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CPAs AND BUSINESS ADVISORS

Are you being relentlessly solicited for ERC?

Here's everything that you should know.

The employee retention credit is really complicated. I've said this so many times in the past 2+ years but ERC is the most complicated thing I've ever worked on and I was preparing tax returns by hand since before my 16th birthday. I'm a tax nerd through and through and this is the most complicated thing I've ever worked on.

I'm really proud of the work our team has done helping clients get ERC. We have helped so many of our clients understand ERC and claim what they qualify for. We've studied the rules, we've discussed the rules, we've come up with reasonable positions when uncertainty existed, we've taken I would say a relatively cautious approach to ERC. We are CPAs and with that comes the AICPA's ethical standards for tax practice and the IRS's ethical standards that help guide us towards doing the right thing. We want to do ERC right so we spent thousands of hours trying to learn about it so we could do it right before we helped even our first client in April 2021 file an ERC claim. We're proud of our work.

There are other ERC providers that don't hold themselves to the same standard and the IRS has certainly noticed.

All those solicitations you are getting are probably from a company that didn't exist before ERC. The company was created for the sole purpose of charging high fees and processing as many ERC claims as they can. They are more interested in high volume and high fees than high quality work. If they are not setup as CPA firms then the AICPA and IRS standards wouldn't apply to them. Do you want to be working with a company setup specifically to avoid the ethical rules of the AICPA and IRS?

Many of these companies pushing the ERC solicitations are doing very poor quality or fraudulent work because they are motivated by one time profit rather than a desire to have a long term relationship with a client. It's a cash grab scheme for them, and they are getting very good at soliciting people because the PPP loan information is publicly available. Some of the solicitations look like IRS notices, some of them look like they have already calculated your ERC and you just need to claim it. They are very clever solicitations, but that's all they are, it's just marketing material. The ERC rules are complex and they are ignoring many of them in pursuit of higher one time fees which can put your business in jeopardy.

Let’s walk through the common red flags you should be looking for:

🚩If the ERC company has solicited you multiple times or sent you materials that make it look like you are prequalified, or make it look like an IRS notice that is a red flag. Reputable firms that do ERC work don’t send out misleading solicitations.

🚩If the ERC company says that every business in the country qualifies. This is clearly not the case. Some businesses do qualify, often times there are businesses that are unaware they will qualify, but to say that every business in the country qualifies is just lying.

🚩If the ERC company charges an up front fee that should probably be a red flag for you. It’s a sign they don’t intend to be around in 1, 2, 3 years when the IRS comes to audit these claims.

🚩If the ERC company charges a flat percentage of the credit as their fee, the 20% or 25% contingent fee is a sign they are motivated only by increasing the fee.

🚩If the ERC company has a name like ERC Specialists or ERC.com it’s clear the company was setup with the sole purpose of processing ERC claims, not having long term relationships with business owners. Working with a company like that should be a red flag and you should investigate their actual qualifications.

🚩If the ERC company refuses to prepare and sign the 941X that should be a red flag for you. They don’t want the IRS to know it was them who worked on the study, and forcing someone else to prepare the 941X obscures their identity to the IRS.

🚩If you can’t find any record of the ERC company existing prior to 2021 that’s a sign they are a business solely created to capture one time profit.

🚩If the ERC company has a process that promises to take a week start to finish that’s a red flag. ERC is complicated and it shouldn’t be possible to finish a legitimate study that quicky.

🚩If the ERC company doesn’t demand to see your PPP forgiveness application that’s a red flag. They are doing the calculations incorrectly if they are not taking into account the information on the Form 3508 PPP forgiveness application. The PPP forgiveness application has a big impact on the amount of the credit you are eligible to receive.

🚩If the ERC company says that employees or customers wearing a mask qualifies the business for ERC that’s a red flag. The IRS guidance is clear that just a mask equals a nominal impact on the business and does not qualify you for ERC.

🚩If the founder of the ERC company is a real estate investor, or salesperson, a banker, or a serial entrepreneur they are not very likely to be tax experts and you aren’t going to want them defending your ERC claim in the case of an IRS audit. Any company doing ERC work that isn’t founded by and run by experienced tax professionals should be a red flag.

