



WRITTEN STATEMENT

OF

THE AMERICAN INSTITUTE OF CPAs

SUBMITTED FOR THE RECORD OF THE

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HEARING OF

THE UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

ON

**THE EMPLOYEE RETENTION TAX CREDIT EXPERIENCE: CONFUSION, DELAYS
AND FRAUD**

INTRODUCTION

The American Institute of CPAs (AICPA) appreciates the leadership taken by the House Subcommittee on Oversight in raising ongoing issues that taxpayers and practitioners are experiencing with the employee retention credit (ERC).

The AICPA is the world’s largest member association representing the accounting profession, with more than 421,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

CREATION AND EVOLUTION OF THE EMPLOYEE RETENTION CREDIT

The ERC was created by the Coronavirus Aid, Relief, and Economic Security (CARES) Act,¹ which passed in response to the COVID-19 pandemic (“pandemic”), to financially assist employers struggling to pay wages to employees. Subsequently, on December 27, 2020, the Consolidated Appropriations Act, 2021,² which included the Taxpayer Certainty and Disaster Relief Act of 2020 (TCDRA), was signed into law. Section 206 of the TCDRA extended and enhanced the provisions of the ERC and allowed Paycheck Protection Plan (PPP) loan borrowers to retroactively take advantage of the credit. The ERC was further extended to December 31, 2021, and enhanced by the American Rescue Plan Act of 2021,³ until it was ended early on September 30, 2021, for most employers, by the Infrastructure Investment and Jobs Act.⁴

Since the creation of the credit, the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) have released various pieces of guidance in the form of frequently asked questions, notices, news releases and a generic legal advice memorandum, to assist taxpayers in implementing the credit.

CONCERNS AND RECOMMENDATIONS

1. General

Since the inception of the credit, the AICPA has diligently and consistently advocated on behalf of taxpayers and CPAs to Treasury and the IRS regarding the following ERC-related topics of concern:

¹ P.L. 116-136.

² P.L. 116-260.

³ P.L. 117-2.

⁴ P.L. 117-58.

- Requested authoritative guidance⁵ on numerous topics related to the implementation of the ERC;
- Urged the IRS to reduce the backlog of unprocessed returns, including those containing ERC claims;⁶ and
- Raised awareness of the alarming trend of unscrupulous third-party vendors promoting improper and fraudulent ERC claims.

The advocacy efforts of the AICPA resulted in some, if not all, of the following actions taken by the IRS related to the ERC:

- Special processing of certain payroll tax returns on which an employer claimed the ERC;
- Increased number of audits of payroll tax returns on which an employer claimed the ERC;
- Public acknowledgment of unscrupulous third-party ERC vendors;
- Communication to the public on how to report bad actors; and
- Inclusion of ERC on the 2023 “Dirty Dozen” list of tax scams.

2. Backlog of Employee Retention Credit Processing

The IRS has faced numerous challenges which have severely impacted its ability to timely process returns, including those containing ERC refund claims. Form 941-X, *Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund*, which is the amended payroll tax return used to claim most ERC refunds, must be paper filed. The paper filing of these returns coupled with added responsibilities related to the pandemic (e.g., the responsibility of the IRS to issue billions of dollars in economic impact payments and advance child tax credits to taxpayers during 2022 as a result of legislation passed by Congress in response to the pandemic),⁷ led to a monumental backlog of payroll tax returns for the IRS to process. This backlog led to delays in taxpayers receiving ERC refunds for over one year in the majority of cases throughout 2021 and 2022. The extensive wait time to receive desperately needed financial assistance created frustration and increased financial hardship for employers.

Recently, IRS Commissioner Daniel Werfel (“Commissioner”) stated that “the IRS has shifted efforts after successfully clearing the backlog of valid ERC claims.”⁸ While our members have

⁵ AICPA letters, “[Request for Guidance Related to the Employee Retention Credit Provisions of the Coronavirus Aid, Relief, and Economic Security \(CARES Act\)](#),” April 17, 2020; “[Request for Guidance related to the Employee Retention Credit Provisions of the Coronavirus Aid, Relief, and Economic Security \(CARES Act\)](#),” October 8, 2020; “[Employee Retention Credit – Sections 206 of the Taxpayer Certainty and Disaster Relief Act of 2020 \(Division EE of the Consolidated Appropriations Act, 2021\)](#),” January 15, 2021; and “[Employee Retention Credit – Sections 206 of the Taxpayer Certainty and Disaster Relief Act of 2020 \(Division EE of the Consolidated Appropriations Act, 2021\)](#),” February 15, 2021.

