IRS Enforcement Around ERC

IRS REPRESENTATION

Conference

Moore Tax Law Group

A Tax Controversy and Tax Litigation Boutique

Kathy A. Enstrom
Moore Tax Law Group, LLC, Chicago, IL

Kathy is currently the Director of Investigations for the Moore Tax Law Group based in Chicago and New York. She assists clients facing governmental investigations and civil matters involving all manner of alleged tax, financial and economic fraud.

Kathy began her career with IRS Criminal Investigation (CI) in Chicago. She was promoted into management, eventually rising to the executive level, and departing IRS as the Director, Field Operations for the Northern Area. Kathy's time in federal law enforcement concluded with her role as Chicago's Special Agent in Charge of FDIC-Office of Inspector General.

Director of Investigations
312-521-5989
Kathy.Enstrom@mooretaxlawgroup.com
www.mooretaxlawgroup.com

Elmer D. Smith III
Internal Revenue Service, St. Paul, MN

IRS REPRESENTATION Conference

Director, Specialty Examination
SB/SE Division
Elmer.D.SmithIII@irs.gov
www.irs.gov

- As the Director, Specialty Examination in the SB/SE Division where he is responsible for providing executive leadership and direction in coordinating the examination of employment, excise, and estate and gift taxes.
- Also responsible for IRS regulatory activities promoting compliance with the Bank Secrecy Act.
- Prior to his current role he served as the Director, Examination Headquarters where he is responsible for providing executive leadership and oversight for the policy, quality/technical support, and workload selection operations for Examination - Field, Campus, and Specialty within the Small Business/Self Employed Division.

- Elmer also served as the Co-Director of the Electronic Case Management Tax Calculator Project Management Office within ED&CMO. This executive position was responsible for developing the Servicewide tax calculator strategy which will deliver tax calculator capabilities accessible to users working within the Electronic Case Management platform as well as modernize, consolidate, and decommission legacy case management systems.

Moore Tax Law Group
A Tax Controversy and Tax Litigation Boutique

James R. Grimaldi, Esq., Citrin Cooperman, New York, NY

IRS REPRESENTATION Conference

Partner, Trusts and Estates
Citrin Cooperman Advisors LLC
212-697-1000
jgrimaldi@citrincooperman.com
www.citrincooperman.com

40 years of experience providing strategic tax planning, research, and compliance services. His clients include business owners in a range of industries including real estate. As a tax attorney, he also advises clients on trust and estate planning. Prior to joining Citrin Cooperman, Jim was a tax partner at two regional firms. He began his career in the tax department of a Big Eight firm.

- He represents clients before the IRS Appeals Office, the U.S. Tax Courts, and state and local taxing authorities on personal, business, and fiduciary income tax matters.
- He has successfully navigated the private letter ruling filing process, and as a result, was able to save millions of dollars in tax.
- Jim also has deep expertise in state residency audits, helping clients to minimize tax exposures and penalties. In addition, Jim is highly knowledgeable in federal and state tax credits.

Jon Thibodeaux
Aprio, Atlanta, GA

IRS REPRESENTATION Conference

Jon is a Senior Manager in the Employee Retention Credit (ERC) and Employment Tax practice at Aprio LLP. In this role, Jon works with employers of all sizes and in all industries on determining eligibility for the ERC and preparing the appropriate amended returns and supporting documentation. Jon also works with clients in the event of ERC reviews, up to an including providing audit representation. In addition, Jon works with businesses on federal, state and local payroll/employment tax issues.

Prior to joining Aprio, Jon was a Lead Internal Revenue Agent at the Internal Revenue Service for 20 years. Jon started his career at the IRS as an income tax revenue agent for two years, then moved to the employment tax practice. Jon recently was detailed for two years in the Office of Fraud Enforcement working on the Emerging Threats Mitigation Team.

Prior to joining the IRS in 2003, Jon focused on employment tax in various other organizations including GEICO, MCI, Marriott Corporation and KPMG LLP.

Jon Thibodeaux
Senior Manager, ERC and Employment Tax
Jon.thibodeaux@aprio.com
www.aprio.com

Agenda

- Overview of Employee Retention Credit (ERC)
- New Guidance
- IRS Points of Focus
- IRS Audit Activity
- Lessons Learned
- Fraud and Criminal Investigations

What is the ERC?