🚩If the ERC company says that the rules for ERC have changed recently. The IRS has not issued meaningful guidance since August 2021. If they are claiming the rules changed in 2022 or in 2023 that's just not true.

🚩If the ERC company says that it's urgent you file for ERC because the time is running out that should be a red flag. Yes there are statute of limitations, but they are not urgently approaching. 2020 claims need to be filed by April 2024 and the 2021 tax year claims need to be filed by April 2025. You still have time to do it right.

I did a podcast with the AICPA in April 2023 to discuss the current state of ERC claims and the professional responsibility that goes with being a CPA.

https://taxodyssey.libsyn.com/employee-retention-credit-and-professional-responsibilities

It has taken the IRS a while to get wise to all the ERC fraud that is occurring, but they are definitely aware of it now. The IRS Dirty Dozen list of tax scams came out March 20th 2023 and not surprisingly the headline at the top of the list is ERC claims.

https://www.irs.gov/newsroom/irs-opens-2023-dirty-dozen-with-warning-about-employee-retention-credit-claims-increased-scrutiny-follows-aggressive-promoters-making-offers-too-good-to-be-true

On March 7th the Office of Professional Responsibility, which is the ethics division of the IRS, warned tax preparers about their responsibilities as it relates to ERC and they were very clear they see the practitioner as having a significant requirement to act with diligence. They referenced the third parties who prepare ERC and the contingent fees they are charging as a reason they may not be relied upon.

https://content.govdelivery.com/accounts/USIRS/bulletins/34d3150

In February 2023 the IRS brought forth the first criminal indictment for a firm that was committing fraud with their ERC claims, and there are surely more of these on the horizon.

https://www.justice.gov/usao-ut/pr/utah-county-residents-and-accounting-business-charged-11-million-covid-related-tax-fraud

The IRS started to warn the public back in October 2022 about third parties promoting improper ERC claims. https://www.irs.gov/newsroom/employers-warned-to-beware-of-third-parties-promoting-improper-employee-retention-credit-claims

Back in June 2022 I did a podcast with the AICPA that went through many of the issues with ERC and we addressed the issue of questionable third parties. https://www.aicpa-cima.com/resources/podcast/mythbust-and-maximize-the-employee-retention-credit-tax-section-odyssey

IRS audits are coming, we just saw our first client get an IRS audit request for their ERC study in late April 2023. IRS indictments and criminal investigations of bad ERC providers are under way. Enforcement is coming, but it will take the IRS a while to catch up with all the bad ERC providers out there. So be careful and be sure you are making a wise choice when you select an ERC provider. If it seems too good to be true, take a pause and consider the source of the information because you might be about to make a big mistake.

The ethics rules that we live by are setup by the AICPA (Statement on Standards for Tax Services) and the IRS (Circular 230). Both of those say that we may rely in good faith based on the information furnished by third parties, but that we have a duty to exercise due diligence. We will be making inquiries of clients who use a third party to calculate ERC to determine whether or not we can reasonably rely on that information. If your ERC qualification or calculations appear to be incorrect, incomplete, or inconsistent with our understanding of the business we will not be able to prepare tax returns based on that third party calculation.

I've done countless webinars on ERC and how to do ERC right, but it boils down to this. First you need a reason that you qualify for ERC. Second you need to have qualifying wages. Third you need to do the calculations to see how much credit you qualify for. Each of those steps sounds simple enough but there are so many nuances to each one.

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First the reason that you qualify for ERC. These 3 situations where you qualify for ERC. Let's dive into each of the 3 just a little bit more with some specific examples of how it works and how it doesn't work.

1. Business fully suspended due to government order
2. Business partially suspended due to government order which had a more than nominal impact on the business
3. Decline in Gross Receipts

The first test is easy to see, the nonessential business that closed entirely. Think of a salon or a restaurant where they were open for business one day and closed the next based on government orders. But even the first test which is so simple when you dig a little deeper you find out it's often the test which results in no credit. It's clear when a business closed, but in my experience the vast majority of the time the business that closed didn't pay people while they were closed. If the employees went on unemployment, and if there is no payroll while the business was closed then there is no ERC for when you are closed. The first test is easy, but it's not very often that people get a meaningful credit from the first test.