⁶ AICPA letters, “[Additional Measures to Address Backlog](#),” July 11, 2022; and “[IRS Operational Plan for Resources Included in the Inflation Reduction Act of 2022](#),” March 28, 2023.

⁷ IR-2023-82, April 14, 2023.

⁸ IR-2023-135, July 26, 2023.

seen a tremendous improvement in wait times for the receipt of refunds from valid ERC claims, they are still experiencing delays of up to six months. In addition, some members have indicated that they have resorted to working with the National Taxpayer Advocate's office to help resolve long-pending claims filed earlier in the pandemic. However, we do agree with the Commissioner's statement that "the further we get from the pandemic, we believe the percentage of legitimate claims coming in is declining."⁹

Recommendation

To ensure that the unprecedented backlog of paper returns resulting from the pandemic is not repeated, the AICPA urged¹⁰ the IRS to take immediate steps to increase the types of returns that can be electronically filed and to automate the processing of paper returns in addition to other forms, statements, elections, and documents.

We are pleased with the unveiling of the IRS Paperless Processing Initiative,¹¹ on August 2, 2023, which will allow taxpayers the option to go paperless for IRS correspondence by the 2024 Filing Season, and for the IRS to achieve paperless processing for all tax returns by the 2025 Filing Season. This initiative is expected to eliminate up to 200 million pieces of paper annually, cut processing times in half, and expedite refunds by several weeks. This initiative has been made possible given that Congress provided the IRS with \$80 billion of additional multi-year funding.

3. Internal Revenue Service Response to Employee Retention Credit Inquiries

The pandemic and related tax legislation overwhelmed existing systems and processes for individuals, businesses, and the IRS. The IRS was not able to assume its new responsibilities pursuant to the newly enacted legislation as quickly as needed by taxpayers and tax practitioners, which resulted in taxpayers and tax practitioners being unable to reach the IRS to inquire about ERC claims.

Additionally, our members have experienced issues with lost ERC refund checks requiring interaction with the IRS on behalf of their clients. While taxpayers have the option to apply the ERC as a credit for the period in which the Form 941-X is filed, rather than request a refund check, taxpayers normally request a check when filing ERC refund claims given it provides more certainty than the credit process. There is no option for taxpayers to have the funds directly

⁹ Ibid.

¹⁰ AICPA letter "[Acceptance of Electronic Signatures and Electronic Filing for All Returns and Other Documents Submitted to the IRS](#)," May 9, 2023.

¹¹ Press release, Department of the Treasury, [IRS Launches Paperless Processing Initiative](#), August 2, 2023.

deposited. Many checks are being lost and the process for check replacement is cumbersome, resulting in further delay in taxpayers receiving refunds. When filing the necessary forms to assist clients to track down their checks, our members have seen further delays from errors in processing Form 3911, *Taxpayer Statement Regarding Refund*, and Form 8822-B, *Change of Address or Responsible Party – Business*.

Recently, the IRS has responded to phone inquiries on the practitioner's priority service line more quickly and has been helpful in addressing ERC-related inquiries. The ability to access tax account transcripts online has resulted in more expeditious resolution of issues.

4. Impact of Employee Retention Credit Fraud on Taxpayers

As the national, professional organization for all Certified Public Accountants, the AICPA's mission is to power the success of global business, CPAs, CGMAs, and specialty credentials by providing the most relevant knowledge, resources and advocacy, and protecting the public interest. Ensuring that tax preparers are competent and ethical is critical to maintaining taxpayer confidence in our tax system. These goals are consistent with the AICPA's own Code of Conduct and enforceable tax ethical standards.