Refundable payroll tax credit

Up to $5,000 per employee in 2020 and up to $7,000 per employee for each of the first three calendar quarters in 2021 (total of $26,000 per employee)

4th Quarter of 2021 is no longer eligible, except for recovery startup businesses (RSUBs)

RSUBs capped at $50,000 per quarter for Q3 and Q4 2021

Exploded in December 2020 when the law changed to allow taxpayers that received a PPP loan to claim the ERC

Two Main Tests for Eligibility

IRS REPRESENTATION Conference

Significant decline in gross receipts (objective test)

- >50% drop in gross receipts in any quarter in 2020 compared to the same quarter in 2019
  - Eligibility extends until quarter where gross receipts recover to at least 80%
- >20% drop in gross receipts in any quarter in 2021 compared to the same quarter in 2019
  - Can elect to test using the immediately preceding calendar quarter (*e.g.*, test Q2 2021 by comparing Q1 2021 vs. Q1 2019)

Full or partial suspension of operations (subjective test)

- U.S. governmental order that limited commerce, travel, or group meetings due to Covid-19
- Impact on business is more than nominal (measured by 2019 gross receipts or employee hours)
- Cannot conduct operations comparably through telework

The Stakes

IRS REPRESENTATION Conference

- The PPP had a finite pool of funds to be distributed; the ERC does not
- 3½ years – the time the ERC program has existed
- 3.6 million claims received – as of mid-September 2023
- 15% – the percentage of all ERC claims received during the 90-day period before the moratorium
- 600,000 – open ERC claims inventory at the time of the moratorium, virtually all of which were received within the 90 days prior to the moratorium

2020 ERC claims can be submitted until **April 15, 2024** – §6511 & §6513(c)
2021 ERC claims can be submitted until **April 15, 2025**

Recent IRS Guidance / Warnings

- October 19, 2022: IRS issues press release advising taxpayers to be wary of third parties that promise tax savings that are too good to be true
  - Tax credit shops are advising taxpayers to claim the ERC when they do not qualify
  - Red flag – large upfront fee or a fee that is contingent on the amount of the refund
  - Improperly claiming ERC could result in being required to repay the credit along with penalties & interest
- November 7, 2022: second IRS warning (Covid Tax Tip 2022-170)
- March 7, 2023: another warning (IR-2023-40) – “Beware of ERC promotions”
- March 7, 2023: IRS issues OPR Memo (2023-02) discussing tax return preparers professional responsibilities under Circular 230
- March 20, 2023: ERC added to top of the Dirty Dozen list of tax scams (IR-2023-49)
- May 25, 2023: IRS warning (IR-2023-105) – “The IRS has stepped up audit and criminal investigation work involving these claims”
- September 14, 2023: IRS announced a moratorium on processing new ERC claims that lasts through at least through December 31, 2023
- October 19, 2023: IRS announced a new withdrawal process to allow businesses and others that filed an ERC claim to withdraw the submission
- November 2, 2023: ERC Webinar, “Employee Retention Credit: Latest information on the moratorium and options for withdrawing or correcting previously filed claims” – recorded version available on IRS Video Portal
- November 3, 2023: posted on IRS.gov a legal memo regarding OSHA communications

Moratorium

- The moratorium affects processing of new ERC claims through at least the year's end to prevent further abuse from predatory promoters using the ERC to scam businesses and organizations. This includes any claims received on or after Sept. 14.

- The IRS understands the valuable impact of the ERC credit and we are working to process valid ERC claims filed before the moratorium, but with increased scrutiny
  - Enhanced compliance review is critical to protect against ineligible claims
  - The review also protects businesses from facing penalties or interest payments stemming from bad claims pushed by promoters
  - IRS may also seek additional documentation from the taxpayer to ensure it is a legitimate claim
  - Processing times could easily stretch to 180 days or longer

- The IRS is also working on guidance to help employers that were misled into claiming the ERC and have already **received the payment and cashed the check**. In the meantime, employers should not spend that money.