The second test is very tricky and this is an area where many ERC solicitors are committing fraud. One the one hand you have the nonessential business, the salon / restaurant where they are limiting capacity to 25% or 50% so they have dramatically less business activity occurring. The government has partially suspended their operations and it's having a big impact on their ability to do business. The impact is clearly more than nominal.

On the other end of the spectrum you have the salad bar example at a grocery store. The grocery store was open for business, but the salad bar was closed. Since the salad bar is probably like .1% of the revenue of the grocery store the fact that it's closed is nominal and the grocery store does not qualify for ERC based on the closure of the salad bar.

The trouble with the second test is that there is a massive range of situations which end up being between the 50% dining restaurant and the salad bar at the grocery store. The concept of more than nominal impact on the business is not very well defined by the IRS and there are so many different type of situations that can occur to discuss them all, but the second test is the trickiest.

The third test is actually very clear unlike the second test. If you understand what makes up the gross receipts of a business this test is easy to calculate. If the quarter is down 50.2% you qualify, and if it's only down 49.8% you don't qualify for 2020. The key with the third test is that you need to understand what makes up the gross receipts of a business. It's measured on a tax basis according to how the income tax returns were filed and sometimes it can lead to surprising results.

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After you make it through finding a reason that you qualify for ERC you still need to have qualifying wages. This trips up a lot of people especially with the first test when a business is closed entirely. If you weren't paying people when you were closed, then you have a reason to qualify but you have no qualifying wages so the credit is going to be zero.

The definition of qualifying wages is complex on its own, there are rules that deny wages to some owners and relatives of owners, there are limits on each employee, and the big one there is no double dipping with PPP funds allowed. You need to allocate the PPP forgiveness to make sure you are not double dipping and this has a huge impact on the results of any ERC study. Understanding the nuances of health insurance, PPP timing, quarterly limitations, owner compensation, are all key to properly calculating the amount of qualifying wages.

ERC is the most complicated thing I've ever worked on. You need to be careful in choosing the right provider for ERC calculations because the business owner who engages with a bad ERC preparer carries a lot of risk if a mistake is made at any step in the process.

So what are the costs of doing a ERC study with a bad ERC preparer? Let's look at this scenario to see what can happen.

ERC claim for the 2020 + 2021 years prepared by a bad ERC provider in 2022 to claim a combined $1,000,000 refund. Taxpayer files and receives a refund of the $1,025,000 in 2023 (the $25,000 is interest that the IRS pays out) and pays out a fee of $250,000 to the bad ERC provider also in 2023. Taxpayers have to amend income tax returns to pay tax on the $1,000,000 let's say they pay $280,000 of income tax on the $1,000,000 of credits back in the 2020 + 2021 years.

IRS audits the ERC claim in 2025 and throws it out because the bad ERC provider has not followed the rules. IRS demands repayment of the $1,000,000 credit. Taxpayer pays the IRS back the $1,000,000 plus now $48,000 of interest. Taxpayer seeks a refund of the $250,000 fee from the bad ERC provider but they are long gone, they've dissolved and vanished so getting a refund of the fee proves to be impossible. Taxpayer seeks to amend the 2020 + 2021 income tax returns to remove the ERC income now that they have paid it back and get a refund of the $280,000 of income taxes they paid, but the statute of limitations has expired on the income tax years and no refund is possible. To summarize:

+1,000,000 ERC received in 2023

+25,000 ERC interest received in 2023

-250,000 fee paid out in 2023

-280,000 income taxes paid in 2023

-1,000,000 ERC paid back in 2025

-48,000 ERC interest paid back in 2025

= negative $553,000 of total cash

A $1,000,000 ERC claimed turned into losing $553,000 of cash. This simple scenario doesn't take into account IRS penalties if the ERC claim was fraudulently submitted, it doesn't take into account penalties on the income tax liability, it doesn't take into account the professional fees for filing these amended returns or dealing with the ERC audit after the bad ERC provider vanished. It's just a basic example of how much risk and exposure the taxpayer is taking when they engage with a bad ERC provider.

Be careful out there with all the ERC solicitations and be sure you are using a reputable provider.

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