Unfortunately, the pandemic and the resulting legislation, which funneled unprecedented amounts of government funds into the economy through small businesses, resulted in many unscrupulous actors promoting "free money" to unwary businesses. Many of these bad actors do not properly evaluate a business' classification as an eligible employer able to claim the ERC. While the IRS has certain protocols in place to catch fraudulent or otherwise insufficient ERC claims prior to their payout (e.g., comparing claims to certain information previously filed on the employer's income tax returns and payroll tax returns), they are not sufficient to stop a significant amount of erroneous claims prior to issuing refunds. Upon audit, employers may have to repay most or all of the ERC and pay penalties and interest. They will also likely be unable to recoup the large contingency fee paid to the ERC promoter, placing taxpayers that struggled financially through the pandemic, and believed that they were legitimately eligible to claim the credit, in a precarious financial position, possibly leading to financial ruin.

For the last two years, the AICPA has diligently and consistently advocated on behalf of taxpayers and CPAs to Treasury and the IRS regarding unscrupulous third-party vendors promoting improper ERC claims. The ERC has been exploited by unethical credit mills and other bad actors submitting claims on behalf of businesses that are either ineligible to claim the credit or eligible for a much smaller credit, charging contingency fees equal to as much as 30 percent of the claimed credit. Taxpayers are willing to pay these amounts even though many claims will be filed without paid preparer signatures.

The AICPA has provided [resources and information](#) to its members to help educate members and their clients about misconceptions around ERC as well as warning them of red flags that indicate a vendor may not be qualified to determine whether their business is eligible for the ERC. The diligent and consistent outreach by the AICPA to the IRS about the unscrupulous practices of third-party ERC promoters has led to a robust communication campaign by the IRS warning the public about these third-party ERC promoters.

We also commend Commissioner Werfel for being a positive force to help combat fraud via high levels of communication and significantly increased ERC-related audit activity.

Recommendations

a. Regulation of Paid Tax Return Preparers

The AICPA is a long-time advocate of providing appropriate and well-defined authority to Treasury to regulate paid tax return preparers. Ensuring that tax preparers are competent and ethical, and that the IRS has the tools it needs to conduct appropriate oversight, is critical to maintaining taxpayer confidence in our tax system and protecting the interests of the American taxpayer. Based on extensive feedback from our membership, and IRS warnings, many preparers holding themselves as ERC “experts” or “tax professionals” were unqualified to give tax advice. Thousands of small businesses and nonprofits will learn that their unqualified ERC preparer improperly prepared their ERC claim. For those entities having consulted with an unscrupulous credit mill or ERC promoter could result in a devastating financial hit (repayment of the refund coupled with the inability to recoup the fee paid to the incompetent preparer).

The looming wave of ERC fraud makes the need clear for IRS oversight of the return preparation industry. The AICPA with a diverse coalition of external stakeholders have endorsed H.R. 4184, the Taxpayer Protection and Preparer Proficiency Act of 2021 (117th Congress).¹² H.R. 4184 gives appropriate authority to the IRS to regulate paid tax return preparers to address incompetent and unscrupulous tax return preparers. H.R. 4184 also allows CPAs, attorneys and enrolled agents to maintain their high standards through licensing by state boards of accountancy or state courts or being awarded credentials by the IRS. The AICPA stands ready to work with Congress to advance H.R. 4184.

b. Mitigation of Marketplace Confusion

Some taxpayers are already confused by the different qualifications of tax return preparers and the varying practice rights that they individually possess. That confusion was magnified by bad actors

¹² Strausfeld, Dave, J.D., Journal of Accountancy, [“Proposed Bill to Regulate Tax Preparers has AICPA Support,”](#) June 30, 2021.

promoting the ERC. Along with providing authority to the IRS to regulate paid tax return preparers, Congress should also direct the IRS to take steps to mitigate that confusion on their website, in their publications and in any public-facing database of preparers. Prior to *Loving v. IRS*,¹³ the IRS recognized the potential for marketplace confusion when they required the currently unenrolled community be made subject to the guidance in Notice 2011-45, 2011-25 IRB 886, with regard to advertising restrictions. To mitigate marketplace confusion, we have strongly recommended¹⁴ that currently-unenrolled PTIN holders using any paid advertising involving print, television, radio, or other medium in which the individual represents themselves as a PTIN holder, a registered tax return preparer or some type of a new IRS category of return preparer, to display or broadcast a statement explaining the differences between the different type of preparers (e.g., qualifications) and, most importantly, educating the public that the IRS does not endorse any particular type of tax return preparer.

