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You Can't Spell 'Mercy' Without ERC: IRS Allows Claim Withdrawal

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Employee Retention Credit filers whose claim has not yet been processed may opt to withdraw it if they now have reason to believe their filing was ill-advised, Akerman's Joshua Hamlet and Stefi George report in light of the IRS's recent introduction of a program for doing so.

The IRS has established a program to provide some much-needed relief for taxpayers wishing to withdraw an Employee Retention Credit claim, and employers who filed for the pandemic relief based on questionable advice may want to do just that.

In [FS-2023-24](#) (herein “the Fact Sheet” (Oct. 1, 2023)), the IRS laid out the withdrawal program, after having released [IR-2023-169](#) (Sept. 14, 2023) in which the agency said such program was in the works and no more new ERC claims would be processed. If a claim is successfully withdrawn, it will be treated as if it was never filed in the first place—no penalties or interest, the IRS made clear in the Fact Sheet.

Why Withdraw?

Employers may want to withdraw an ERC claim for a variety of reasons. While the IRS has emphasized withdrawal for those who acted on incorrect or fraudulent advice from third-party ERC promoters without properly vetting their eligibility for the credit, other employers may also wish to consider this option.

The Use of Promoters and the Financial Consequences

Despite issuing a plethora of warnings, the IRS continues to see these “aggressive advertising, direct mail solicitations and online promotions” encouraging taxpayers to claim the ERC, even when they are ineligible. *Id.* Some of these promoters have misled and harmed honest employers by misrepresenting or exaggerating their eligibility to claim the tax credit.

Additionally, a number of these aggressive promoters charge large contingency fees based on the amount of the

ERC claimed, providing these promoters with an incentive to maximize the credit. By withdrawing a claim, it is possible that employers may be able to avoid paying these contingency fees. Even if a promoter acted in bad faith to maximize their contingency fees, liability may still ultimately fall on the employer.

In some situations, withdrawal may be appropriate to avoid potential significant financial consequences. If the IRS determines that a business incorrectly claimed the credit, the employer will have to repay the ERC—and may be subject to substantial penalties and interest, including a possible 20% accuracy-related penalty under I.R.C. [§6662](#) or even a 75% fraud penalty under [§6663](#) depending on the circumstances.

If an employer willfully filed a fraudulent ERC claim, or assisted and/or conspired in such conduct, withdrawing a fraudulent claim will not prevent the IRS from pursuing criminal investigation and prosecution, as stated in the Fact Sheet.

Reevaluating ERC Eligibility

Given the IRS's repeated warnings, some businesses may be rethinking their eligibility to claim the ERC for a particular quarter, or to claim it at all. Generally, an employer may qualify for the ERC during any quarter beginning March 13, 2020 through September 30, 2021, in which it “experienced a significant decline in gross receipts” (the “Gross Receipts Test”) or experienced “a full or partial suspension of the operation of a trade or business due to a governmental order” (the “Suspension Test”), pursuant to [Notice 2021-10](#). See also the agency's [ERC FAQs](#) (last updated Oct. 19, 2023).

While the Gross Receipts Test is objective, the Suspension Test is based on facts and circumstances, and requires a detailed analysis of the business' operations during the relevant period, as well as a review of the “governmental orders” (as defined by the IRS) relied upon in determining that the business was “fully or partially suspended.” Thus, there is greater risk that the IRS will disagree with a business's qualification under the Suspension Test for a particular quarter than for businesses that meet the Gross Receipts Test.

It is prudent for all businesses to carefully review their eligibility on a quarter-by-quarter basis. For instance, even jurisdictions with the strongest restrictions

largely lifted those restrictions by the end of the second quarter of 2021. While it is possible for a business to qualify for the ERC for the third quarter of 2021 under the Suspension Test, it is harder to establish eligibility for that quarter.

Employers generally should ensure that they have sufficient documentation to support eligibility for each quarter. If a business lacks such documentation, it may consider withdrawal (for one or multiple quarters).

Updated Guidance

Since the enactment of the ERC, the IRS has released additional guidance regarding eligibility. For example, on July 21, 2023, the IRS Office of Chief Counsel released [AM 2023-005](#) (herein, “the AM”) including examples of when supply chain disruptions constitute a “full or partial suspension” of business operations under the Suspension Test.

Initially, the IRS in [Notice 2021-20](#) merely indicated that if a business’s suppliers were unable to make deliveries of critical goods or materials due to a full or partial suspension of its operations, the business itself may also qualify. This guidance left many questions unanswered. What are “critical goods or materials”? What happens if some “critical goods or materials” may be delivered, while others cannot? Is a business “fully or partially suspended” if it was able to obtain “critical goods or materials” elsewhere, but at a significant cost?