Withdrawal Process

- Announced October 19, 2023, the process allows businesses and others that filed an ERC claim, many of whom are honest employers who were misled by promoters, to withdraw their submission to avoid future repayment issues, interest, penalties, and contingency fees to promoters
- The withdrawal option can be used by taxpayers:
  - Whose claim has not yet been paid or
  - Who have not cashed or deposited their refund check
  - Taxpayers who have willfully filed fraudulent claims or conspired to do so should be aware that withdrawing a fraudulent claim will not exempt them from potential criminal investigation and prosecution
- Procedures to withdraw an ERC claim and other resources are available on IRS.gov/ERC

IRS Legal Memorandum

- IRS recently issued guidance about whether communications from OSHA are considered a government order for purposes of qualifying for the ERC due to a full or partial suspension of operations
- The new legal advice addresses another area where aggressive promoters have stretched the definition of the guidelines

- The memorandum concludes that generally an employer won't be considered eligible for the ERC just because they followed general guidance or recommendations contained in OSHA communications

- There are more details in the ERC FAQs and in the IRS legal memo AM-2023-007, both on IRS.gov/ERC

Promoter Activity

- We continue to investigate promoter activity related to the ERC
- IRS encourages everyone to report ERC fraud, including
- Tax-related illegal activities relating to ERC claims
- Individuals who promote improper and abusive tax schemes
- Tax return preparers who deliberately prepare improper returns
- Report ERC fraud by completing Form 14242, Report Suspected Abusive Tax Promotions or Preparers
- Send the form and supporting materials to the IRS Lead Development Center
- Form 14242 and the address of the Lead Development Center is on IRS.gov

Statute of Limitations

- IRS generally has 3 years to assess under §6501, and 941s are deemed filed on 4/15 of following tax year under §6501(b)(2)
- Congress extended Q3 and Q4 2021 to 5 years in §3134(l)
  - 941s for Q1, Q2, Q3 & Q4 2020 are deemed filed on April 15, 2021, which means the 3-year SOL expires on April 15, 2024;
  - 941s for Q1 & Q2 2021 are deemed filed on April 15, 2022, which means the 3-year SOL expires on April 15, 2025; and
  - 941s for Q3 2021 & Q4 2021 (for RSUBs) are deemed filed on April 15, 2022, which means the 5-year SOL expires on April 15, 2027
- SOL does not restart when an amended return is filed

- Civil Actions for Erroneous Refunds – §7405(b) & §6532(b)
  - IRS can bring civil action within 2 year of payment on an ERC claim – and 5 years in cases of fraud or misrepresentation of a material fact
  - Need DOJ involvement and unclear how widely this procedure will be used
  - Similarly, taxpayers have 6 months to bring suit after a refund claim is filed and ending 2 years from IRS disallowance of the claim – §6532(a)

IRS Audits

- IRS is aggressively auditing ERC claims
- It is auditing each and every issue that relates to the ERC, including aggregation, eligibility, number of 2019 FTEs, qualified wages, no double dipping with PPP and other credits, and other aspects of calculating the credit
  - For example, IRS is auditing the calculation of gross receipts to ensure there is no shifting between or among calendar quarters
- IRS is asking for governmental orders and for an explanation of the effect they had on business operations
  - When it comes to supply chain issues, remember that there must be a US governmental order relating to Covid that affected the taxpayer's supplier, the supplier could not deliver critical goods because of the governmental order, the taxpayer could not obtain the goods from alternate sources, and the inability to obtain the goods has more than a nominal effect on the taxpayer
- IRS is auditing some ERC claims BEFORE they are paid, and is committing to an audit timeline upfront
- IRS is asking for taxpayer interviews and site visits

Audits - ERC Calculation

- IDRs request the signed PPP loan forgiveness application that was submitted to the lender, and sometimes the forgiveness letter received from the SBA
- IRS generally does one of the following:
  - Tracing analysis of wages on an individual basis from the ERC calculations back to documentation filed with taxing authorities (W-2s, for example)
  - Reconciliation on the population of wages to the originally filed Forms 941
- For large eligible employers, IDRs require substantiation on how the taxpayer determined qualifying wages that were paid to employees not to provide services

Substantiation and Taxation

- Make sure your clients maintain adequate records to substantiate eligibility and the ERC calculation – Notice 2021-20, Q&As #71-71
  - Generally, requires taxpayers to maintain documents on eligibility and the ERC calculation for at least 4 years
- Make sure your clients amend their 2020 and/or 2021 income tax returns to pay tax on the ERC
  - Reduce the wage/health plan expenses that were used for the ERC – Notice 2021-20, Q&A #60-61
  - Reductions must be made on the tax return for the tax year in which they were paid, not the year in which the ERC was applied for or received
  - IRS view is that amended returns must be filed when the ERC claim is filed, not when it is received

