

## Kwong's Next ERC Ripple: Sizable Refunds for Improper IRS Assessments on Businesses that Properly Reduced Wage Deductions

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**The Employee Retention Credit has been one of the most complex laws the Internal Revenue Service has ever administered. And in a new twist, there is the possibility of additional ERC-related refunds for a wide range of corporations, partnerships, and sole proprietors.**

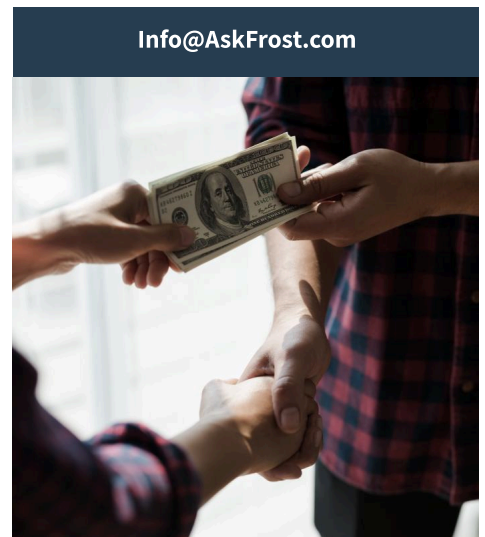
For ERC claimants, receipt of the refund check was never the end of the story. The law required another step—reducing wage deductions pursuant to section 280C(a), often accomplished by filing amended income tax returns that resulted in additional taxes owed. The surprise is that there may be one more step following a recent court ruling.

The U.S. Court of Federal Claims in *Kwong v. United States* raised questions regarding federal tax filing and payment deadlines during the COVID-19 pandemic. The significance of the case may, however, extend much further, including ERC. If *Kwong* means that the 2020 and 2021 income tax returns were not actually due (or at least if any noncompliance must, by operation of law, be disregarded) until July 10, 2023, then IRS bills for failure-to-pay penalties and underpayment interest may be overstated, and taxpayers who paid those charges may be entitled to a refund.

### Intersection of Several Tax Provisions and Kwong Creates Refund Possibility

This issue arises from the interaction of several familiar rules. CARES Act section 2301(e), and later Internal Revenue Code section 3134(e), incorporated the tax-benefit rule reflected in section 280C(a). In practical terms, that meant a business claiming the ERC could not also keep the full deduction tied to the qualified wages that generated the Credit in the first place. Since an overwhelming majority of ERC refund claims were made long after the corresponding income tax returns were filed, claiming the Credit meant taxpayers had to amend the returns to reduce the deduction for wages.

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That part is not new. What may be new, after Kwong, is the timing.

Many taxpayers followed IRS guidance and reduced wage deductions on income tax returns when filing Forms 941-X to claim ERC. Others made the adjustment later, when the claimed overpayment was refunded. Either way, the result was often the same—an amended income tax return, additional tax due, and a bill that included not only the tax itself but also underpayment interest under section 6601 and additions to tax for failure-to-pay under section 6651(a) (2). But here's the catch: Those accruals depend on payment due dates. And if the due date was effectively later than the IRS assumed, then the assessments may have been inflated from the start.

That is where Kwong comes in. If the Kwong case is right that the relevant income tax return due dates were postponed until July 10, 2023, then interest and failure-to-pay additions tied to ERC-related wage-disallowance adjustments should not have begun accruing until July 11, 2023. Why does this matter? Many ERC recipients were trying to do exactly what the law required. They were not seeking a second windfall. They were complying with section 280C(a) by reducing wage deductions and paying the resulting income tax. If the IRS then computed interest and additions to tax (i.e., penalties) as though the return had been due earlier, those taxpayers may have paid more than required.

### **Who Might Be Due a Refund? C-corps, Partnerships, S-corps, & Sole Proprietors**

This could affect a broad range of tax filers. A C corporation may have filed on Form 1120-X and then paid the resulting tax, interest, and penalties. A partnership or S corporation

may have issued amended Schedules K-1, causing owners to file Forms 1040-X and pay the resulting charges individually. A sole proprietor or owner of a disregarded entity may have done the same on Schedule C and an amended income tax return. The details for these groups change, but the core argument does not: If the income tax return was not due until July 10, 2023, interest and failure-to-pay penalties should not run before July 11, 2023.

The refund procedure is somewhat counterintuitive. Even though the original adjustment may have been reflected on an amended Form 1120-X or Form 1040-X, a taxpayer seeking a refund of improperly assessed interest or penalties must pursue that relief by using Form 843, Claim for Refund and Request for Abatement. The same is true whether the claimant-taxpayer is the business itself or an owner of a pass-through entity who paid the liability on an individual return after receiving an amended Schedule K-1.

This is another example of Kwong's potential ripple effect. The case is not only relevant to refund claim timing. It may also bear on whether the government overstated the consequences of ERC compliance by incorrectly computing penalties and interest.

### **The Bottom Line for Refunds: ERC Taxpayers Should Check for Interest, Penalties**

So what's the next step? Taxpayers who made ERC-related income tax amendments should therefore look closely at the bill they paid because the interest and penalty assessment almost certainly included the time between January 20, 2020, and July 10, 2023.

The amounts at issue will vary, but the principle is straightforward. If the return due date was postponed, then





the clock for interest and failure-to-pay additions was postponed too. For taxpayers who already paid those charges, the next ERC ripple may not be another bill. It may be a refund.

ERC continues to be a complicated area of tax law. Frost Law can help. Our team understands these nuances and has written extensively on the implications of the Kwong case. Contact our team today at [\(410\) 864-1163](tel:4108641163) or [schedule a confidential consultation](#).

### **Frost Law has additional information on Kwong and ERC:**

- [If Kwong Is Right, the ERC Deadline May Be Wrong](#)
- [Padding the Bill: Is the IRS Charging Employers Too Much Underpayment Interest When It Recaptures ERC Refunds?](#)
- [Alert: Recent Court Decision May Allow Some Taxpayers to Seek Refunds or Abatement of Penalties, Interest From Pandemic Period; Frost Law Can Help](#)
- [Facing an IRS Audit? A Powerful Argument ERC Refund Recipients Must Preserve](#)
- [Frost Law Calls on IRS to Accept National Taxpayer Advocate's Recommendations on Refund Delays Involving Employee Retention Credits](#)

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