warning signs are simply factors the IRS identified that might indicate a particular ERC claim was improper. They are not legally binding factors that are dispositive of an improper ERC claim.<sup>52</sup> Eligibility for the ERC is a business-specific, facts-and-circumstances determination.

### V. Potential Fraud

Public announcements by the IRS have claimed that ERC fraud has been rampant.<sup>53</sup> Below is a list of warning signs posted on the IRS’s website for businesses to be aware of:

- unsolicited calls or advertisements mentioning an “easy application process”;
- offers to check eligibility “in minutes” on a website or app, in person, or by phone;
- large up-front fees to claim the credit;
- pressure to accept a promoter’s offer of a refund anticipation loan;
- fees based on a percentage of the refund amount of ERC claimed;
- preparers refusing to sign the ERC return being filed by the business, exposing just the taxpayer claiming the credit to risk;
- aggressive claims from the promoter that the business receiving the solicitation qualifies before any discussion of the group’s tax situation; and
- wildly aggressive suggestions from marketers urging businesses to submit the claim because there is nothing to lose.<sup>54</sup>

### VI. IRS Enforcement

With a massive amount of money at stake, the IRS needs to commit substantial personnel and resources to make sure the public’s tax dollars are distributed to those whom Congress intended. It appears that the IRS has been doing this over the past year. The agency is already sending out

<sup>52</sup> While outside the scope of this article, the ERC is heavily rooted in administrative guidance from the IRS, which is susceptible to challenges under the Administrative Procedure Act.

<sup>53</sup> IR-2023-135; IR-2023-193; IR-2023-247; IR-2024-169; Associated Press, “A COVID-Era Program Is Awash in Fraud. Congress Aims to Wind It Down and Expand the Child Tax Credit,” *U.S. News & World Report*, Jan. 27, 2024.

<sup>54</sup> IR-2023-170; IRS, “Frequently Asked Questions About the Employee Retention Credit,” at ERC Scams, Q&A 1 (last visited Sept. 13, 2024).

denial letters, opening audits, and going after so-called promoters.<sup>55</sup> Starting in July, the IRS sent out 28,000 denial letters with more to come.<sup>56</sup> In August, the agency announced plans to send approximately 30,000 recapture letters to claw back \$1 billion in claims for 2021 and additional, later-filed claims for 2020.<sup>57</sup>

According to an IRS webinar, the IRS is using traditional audit methods to verify ERC claims.<sup>58</sup> The agency is also using several other channels to identify and target potentially unscrupulous advisers, including data analytics, whistleblowers, undercover operations, and is soliciting Forms 14242, "Report Suspected Abusive Tax Promotions or Preparers," from taxpayers.<sup>59</sup>

The IRS's campaign against ERCs has already borne fruit. According to a June 20 announcement:

- the IRS has already made assessments of \$572 million for ERC claims it deemed improper;
- the ERC withdrawal program led to \$531 million in withdrawn ERC claims;
- the first ERC VDP yielded \$1.09 billion for surrendered claims;
- the IRS is auditing thousands of ERC claims;
- IRS Criminal Investigation is working 450 criminal cases with \$7 billion at stake;
- IRS Criminal Investigation has charged many individuals, some resulting in convictions, and the average prison sentence was 25 months;
- IRS's Office of Promoter Investigations is investigating supposed promoters;
- the IRS is processing 17,000 ERC claims per week; and
- 1.4 million ERC claims remain unprocessed.<sup>60</sup>

All signs point to the IRS continuing to ramp up its enforcement campaign in the future. Based

on anecdotal evidence, the IRS's initial review of many ERC claims has been cursory, the IRS has a propensity to fully deny claims, and the grounds to deny the claims have been inadequate and often, incorrect.

Given the number of unprocessed claims, it appears that many businesses will be waiting for months, or even years to receive their refunds. More and more businesses will need to enlist help from tax professionals with ERC expertise to prove denied claims and help the businesses obtain the funds they deserve.

