

EMPLOYEE RETENTION TAX CREDIT AUDITS

What You Need To Know
& What To Expect



BROTMAN LAW

402 W. Broadway, Ste. 800 • San Diego, CA 92101
SamBrotman.com • (619) 378-3138



BROTMAN LAW

The Employee Retention Tax Credit Is Making Headlines Everywhere, And Not In A Good Way.

The New York Times

MSNBC

THE WALL STREET JOURNAL.

Don't Fall for Employee Retention Credit Scams

English | العربية | 中文(简体) | 한국어 | ਪੰਜਾਬੀ | Tifin Yell | Kreyol Ayisyen

The IRS is urging people to beware of ads that promise big money by claiming the employee retention tax credit. This is a real tax credit that helps businesses that were affected by the pandemic - but the scammer takes a fee and your personal information. If you're a lot, The IRS doesn't want that to happen to you, so check out the

IRS Warns On ERC Scams As It Announces Annual Dirty Dozen

Kelly Phillips Erb, Forbes Staff
7 min read · Updated on March 20, 2023

Listen to article · 9 minutes



The IRS rolled out a first look at this year's Dirty Dozen - but not surprising - only: Employee Retention Credit, or ERC.

Dirty Dozen

The "Dirty Dozen" is an annual list of tax scams. Many of these schemes pose as people prepare their returns or hire accountants. The schemes get taxpayers and tax professionals' personal information, data, and more.

Retention Credit claims; increased scrutiny follows aggressive promoters making offers too good to be true

English | العربية | 中文(简体)

March 20, 2023

WASHINGTON — In a further warning to people and businesses, the Internal Revenue Service added widely circulating promoter claims involving Employee Retention Credits as a new entry in its annual "Dirty Dozen" list of tax scams.

For the start of the annual Dirty Dozen list of tax scams, the IRS spotlighted Employee Retention Credits following blatant attempts by promoters to run unscrupulous people to claim the credit. Following several earlier alerts, the IRS highlighted schemes from promoters who have been making ads on radio and the internet touting refunds involving Employee Retention Credits, also known as ERCs. These promotions can be based on inaccurate information related to eligibility for and computation of the credit.

"The aggressive marketing of these credits is deeply troubling and a major concern for the IRS," said IRS Commissioner Danny Werbach. "Businesses need to think twice before being a claim for these credits. While the credit has provided a financial lifeline to millions of businesses, there are promoters misleading people and businesses into thinking they can claim these credits. There are very specific guidelines around these pandemic-era credits; they are not available to just anyone. People should remember the IRS is actively auditing and conducting criminal investigations related to these false claims. We urge honest taxpayers not to be caught up in these schemes."

The IRS is stepping up enforcement action involving these ERC claims, and people considering filing for these credits - only after during the pandemic, for a limited group of businesses - should be aware they are ultimately responsible for the accuracy of the information on their tax returns. The IRS Small Business/Self-Employed Division has named authors warning these types of claims, and the IRS Criminal Investigation Division is on the lookout for promoters of fraudulent claims for credits. Annual ERC promotions highlight key areas of the IRS annual Dirty Dozen campaign - a list of 12 scams and schemes that put taxpayers and the tax professional community at risk of losing money, personal information, data and more.

This annual list of schemes and scams is aimed at helping taxpayers in distress; however, honest taxpayers from aggressive promoters and scammers are at risk of losing money, personal information, data and more.

Learn the warning signs of Employee Retention Credit scams

English | العربية

IRS Tax Tip 2023-03, July 24, 2023

Businesses and tax exempt organizations should watch out for telltale signs of misleading claims involving the Employee Retention Credit. Scammers and unscrupulous promoters continue to run aggressive broadcast advertising, direct mail solicitations and online promotions for the credit. Many of these ads wildly misrepresent and exaggerate who can qualify for the ERC, which is sometimes also called ERTC or the Employee Retention Tax Credit.

Anyone who improperly claims the ERC will have to pay it back, possibly with interest. Employers should know what the credit is and who qualifies. And they should rely on the advice of a trusted tax professional, not aggressive promoters.

About the ERC

The ERC is a refundable COVID-era tax credit designed for employers that were in operation during the COVID-19 related government order or that had a requisite decline in gross receipts.

Anyone considering claiming the ERC should carefully review the special instructions for claiming the credit, which are available on the IRS website.