The AM addressed some of these questions by analyzing five supply chain scenarios and determining whether each employer met the Suspension Test. For example, Scenario 4 addressed whether being forced to use an alternate supplier at an increased cost of 35% was sufficient. The IRS concluded that incurring a higher cost for critical goods was insufficient to constitute a full or partial suspension of operations. Prior to this guidance, employers may have believed that such an impact was sufficient under the Suspension Test.

Thus, employers who relied on supply chain arguments for ERC eligibility should review their facts to determine if withdrawal is warranted under the guidance set forth in the AM.

The Withdrawal Process

Eligibility

In order to be eligible to withdraw an ERC claim, the IRS explained in [IR-2023-193](#) (Oct. 19, 2023), all of the following criteria must apply: (1) the employer made the claim on an *adjusted employment tax return* (such as Form 941-X); (2) the employer filed an adjusted return *only* to claim the ERC, and made *no other adjustments*; (3) the employer wants to withdraw *the entire amount* of the ERC claim; and (4) the IRS *has not paid* the claim, or the employer has not cashed or deposited the refund check.

Withdrawing an ERC Claim

If an employer has filed but not yet received a refund or audit notice, the employer may withdraw the claim *for each tax period* in which the ERC was claimed by writing “withdrawn” on a copy of the filed return, having an authorized person sign and date it, and faxing or mailing it to the IRS, per instructions on its [Withdraw an Employee Retention Credit \(ERC\) Claim](#) page (last updated Oct. 24, 2023).

An unexpected aspect of the withdrawal process is that the IRS is extending it to taxpayers whose claims are currently under audit. Thus, even an employer that has been notified of a pending or ongoing examination may seek to withdraw the ERC claim, by notifying the examiner of its intent to do so. *Id.* There is no guarantee that the auditor will accept the withdrawal, as it will depend on the specific facts.

Even employers who have received a refund check may be eligible to withdraw, provided the check has not yet been cashed. In this situation, the employer should void the check and return it to the IRS with a note that says “ERC Withdrawal” and briefly explain the reason. *Id.*

What to Expect After You Submit a Withdrawal Request

It is important to note that the withdrawal request is exactly that—a *request*. Until the IRS formally accepts the withdrawal, it is not effective. The IRS reserves the right to deny any request, depending on the specific facts and circumstances. *Id.*

If withdrawal is accepted, the employer may need to amend the associated amended income tax return in order to reverse the reduction of its payroll tax deductions (by the amounts claimed as ERC as was necessary to avoid receiving a double benefit on the same expenses). In such situations, those payroll tax deductions should now be reinstated.

If a business operates across multiple jurisdictions, it may also need to amend state income tax returns. The rules for amending a state income tax return will vary by state. Taxpayers should consult a tax professional to confirm multistate requirements.

What if You’re Ineligible to Withdraw Your Claim?

Not all taxpayers can utilize the withdrawal process for ERC claims. In the [ERC FAQs](#), the IRS specifies in “Correcting an ERC claim” Q2 that an employer is not eligible if (1) the credit was claimed on an original employment tax return (such as Form 941); (2) the employer wants to withdraw only a portion of the ERC; (3) the adjusted return (such as Form 941-X) reports tax items not on the original return in addition to the ERC claim; (4) the employer needs to make other corrections to the return; (5) the employer received the ERC refund check and cashed

or deposited it; or (6) the IRS has already disallowed the ERC in full.

However, the IRS notes in [IR-2023-193](#) that it is working on guidance to help employers that were misled into claiming the ERC and have already received and deposited the payment. More details are expected later in the fall.

In the meantime, it may be possible to file another amended return to reduce the amount of an ERC claim.

Report Scams

The IRS is also encouraging employers to come forward and report tax-related illegal activities relating to the ERC, individuals who promote improper and abusive tax schemes, and tax return preparers who deliberately prepare improper returns. Employers should use Form 14242, *Report Suspected Abusive Tax Promotions or Preparers*, for this purpose. [ERC FAQs](#) at “ERC Scams,” Q3.

Conclusion

Employers should take the time to review their eligibility for the ERC, discuss their options with a trusted tax professional, and review their tax positions and filing re-

quirements for any periods in which the ERC was or will be claimed. In the event of an audit, they should be prepared to support their determination of eligibility, as well as their method for calculating the amount of the credit. As these are fact-specific determinations, taxpayers who claimed the ERC should discuss any uncertainty with a tax attorney or CPA to determine whether withdrawal is the best way forward.

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