Lessons Learned

- If you didn't prepare the eligibility analysis or the ERC calculation, do it yourself before your first response to the IRS – errors are common
- Consider amending the claim, if necessary, in your first response to the IRS
- Only submit responses that you can verify or are comfortable submitting
- Always be polite and recognize that most agents act in good faith and try to do his/her job to get to the right answer
- Agents do not always accommodate requests for extra time to deliver IDR responses, so document ERC claims in advance of an audit

Fraud Indicators

- Fictious Businesses
  - Newly Created Business after CARES Act was enacted
  - Employment Tax returns filed for periods that precede the entity establishment date
  - Non-Sequential Filing Pattern of E.T. Returns (later periods filed before earlier periods)
  - Multiple Form 941s filed simultaneously
  - No corresponding income tax returns
  - No corresponding W-2 forms

- ID Theft
  - Multiple original returns filed for same entity
  - Dormant filing history prior to enactment of CARES Act
  - Entity created under deceased person's taxpayer identification number (TIN)

- False/Inflated ERC
  - Inconsistent Wage Reporting (W-2 forms / Employment Tax Returns / Income Tax Returns)
  - Original or amended tax returns prepared by individual/firm that is under civil or criminal investigation
  - Significant payroll increase after CARES Act was enacted

Categories & Statistics

Categories of Fraud

1. Single or small group of individuals
2. CPAs/Return Preparers
3. Promoters – companies set up business specifically for these credits

Criminal Investigation Statistics - as of September 2023

- IRS-CI has initiated 301 investigations involving ERC which amounts to $3 billion of potentially fraudulent claims
- 15 resulted in federal charges.
  - 8 investigations have resulted in convictions,
  - 4 investigations have resulted in sentencings
  - the average sentence is 21 months.

Utah Preparer

Return preparer that plead guilty to aiding and assisting in the filing false returns - US v. Walker, 22-Cr -00178 (D. Utah)

- Defendant worked at an accounting firm where he actively solicited independent contractors involved in door-to-door sales, rideshare drivers, and sole proprietors to convert their "businesses" into LLCs to allow them to qualify for ERC credits and sought ERC credits for LLCs regardless of whether they were statutorily eligible to receive the ERC, resulting in false and fraudulent claims.
- Defendant claimed more than **$11 million** in ERC and sick and family leave wage credits.
- In court documents, defendant claimed that his employer advised him that all businesses were impacted by COVID-19 and therefore qualified for the ERC and that the defendant should advise clients to list their spouse and children as employees regardless of whether that were true.

Indictment – Hollywood, CA

Hollywood man indicted for fraudulently seeking over $65 million in ERC - US v. Gregory (Central District of California)

- Kevin Gregory made false claims to the IRS for the payment of nearly $65.4 million in tax refunds for a purported Beverly Hills-based farming-and-transportation company named Elijah USA Farm Holdings
- The IRS issued a portion of the refunds Gregory claimed, and Gregory allegedly used that portion – more than $2.7 million – for personal expenses.

New Jersey Preparer

Preparer arrested for fraudulently seeking over $124 million in ERC - US v. Haynes (New Jersey)

- Haynes allegedly prepared and submitted approximately 1,387 false forms to the IRS claiming COVID-related tax credits on behalf of himself and his clients.
- The complaint further alleges that Haynes falsely told his clients that the government was giving out COVID-relief money for businesses and that they were eligible for the money simply because they had a business.
- Without consulting with his clients, Haynes then submitted forms to the IRS on behalf of their businesses that grossly overstated the number of employees and amount of wages paid. Haynes allegedly submitted similarly false forms for three of his own companies.
- The IRS allegedly mailed Haynes multiple tax refund checks totaling $1,007,966 for his own companies and allegedly disbursed a total of $31.6 million in refunds to Haynes' clients and himself based on the false tax forms that Haynes submitted.
- The complaint further alleges that Haynes charged many clients a fee of as much as 15% of the refund they received.

IRS REPRESENTATION
Conference

Thank you