## VII. Expediting Unprocessed Refund Claims

Unfortunately for taxpayers, the IRS has no statutory obligation to process a refund claim within a certain time frame. What can a business with an unprocessed ERC refund claim do? There are several options. First, a business can sit idle and hope that the IRS processes the ERC claim soon. This might not be palatable for businesses that desperately need the funds to survive. Many businesses have operated over the past few years in reliance on receiving the ERC funds. To keep the businesses running and their employees on the payroll, some business owners borrowed from the business's retained earnings, personal savings, retirement accounts, or their children's education accounts to pay their workers. Other business owners took reduced salaries or no salaries at all. For many businesses, waiting might not be the best answer.

Second, a business can seek assistance from the Taxpayer Advocate Service, an independent organization within the IRS tasked with helping taxpayers resolve tax issues. The TAS is a valuable resource for many taxpayers experiencing financial hardship. But the TAS cannot process an ERC claim; the IRS is still the gatekeeper. Given that the parties at the IRS responsible for administering the ERC are struggling to process the massive backlog of claims, it might be difficult for the TAS to persuade the IRS to expedite certain claims.

Third, a business can contact members of Congress to request assistance. Senators and representatives work tirelessly to help their constituents. Several members of Congress have submitted letters to the IRS in connection with the ERC delays, mostly general letters encouraging

<sup>55</sup> IR-2024-203.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> IRS Webinar, "Employee Retention Credit — Presented by Officer of Fraud Enforcement and National Fraud Counsel" (July 25, 2023).

<sup>59</sup> IR-2023-135; IR-2024-169; IRS Webinar, *supra* note 58.

<sup>60</sup> IR-2024-169.

the IRS to speed up the process.<sup>61</sup> While most members of Congress and their staffs are likely aware of the massive administrative delay in processing ERC claims, they may not have the time or resources to devote to tackling the issue for thousands of individual claims submitted by their constituents.

Fourth, a business can go on the offensive by filing suit in federal court. This forces the government to take action on the specific ERC claim instead of letting the claim sit in a large pile in a back room of an IRS warehouse. Six months after a refund claim is submitted, a business can file suit in the relevant district court or the Court of Federal Claims.<sup>62</sup> Attorneys for the business and the government then exchange documentation, discuss the merits, and determine whether there is a basis to fully allow the claim or reach a compromise. The length of time required to resolve a case in federal court depends on the complexity of the claim, the urgency of the government attorneys, and various other factors. Filing suit in federal court can be advantageous

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<sup>61</sup> E.g., Sen. Mark R. Warner and Sen. Tim Kaine, "Letter to Commissioner Werfel on ERCs," Aug. 15, 2024; Rep. Jason Smith and Rep. David Schweikert, "Letter to Commissioner Werfel on ERCs," House Committee on Ways and Means, Oct. 3, 2023; Sen. Kirsten Gillibrand, "Letter to Commissioner Werfel on ERCs," May 4, 2023; Rep. Claudia Tenney, "Letter to Commissioner Werfel on ERCs," June 11, 2024.

<sup>62</sup> Section 7422(a); section 6532(a). Note that the right to file suit in federal court vests immediately when the IRS denies the refund claim.

for many unprocessed claims and might be particularly attractive for ERC claims that businesses filed after January 31, 2024, which the IRS is now not even considering.<sup>63</sup>

It is important to note that if the IRS reviews an ERC claim and issues a notice of disallowance, the business has two years from the date of the notice to file suit in federal court contesting the disallowance.<sup>64</sup>

### VIII. Conclusion

The ERC was a savior for many businesses that submitted early claims. Because of some claims the IRS considered potentially improper, hundreds of thousands of businesses are still waiting to receive their ERC funds. Many businesses likely closed their doors because of payment delays. Other businesses are simply waiting on their rightfully claimed refunds. Filing suit in federal court is a practical offensive strategy to force the government to review an ERC claim and transmit the funds. Businesses seeking to expedite the payment of their ERC claims or needing other advice should contact a knowledgeable tax professional to discuss their options. ■

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<sup>63</sup> IR-2024-203.

<sup>64</sup> Section 6532(a). Before filing suit in federal court, a business might have the opportunity to resolve matters with the IRS examinations division or Appeals.