CARES Act Employee Retention Credit (ERC): Increase In Scammers And Delays In Refunds

Brook Blake, Contributor

March 20, 2023 · 6 min read

Listen to article · 6 minutes

By Brook Blake, Forbes Contributor

Just in time for tax season, the IRS recently released its "Dirty Dozen" list. The agency says this list represents the worst of the worst tax scams, and it issues it as a way to warn and urge businesses and consumers to be vigilant in not falling victim to one of these scams. In theory, this is a great way to protect both businesses and consumers. However, this year, many legitimate organizations are voicing concerns that the list may have caused more harm than good in the Employee Retention Tax Credit (ERTC or ERC) industry. As possible evidence of this, the volume of bad actors and illegitimate ERC applications has spiked to an all-time high since the release of the list.

BBB Business Scam Alert: Stay alert to Employee Retention Credit (ERC) scams this tax season

By Better Business Bureau, April 14, 2023



Charity Maguire

Business owners, run alerts want to trick you this tax season. BBB warns about scams involving the Employee Retention Credit (ERC) that could cost you money and your business. Stay alert to these scams and don't fall for them. While most companies are advertising ERC credits, some are not.

What's in it for them? As promised, scammers have information for identity theft, or worse cases, the defrauder is to get to know the scam so that you can

IRS weighs guidance for small business tax credit. 'People were duped,' taxpayer advocate says

PUBLISHED THU, JUN 29 2023 8:54 PM EDT | UPDATED THU, JUN 29 2023 9:28 PM EDT

Kate Dore, CFP®
@KATEDORE

SHARE f t in

KEY POINTS

The IRS is weighing guidance for small businesses that wrongly claimed the employee retention tax credit, according to the national taxpayer advocate.

IRS Targets Schemes To Claim ERC Employee Retention Credits

Robert M. Wood, Senior Contributor
7 min read · Updated on July 24, 2023

Listen to article · 6 minutes



Contributor, Entrepreneur

IRS audits of businesses are in full swing. Taxpayers claiming it, and all the other things that are in various forms, are still drawing fire.

IRS Warns Taxpayers on False Employee Retention Credit Claims

Kelly Phillips Erb, Editor

The Employee Retention Credit was intended to encourage businesses to keep employees on their payrolls. But as the economy tightens, the IRS is warning about fraudulent schemes. Here's what you need to know.

What would you do if I told you I could guarantee your small business a refundable tax credit of \$26,000 per employee - without ever having seen your books?

I hope you'd run in the opposite direction.

But increasingly, employers are sticking around to hear more, and some have been convinced to claim the Employee Retention Credit, or ERC, when they might not qualify. This week, the IRS warned businesses to be cautious when third parties promise tax savings that are too good to be true.

Is My Employee Retention Tax Credit Legitimate?

The Employee Retention Tax Credit (ERC) was passed on March 27, 2020 as part of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). When the legislation was passed, few people had heard of the credit. However, over the last year, business owners have been bombarded by advertisements from companies they have never heard of before offering to help them claim their credit.

Many of these companies hold themselves out as “experts” in obtaining the credit. They make wild claims, tout their expertise, and make promises to defend their customers in an audit. With promises of hundreds of thousands or even millions of dollars in refunds, many business owners and non-profit organizations have turned a blind eye to the dangers that these companies present.

The fact is that you may have been misled about the strength of your ERC claim.

The New York Times recently highlighted the problem in a front-page article. “The money was intended to be a lifeline for struggling companies. Instead, it has become a magnet for fraud, creating a cottage industry of firms that market themselves as tax credit specialists who can help clients — even those who don’t qualify for the money — reap huge refunds from the IRS,” said the article.

www.nytimes.com/2023/05/26/us/politics/employee-retention-credit-tax-fraud.html

ERC fraud has already cost the federal government more than one hundred billion dollars. As such, The IRS has been ramping up swiftly to take strong action against these companies and the taxpayers who have improperly claimed the credit.

The IRS has already issued multiple warnings to the public not to use these services. In March 2023, the IRS wrote, “The IRS and tax

professionals continue to see third parties aggressively promoting these ERC schemes on radio and online.

These promoters charge large upfront fees or a fee that is contingent on the amount of the refund....The IRS is actively auditing and conducting criminal investigations related to these false claims. People need to think twice before claiming this.”

