

The PEO Black Box: Breach of Contract and Unjust Enrichment Claims for Withheld ERC Refunds

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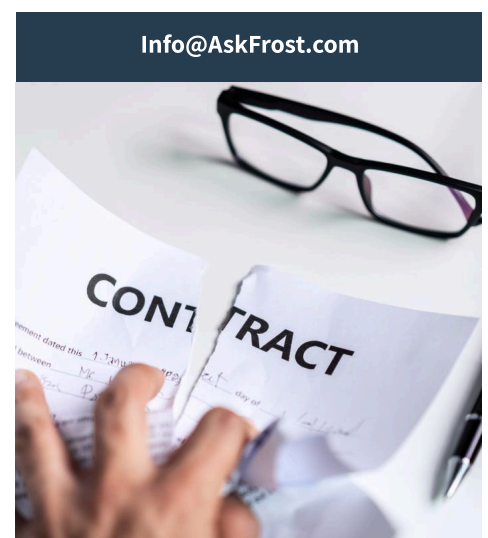
As the IRS continues processing Employee Retention Credit (ERC) claims into 2026, many businesses are facing an unexpected legal issue: their refunds are being withheld by Professional Employer Organizations (PEOs) rather than being passed through to the companies that funded the underlying payroll taxes.

For many small and midsize businesses, these ERC refunds, and the accompanying interest, represent critical capital. When those funds are withheld, the consequences can directly impact cash flow, operations, and the long-term financial stability of the business

PEOs: A Lack of Transparency and Withheld Funds

This issue arises from the structure of the PEO relationship. Many PEOs file payroll taxes under their own Employer Identification Number (EIN), which means the IRS issues ERC refunds directly to the PEO. While this simplifies tax reporting, it also creates a lack of transparency for client employers. These employers waiting for their refunds often have limited visibility into whether refunds have been received by the PEO, how much has been paid, and whether interest has been included.

In this environment, some PEOs have taken the position that they may retain ERC refunds due to audit risk, potential clawbacks, or joint and several liability concerns. Under IRS Office of Chief Counsel Memorandum AM 2024-001, both the PEO and the client employer may share liability for improper ERC claims.¹ However, the existence of shared liability does not automatically give a PEO the right to withhold funds that belong to its client. Without clear contractual authority, such retention may give rise to actionable claims for breach of contract and unjust enrichment.



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How Breach of Contract and Unjust Enrichment Apply

Breach of contract claims frequently arise where PEO agreements include provisions requiring the pass-through of tax credits, refunds, or other economic benefits to the client. When a PEO receives an ERC refund but fails to remit it, or retains the associated interest, it may be in direct breach of those contractual obligations. Even where the contract is silent or ambiguous, courts routinely examine the substance of the relationship. Because the client employer bore the economic burden of the payroll taxes, the refund is intended to restore that employer's financial position.

Unjust enrichment provides an additional and often powerful basis for recovery. Under well-established legal principles, one party should not be permitted to retain a financial benefit at another's expense where doing so would be inequitable.² When a PEO keeps both the funds originally paid by the client and the subsequent ERC refund, along with any accrued interest, it creates a classic unjust enrichment scenario. Courts consistently reject this type of double recovery, particularly where the benefit was derived directly from the client's payments.

The issue of statutory interest further strengthens both breach of contract and unjust enrichment claims. The IRS includes interest on ERC refunds to compensate for the time value of money during processing delays. In many cases, that interest is substantial. As a matter of law, interest follows the principal. If the client is entitled to the ERC refund, it is likewise entitled to the interest. A PEO's retention of that interest, whether disclosed or not, may independently support claims for breach of contract and unjust enrichment.

Timing Matters When Asserting Claims

Timing is critical when pursuing breach of contract and unjust enrichment claims against a PEO. Many PEO agreements contain shortened limitation periods, notice provisions, or mandatory dispute resolution clauses that can affect a business's ability to recover funds. At the same time, key records such as Schedule R filings, payroll tax submissions, and internal accounting data are often controlled exclusively by the PEO. Delays in asserting claims can make it more difficult to obtain evidence and enforce legal rights.

Businesses should not assume that a PEO's retention of ERC funds is justified or permanent. When refunds remain in the hands of a PEO, there is often limited visibility into their status or handling, which can make recovery more complex over time. Where funds or associated interest are withheld without clear contractual authority, businesses may have viable claims for breach of contract and unjust enrichment. Taking a proactive approach by reviewing agreements, requesting documentation, and evaluating legal options can help clarify entitlement and support a more efficient path to recovery.

Contact Frost Law About Your ERC Refund Options

If your PEO is withholding ERC funds or the associated interest, don't assume they have a right to, or that there's nothing you can do about it. Contact Frost Law for a confidential evaluation to determine whether you have grounds to demand release of principal and interest and what steps may be necessary to protect your rights. Early review is important because PEO contracts, Schedule R allocations, and statutory limitation windows vary. Prompt





action on your part will preserve evidence, clarify filing histories, and protect potential claims. Reach out to discuss your situation and get a clear read on options specific to your circumstances.

If you believe your ERC refund or the related statutory interest is being improperly retained, call Frost Law at **(410) 497-5947** or **fill out our contact form** to discuss next steps and secure a confidential review of your matter.

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¹ IRS Office of Chief Counsel Memorandum AM 2024-001, "Liability of Certain Third-Party Payers for an Underpayment of Certain Employment Taxes" (Feb. 5, 2024).

² Restatement (Third) of Restitution and Unjust Enrichment § 1 (2011).

