

IRS Steps Up Civil and Criminal Tax Enforcement Regarding Employee Retention Credit

by Steve Toscher and Philipp Behrendt

I. Introduction

The Employee Retention Credit (ERC) has been a lifeline for businesses struggling during the COVID-19 pandemic. Designed to provide financial assistance to eligible employers who kept their workforce employed during times of economic hardship, the ERC has proven to be a vital source of support for many. However, with its increasing popularity, aggressive marketing tactics, and potential for misuse, the IRS has found itself facing a growing challenge in ensuring the program's integrity.

II. Recent Developments

In [a recent statement](#), IRS Commissioner Danny Werfel acknowledged the significant progress made by the agency in processing ERC claims. The backlog of valid claims has been successfully cleared, allowing the IRS to shift its focus to the next phase - combating fraud and addressing dubious submissions.

The new phase of ERC work entails intensified compliance efforts, increased audits, and criminal investigations targeting both promoters and businesses filing questionable claims. With the IRS increasingly concerned about misleading marketing tactics, Commissioner Werfel highlighted the need for continued vigilance to ensure that only eligible employers receive the credit they are rightfully entitled to.

III. Fraud Risk and Misleading Marketing

As the pandemic's impact begins to wane, the IRS believes that the percentage of legitimate claims is declining. Meanwhile, misleading marketing tactics from unscrupulous promoters are leading to an increase in questionable claims. Businesses are lured by promises of easy application processes, guaranteed eligibility, and the potential for substantial refunds. Unfortunately, many fall prey to these schemes without fully understanding the strict eligibility requirements or the potential consequences of fraudulent claims.

IV. The IRS's Call for Congressional Support

Commissioner Werfel urged Congress to consider legislative solutions to address the growing fraud risk in the ERC program. One proposed solution is setting an earlier ending date for businesses to claim the credit, preventing opportunistic promoters from exploiting the credit's availability for an extended period. Additionally, increased IRS oversight of return preparers could help weed out unscrupulous actors and protect honest tax professionals.

V. Protecting Businesses and Taxpayers

To safeguard businesses and taxpayers from fraudulent schemes, the IRS advises vigilance and caution when dealing with ERC claims. Eligible employers are encouraged to work with trusted tax professionals who can provide accurate guidance and support throughout the application process.

VI. Warning Signs of Aggressive Marketing

The IRS has highlighted several warning signs that businesses and taxpayers should be wary of regarding aggressive ERC marketing:

- Unsolicited calls or advertisements offering an "easy application process;"
- Promoters claiming they can determine ERC eligibility within minutes;
- Large upfront fees to claim the credit;
- Preparers basing their fees on the size of the ERC refund;
- Refusal to sign the ERC return, exposing the taxpayer to risk;
- Promoters claiming eligibility without properly evaluating the business's individual circumstances or even before discussions about the tax situation at all;
- Misleading suggestions that there is nothing to lose by applying for the credit;
- Refusal to provide a detailed computation of the ERC.

To avoid falling victim to fraudulent schemes and ensure proper ERC claims, businesses must meet specific eligibility requirements. This includes demonstrating a full or partial suspension of operations due to COVID-19 orders or experiencing a significant decline in gross receipts during eligible periods.

VII. Support for Practitioners

To support practitioners, the IRS published a legal advice memorandum addresses ([AM 2023-005](#)), laying out exemplary five scenarios is to determine whether an employer's trade or business was fully or partially suspended during a calendar quarter due to governmental orders related to COVID-19. This assessment is referred to as the "suspension test." The goal is to ascertain whether the employer meets the criteria of an "eligible employer" as defined under section 2301(c)(2)(A)(ii)(I) of the CARES Act and section 3134(c)(2)(A)(ii)(I) of the Internal Revenue Code (Code).

VIII. Conclusion

The Employee Retention Credit has been a critical lifeline for businesses navigating the challenges brought on by the COVID-19 pandemic. However, the IRS's recent warnings about growing fraud risk underscore the need for caution and vigilance when claiming the credit.

Businesses are advised to seek assistance from trusted tax professionals and avoid falling prey to misleading marketing tactics.

After clearing comes the gearing. The IRS cleared its backlog in handing out the credits, and now gears up to reclaim ERC credits from ineligible claims and chase down fraudsters.

Businesses that once fell for promoter schemes will now find themselves under the relentless scrutiny of the IRS, as they reclaim the credits.

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