Furthermore, the IRS has made itself very clear, stating, “Taxpayers are always responsible for the information reported on their tax returns. Improperly claiming the ERC could result in taxpayers being required to repay the credit along with penalties and interest.” www.irs.gov/newsroom/irs-issues-renewed-warning-on-employee-retention-credit-claims-false-claims-generate-compliance-risk-for-people-and-businesses-claiming-credit-improperly

Once misleading/false ERC credit claims made the IRS Dirty Dozen List, tax attorneys started ramping up to defend taxpayers against the IRS. The Dirty Dozen List, is the IRS's annual published list of tax scams that the government considers to be the "worst of the worst." Indeed, the IRS has responded by using its internal resources to create audit groups that are specially trained to audit ERC claims. We spoke with one auditor recently, who confirmed her job was to audit as many taxpayers as possible.

So, if you are one of the people that was potentially victimized by one of these ERC credit mills or otherwise improperly claimed the credit, you are now faced with the prospect of paying back hundreds of thousands and maybe even millions of dollars, plus potential penalties and interest.

The question now is: What Do You Do?

How Do I Know If My Employee Retention Credit Was Improperly Filed?

There are some telltale signs that will signal to you if you may have a problem with your Employee Retention Tax Credit claim. Just because the IRS processed your Employee Retention Tax Credit and gave you a refund does not mean that you do not have a problem or does not mean that the government cannot go back and try to collect the money from you later.

The fact is that the IRS already has an established system for processing amended payroll tax returns and, because of the large number of Employee Retention Tax Credit Filings, the government was not able to stop the processing of refunds. However, if the government goes back now and disallows your credit claim, you will not only owe the amount of the credit that you received, but potentially severe penalties and interest as well. Here are some of the warning signs that your credit may be improper:



- **Did you use an ERC company or outside service to claim your credit that was not a tax law firm or a CPA Firm?**
- **Did you find out about this company through advertising?**
- **Did this organization charge you a contingent fee, i.e. based on the credit amount, to help you file the credit?**

While not all ERC companies or claims filed by them are bad, very few of them had reputable experts on staff. Most of the time, taxpayers were dealing with sales people, who were incentivized to maximize their claim because it maximized the fee due to the ERC company. These people were unlicensed and in almost all cases have no prior experience in tax.

Some of these companies even employed “attorneys” that held themselves out to be tax attorneys, but did not have tax experience, were not properly trained, and even practiced in other areas of the law. Some of these attorneys even provided tax “opinion letters,” which do not meet the standard of a legal opinion and that will not hold up in an audit.

As stated in the IRS’s March 2023 warning, “The IRS and tax professionals continue to see third parties aggressively promoting these ERC schemes on radio and online.

These promoters charge large upfront fees or a fee that is contingent on the amount of the refund.”

Were you told that you qualified before a thorough and substantive analysis was done regarding your eligibility for the credit?

As the IRS has warned, “Aggressive claims from the promoter that the business receiving the solicitation qualifies before any discussion of the group’s tax situation. In reality, the Employee Retention Credit is a complex credit that requires careful review before applying.”

www.irs.gov/newsroom/irs-issues-renewed-warning-on-employee-retention-credit-claims-false-claims-generate-compliance-risk-for-people-and-businesses-claiming-credit-improperly

How much diligence did you do on the company and the persons at the company that you were dealing with?

< Did your ERC Company identify itself by saying it was “one of the largest ERC processors” or tout large numbers of businesses that they have helped?

Tax is a highly complex and sophisticated area of the law. Furthermore, ERC calculations and eligibility are a determination that needs to be undertaken by a tax professional and that are specific to the individual businesses. Logically, if you are doing something that is technical and fairly sophisticated, like a doctor performing surgery, this is not something that you want to do in bulk.

Many of these companies in an attempt to process as many ERC claims as possible (in order to get as much in fees as possible) took shortcuts in their math and/or in their qualification process. These shortcuts put your payroll tax returns at risk.

< If you asked for backup to support the calculations for the credit on your amended payroll tax returns, were you provided with a spreadsheet or something that looks like a spreadsheet?

Many ERC credit mills have been utilizing spreadsheets or software applications that they have created in order to expedite the processing of the ERC. These programs were aided by the hiring of foreign workers in places like India and the Philippines. However, these spreadsheets and software programs are limited in their nature and cannot account for all the nuances with the ERC.