c. IRS Communication of Existing Taxpayer Relief

Upon audit by the IRS, ERC claims deemed to not meet the ERC requirements will result in the taxpayer having to repay the funds, in some cases with interest and penalties. To ease the financial burden on taxpayers exploited by unethical credit promoters and other bad actors, the IRS should make clear via a communications campaign that meaningful relief may be available to taxpayers acting in good faith. For example, the IRS may want to communicate the fact that certain penalties and interest will not apply to taxpayers who self-correct if the tax due (i.e., the amount of the ERC) is paid with the amended return (e.g., Form 941-X). Penalty relief for reasonable cause, determined on a case-by-case basis considering all relevant facts and circumstances, will also be available. In addition, taxpayers required to pay back large ERC sums should be eligible to pay back the money with an installment plan if their business would be jeopardized by large negative cash flow.

5. Amended Federal Income Tax Returns

An employer's deduction on its federal income tax return for qualified wages, including qualified health plan expenses, must be reduced by the amount of the ERC claimed. This wage reduction must take place in the year the qualified wages were paid or incurred. Therefore, the filing of an amended payroll tax return to claim the ERC triggers the need to amend the corresponding federal income tax returns to reduce the amount of wages deducted on the originally filed return by the amount of the credit.

ERC promoters preparing amended payroll tax returns to claim the ERC often do not inform employers of the need to amend federal income tax returns. This negligence exacerbates an already complex problem for employers, CPAs and other tax preparers who understand the requirement. We have heard from members of our organization who have had difficult conversations with their

¹³ 917 F. Supp.2d 67, 74-75 (D.D.C. 2013), *on appeal*, No. 13-5061 (D.C. Cir).

¹⁴ AICPA letter "[Tax Return Preparer Competency Act of 2015 \(H.R. 4141\)](#)," December 4, 2015.

clients about the need to amend the federal income tax returns and the associated fees to do so.

In addition, some of our members are concerned that signing an amended income tax return to disallow the deduction for the amount of the ERC is acknowledging that as a paid preparer they are agreeing with the erroneous ERC claim. This belief was the result of a communication from the IRS Office of Professional Responsibility, which appeared to suggest that a preparer signing an income tax return disallowing deduction of the credit amount is “perpetuating” an improper credit.¹⁵ These concerns have delayed some taxpayers from amending income tax returns, amplifying the fiscal impact of potentially improper claims.

CONCLUDING REMARKS

The ERC was a welcome and necessary financial lifeline provided by Congress to businesses during the pandemic. While many taxpayers have experienced the positive impacts of the credit that Congress intended, other taxpayers and CPAs have experienced substantial negative, unintended consequences brought on by the complexity of the credit coupled with the need to paper file amended payroll tax returns. The complexity of the credit coupled with a confusing marketplace of various types of tax return preparers allows ERC promoters to use aggressive marketing tactics to lure businesses into making fraudulent ERC claims while collecting exorbitant fees based on the amount of the credit claimed. Also, the unprecedented backlog of unprocessed returns at the IRS has resulted in eligible businesses waiting up to a year or more to receive their refunds.

We are hopeful that the lessons learned regarding the ERC will serve as a springboard for the changes recommended in our testimony. We acknowledge that in recent months, the IRS, under the leadership of the Commissioner, has taken steps to communicate to the American public about the unscrupulous third-party ERC vendors, and put into place increased protocols to clear the backlog of unprocessed returns and detect fraudulent ERC claims.

The AICPA appreciates the opportunity to submit this written statement for the record.

¹⁵ Alert from the Internal Revenue Service, Office of Professional Responsibility, [Professional Responsibility and the Employee Retention Credit, Issue Number 2023-02](#), March 7, 2023.