The Tax Court Delivers a Powerful Signal to PEOs Holding ERC Refunds for Their Client Businesses

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For businesses at odds with a Professional Employer Organization ("PEO") or other third-party payer over the Employee Retention Credit or any other tax credit they are entitled to, there has been an important legal development that serves as a powerful reminder about who is really entitled to that money.

On March 30, 2026, the United States Tax Court issued a pointed reminder to the PEO industry: Tax credits enacted by Congress to help American businesses are not theirs. The opinion in Barrett Business Services, Inc. v. Commissioner, 166 T.C. No. 7, is not a close call. It is a comprehensive rejection of the legal theory advanced by at least one PEO to justify claiming tax credits that were never intended for them.

The implications of this are far-reaching. And it is a clear, distinct signal that PEOs should not be holding onto refunds that belong to the operating businesses they serve. This includes ERC refunds and interest amounts paid by the IRS to the PEO. Some third-party payers continue to hold substantial amounts of ERC refunds and interest money instead of sending it to where it legally belongs—with the common law employer.

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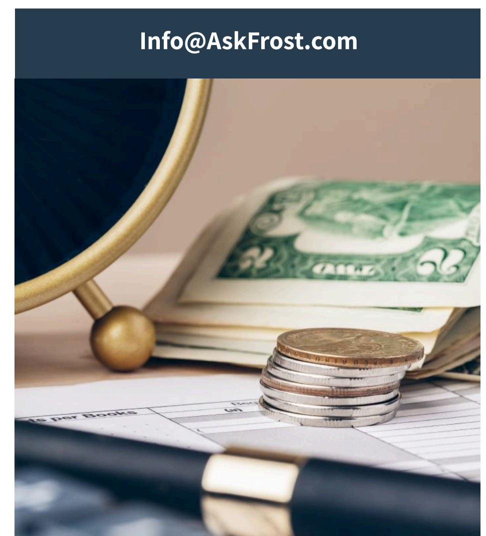

Frost Law continues to work with businesses on issues involving ERC, PEOs, and related topics. Here is a closer look at this important Tax Court decision.

What the Tax Court Decided

Barrett Business Services, Inc. ("BBSI" or "Barrett") is one of the larger PEOs in the country. Like many PEOs, it manages payroll, employment tax reporting, and related services for its client businesses—the actual employers whose workers show up every day, do the work, and drive the economic activity that Congress often seeks to encourage through the tax code.

BBSI claimed the Work Opportunity Tax Credit ("WOTC") and the Empowerment Zone Employment Credit on its own income tax returns for tax years 2017 through 2020. These credits were designed to incentivize employers to hire veterans, ex-felons, individuals with disabilities, and people living and working in economically distressed communities. BBSI argued that because it controlled the payment of wages to client businesses, it qualified as a statutory employer under I.R.C. § 3401(d)(1) and was therefore entitled to these tax credits. It also argued that as a § 3504 agent of its clients, all employer provisions of law, including the right to claim tax credits, flowed through to it.

The Tax Court rejected each argument—completely.

The Intended Beneficiary Problem for PEOs

The most important passage in the Tax Court's opinion is not a technical statutory analysis. It is this:

> Barrett is not the entity that is providing the work opportunity for disadvantaged individuals or in distressed economic areas and therefore is not Congress's intended beneficiary of these credits. A statutory employer who pays wages for services provided to another person is not Congress's ***intended beneficiary*** of these credits.

The emphasis is added, but it is a point worth reading again for any business struggling with a third-party payer.

Congress enacted WOTC to encourage employers to take a chance on workers who face barriers to employment — veterans returning from combat, individuals rebuilding their lives after incarceration, and people living in communities that the broader economy has left behind, for example. And it created the Empowerment Zone Employment Credit to revitalize distressed urban and rural areas by incentivizing businesses to hire locally. In both cases, the intended beneficiary is the employer doing the hiring, taking the risk, and making the commitment to those workers and those communities.

A PEO that processes payroll is not doing any of those things. It provides an administrative service for which it is compensated. That is a legitimate and valuable endeavor, but it does not entitle a PEO to reach into the tax code and claim credits that Congress designed for someone else.

The court considered and rejected the arguments BBSI advanced, leaving no viable legal theory for PEOs seeking to claim credits that belonged to their clients.

Why This Reaches Beyond WOTC & EZEC and into ERC

The *Barrett* decision did not involve ERC. But anyone who has spent time in the ERC space should read this opinion carefully, because the principle it establishes applies with equal force.

ERC was enacted to help businesses survive an unprecedented economic disruption. Congress's intended beneficiary was the employer that kept workers on payroll when it had every financial incentive to let them go. That is not the payroll company. That's not the PEO acting as employer of record.

Yet in the years following the pandemic and the CARES Act, some third-party payers have retained ERC refunds belonging to their clients or simply failed to file refund claims for them altogether. That leaves client businesses empty-handed and without tax credits they had legitimately earned.

The Tax Court has now made clear what should have been obvious all along: When Congress creates a tax credit to reward an employer for doing something—like hiring a veteran, investing in a distressed community, or keeping workers employed through a crisis—the employer Congress had in mind is the one actually doing it. It is not the entity cutting the checks on its behalf.

The Bottom Line: Credits Belong to Businesses, Not PEOs

PEOs and other third-party payers occupy an important and legitimate role in the American economy. But that role has boundaries. Processing payroll does not make a PEO the intended recipient of every tax benefit attached to the wages it administers. The Tax Court just said so, clearly and without equivocation.

For businesses that used a PEO to administer their ERC claims and are now wondering whether they received everything they were entitled to, this opinion is an important development. The legal framework has always pointed in the same direction. Now there is a Tax Court opinion saying so out loud.

For businesses frustrated with delays by third-party payers, this further illustrates the importance of not giving up. And Frost Law can help.

The Frost team continues to advise businesses with all aspects of the Employee Retention Credit including audits and examinations, protests and appeals, alternative dispute resolution, including Post-Appeals Mediation (PAM), and litigation—including refund claim lawsuits and actions related to Professional Employer Organizations and other third-party payers. Contact our team today at (410) 497-5947 or **schedule a confidential consultation**.

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