Think about it this way: Would you trust your business's tax returns to Turbo Tax or do you rely on a CPA each year to think about your business's individual situation. Software has its limitations and should have never been relied upon to calculate the ERC.

< **Did you claim the credit in Q2 and Q3 2021 and are you in a Republican state and/or in a rural area?**

While the credit is not politicized, eligibility for the credit (unless you qualify based on a decline in gross receipts) is based on operational impact to your business because of a government order. The fact of the matter is that although most of the dollars for the credit were in Q2 and Q3 2021, there were significantly fewer government orders still in effect that were causing a more than nominal impact on most businesses. Although taxpayers can still qualify in these states, this is an exception rather than a rule.

< **Do you have a government order that you can readily cite to that caused specific detriment to your business?**

Many of these organizations used the general stay at home order issued by your state's governor or cited to orders without a specific link to the impact on your business. However, the IRS has made clear that in order to qualify for the Employee Retention Credit, you must be able to demonstrate a shutdown that was caused by a government order. Impacts to your business that are based on the inability to hire people, loss in customers, or general economic downturn do not qualify.

< **Did your revenue increase during the pandemic or would you consider the impact of government orders to your business to be less than nominal?**

In spite of anything you may have been told, many businesses fail to qualify for the credit because their impact specifically tied to government orders was less than nominal. While revenue does not have anything to do with operational impact to a business, increases in revenue may be a warning sign that your business was not more than nominally impacted. While most businesses were impacted during the pandemic, whether or not that impact was more than "nominal," is being heavily scrutinized by the IRS. The bigger the business, the more difficult it is to show a more than nominal impact on a quarter by quarter basis.

< **Is the basis for your credit a "supply chain" argument?**

While you can qualify for the Employee Retention Credit based on supply chain issues, a recently released memorandum from the IRS office of Chief Counsel provided guidance that significantly limited which employers are eligible for the credit based on supply chain disruptions. Those who were not ordered to shut down or experienced a critical disruption to supplies that are essential for them will not be viewed as "eligible" for the credit.

< **Were you ever asked to provide documentation to the company that prepared your ERC? If asked, could you readily provide documentation to substantiate both the government orders that impacted you and that impact?**

The problem with many of the ERC companies is that because they were motivated by greed and collecting as much in contingent fees as they possibly could, they took shortcuts with what a tax professional would consider reasonable due diligence.

Most of these companies did their analysis orally and, worse, had their clients essentially sign statements disclaiming any liability as the result of an improper analysis.

If you were never asked to provide documentation, how can you be sure that someone really took the time to make sure your claim was accurate and would withstand scrutiny?

What Do I Do If I Believe My Employee Retention Tax Credit Was Improperly Filed?

- Finding out that your ERC claim may be too good to be true is a terrible feeling.
- This is even more true after paying a substantial fee, maybe 25% or more, to a less than reputable company and not having the full sum to pay back to the government.
- Even worse is realizing that you have left your company exposed to an audit where you may have to pay substantial interest and penalties on top of paying back the money that you receive and which also may expose you to an income tax examination for the years in question.



So, what do you do?

1 Understand the Seriousness of the Situation, but Don't Panic

Yes, this is very serious. This could cost your business a lot of money or get you locked in a face-off with the IRS. Audits are serious business, particularly if the government thinks you have done something wrong. First though, don't panic. The tendency of people who find themselves in a hole is that they want to climb out of it as quickly as possible without strategizing the best way out of the situation. Instead, take a deep breath and deal with the realization that you have made a mistake, but equally recognize that you are going to do what it takes to fix it. You have to have a gameplan or you are just going to make matters worse.

2 Don't Re-Amend Returns, Don't Contact the IRS

Your first reaction is going to be to try and unwind the problem by reamending returns and reversing the credit. This is the last thing you should do. Much like stealing something and thinking that returning stolen goods is going to solve all your problems, reamending your returns without proper guidance is not going to help. In fact, it will just make matters worse. Think about every cop show that you have seen on TV and exercise your right to remain silent (at least for the time being).

3 Don't Tip Off the ERC Company that You Think/Know There's a Problem

Understanding that you have already paid a substantial fee to the company that got you in this mess in the first place, don't circle back with them and expect them to just fix it. Keep in mind that you doing what is in your best interest is adverse to their interest of making as much money as possible off of your ERC claim. How can you expect them to be impartial if they make money by making sure your ERC stays just the way it is? The ERC company has a conflict of interest and, if push comes to shove, will do whatever needed to keep themselves out of trouble (think about how much trouble they might be in).

