GattoMcFerson
Certified Public Accountants

November 19, 2022

Dear Friends and Colleagues,

If you're like most small business owners, you've been bombarded by emails, voicemails, and text messages about the Employee Retention Credit and how you're almost certainly eligible.

Up to $26,000 per employee! Easy to qualify! Deadlines are looming! Don't miss out!

A few friendly words of advice…

Be careful.

What is this Employee Retention Credit exactly?

The Employee Retention Credit (ERC) was introduced in March 2020 as part of the CARES Act. It was meant to assist small businesses that continued paying employees while their doors were shut or while they were experiencing significant declines in gross receipts.

To qualify for this credit, your business must have experienced a significant decline in gross receipts during 2020 and/or the first three quarters of 2021, or sustained a full or partial suspension of operations due to orders from an appropriate governmental agency limiting commerce, travel, or group meetings due to COVID-19 during this time period.

For most businesses, the credit applies to wages paid between March 13, 2020 and Sept. 30, 2021. The credit is tied to payroll and is calculated quarterly. Businesses that didn't claim the credit when filing their original returns can file amended tax returns now.

Reasons for Concern

So far, close to one trillion dollars' worth of Employee Retention Credits have been applied for, and this, as you would guess, has gotten the attention of the IRS.

In fact, this month, the IRS warned that "some third parties are taking improper positions related to taxpayer eligibility for and computation of the credit." There has been a feeding frenzy of ERC "mills" that are charging huge sums of money for promises that they may not be able to keep. We've recently run across one company asking for an up-front fee of $25,000, non-refundable.

The IRS has also confirmed that they will be using a portion of its recently appropriated $85 billion enforcement funding to beef up examinations of ERC claims.

Like a corporate or individual tax return, no supporting documents are required by the IRS to verify the credit calculations before issuing a refund check. You only have to show your work if auditors come knocking on your door.

Taxpayers are always responsible, the IRS notes, for the information reported on their tax returns. Improperly claiming the ERC could result in repayment of the credit, plus penalties and interest. If you're already out the fees paid to a third party, it's even more painful.

Do you qualify?

"Drop in revenue" is easy to quantify.

"Sustained a full or partial suspension of operations due to orders from an appropriate governmental agency limiting commerce, travel, or group meetings due to COVID-19" is harder to quantify.

A portion of the business must be suspended, not just disrupted. For example, an accounting firm that switched from in-person to remote meetings was merely disrupted, not suspended, and would not qualify.

You must also have evidence that the business was more than nominally impacted by the government order. The IRS defines this as greater than 10% overall impact on either revenue or hours compared to the same period in 2019. The IRS is fleshing out the specifics on these qualifications, and also what documentation you would need to prove the above.

As parameters are further established, this is where the risk of qualifying or not qualifying will lie.

Recommendations

There is plenty of time before the deadline to file. The deadline to apply for 2020 payroll credits isn't until April 2024, and you have until April 2025 to submit applications pertaining to 2021. Waiting a few months to gain clarification from the IRS is probably smart.

Make sure the company filing your ERC claim provides you with documentation and an analysis proving you're eligible.

GattoMcFerson
Certified Public Accountants

Be sure to ask if the company provides audit protection. The IRS is backlogged now, but they are beefing up staff to focus on Covid-19-related fraud. If and when an audit arrives, will this company protect you?

If you receive an ERC, you must pay tax on the amount (you had deducted those payroll taxes as an expense, so now the amount refunded is considered income). If the IRS one day determines your ERC should have never been paid, you will lose that money, be subject to fraud penalties, and you also will have to file an amended return to try and recoup the tax paid on that credit. And good luck getting your ERC fees back.

Do your own smell test. Is this too good to be true?

Finally…be careful.

We will keep you posted on further developments and legislative updates. Please let us know if you have any questions.

Sincerely,

Tom A. McFerson, CPA, ABV
Gatto McFerson, CPAs