4 Don't Turn to Your CPA, Hire a Tax Attorney Qualified to Analyze at Your Situation

Equally, your CPA is also not the person to help you with this situation either. Your CPA, as good as they may be at tax reporting, is not trained to deal with these types of issues. First, CPAs generally do not deal with payroll tax issues. Second, if the situation goes south, your CPA is not trained in advocacy or defending businesses against the IRS and is going to recommend that you hire an attorney anyway. As we will explain, the fixes to this situation are usually above the depth of your CPA's experience. Make no mistake, you need someone that is equally versed in tax law and tax procedure (i.e. how the IRS works).

What Could The Fix For A Illegitimate ERC Claim Look Like?

First, there is no one-size-fits-all solution to this. As we have explained, determining qualification for the ERC is not a one-size-fits-all process, but a technical and fact-specific endeavor. The solutions we would provide as a law firm would obviously be on a case-by-case basis.

However, in the interest of full disclosure, here are what some solutions could look like.

< **Pre-Screening Your Audit Risk:**

Tax Attorneys have access to certain things within the IRS that we can use to check to see if you have been flagged for audit. Some of the strategies we propose would depend on whether or not IRS has “caught” you yet. We can check to see what the IRS is doing and where your file is, which generally keeps us one step ahead of the game.

< **Building a Litigation File/Opinion Letter:**

Understanding that you have already paid a substantial fee to the company that got you in this mess in the first place, don’t circle back with them and expect them to just fix it. Keep in mind that you doing what is in your best interest is adverse to their interest of making as much money as possible off of your ERC claim. How can you expect them to be impartial if they make money by making sure your ERC stays just the way it is? The ERC company has a conflict of interest and, if push comes to shove, will do whatever needed to keep themselves out of trouble (think about how much trouble they might be in).

As part as of our standard best practices as a Firm, each one of our clients that we did the ERC for received an opinion letter. Our opinion letter for ERC is unique in that it draws from our background and experience in audits and in representing our clients in various court settings because of our familiarity (our principal has been involved in more than 500 audits), we know how IRS auditors examine cases and can essentially pre-audit clients to shield them from any risk.

As part of this process, we can work to build your litigation file so that if you are audited, you are properly protected. We understand the IRS thought process when it comes to ERC and what they are looking for and, therefore, can tailor our approach to keep you as safe as possible and to ensure that you keep most of the credit.

By the way, our Firm stands behind all of its tax opinions and audit defense is always included for our clients when we draft an opinion letter.

< Voluntary Disclosure:

If we determine that some or all of your ERC claim is illegitimate, depending on your risk, we may recommend a domestic voluntary disclosure to avoid some of the more serious penalties and even criminal charges. The domestic voluntary disclosure process involves coming clean and may potentially avoid an audit or any further scrutiny once it is complete.

< Defending You in an Audit:

If push comes to shove, our Firm is more than willing to defend you in an audit. We have developed an extremely deep knowledge base around ERC, which stems from our experience in preparing and advising others in the preparation of extremely difficult ERC claims. Furthermore, our Firm has been representing taxpayers before the IRS since its inception and we have more than 50 years of combined experience representing taxpayers in all stages of controversy.

Even if your case were to turn criminal, we have the expertise as a Firm to defend you no matter how difficult the matter becomes. And, because our practice is Federal, we have the ability to represent taxpayers in all fifty states.

About Us

Brotman Law is an established team of law professionals that have been helping clients and their businesses navigate the intricacies of tax law for over 10 years. The extensive experience of the team enables Brotman Law to pivot and effectively tackle whatever tax question their client is navigating, and the firm has the results and testimonials to prove it.

Brotman Law is dedicated to providing every client with exceptional legal services accompanied by a compassionate approach that is unheard of in the industry. Beyond just successes with the IRS and tax agencies, the Brotman Law team is singularly united by genuine empathy for all clients, a strong desire to help, and a never-say-quit tenacity that propels the firm to the best possible results on their clients' behalf.



BROTMAN LAW

**For more information or to book a consultation with our team,
visit SamBrotman.com or call (619) 378-3138.**



BROTMAN LAW

402 W. Broadway, Ste. 800 • San Diego, CA 92101
SamBrotman.com • (619) 378-3138