

IRS Hard Line on ERC Eligibility Earns Kudos From Tax Pros

by Caitlin Mullaney

Employers that experienced pandemic-related supply chain disruptions aren't eligible for the employee retention credit on that basis alone, the IRS advised in a clarification that was welcomed by the tax community.

"The IRS opinion seems to be in lockstep with our position and that of many of our members who have concluded that supply chain issues are in fact a weak argument for ERC qualifications," Tom O'Saben of the National Association of Tax Professionals told *Tax Notes*.

In a generic legal advice memorandum (AM-2023-005) released July 20, the IRS clarified that under Notice 2021-20, 2021-11 IRB 922, only employers that had to suspend their business operations because their suppliers were unable to provide critical goods or materials under a government order are eligible for the ERC. The refundable tax credit was created by the Coronavirus Aid, Relief, and Economic Security Act to help eligible employers pay employee wages during the COVID-19 pandemic.

According to O'Saben, it appears that taxpayers that base their ERC claim argument on supply chain disruptions could face IRS claim challenges, have to repay credits already taken, and be subject to penalties and interest under payroll rules. He noted that the rules have "substantial penalties for underpayment."

Rebecca Sheppard of Frost Law was also unsurprised by the clarification in the memo. "The takeaway is what we suspected all along: It's a 'narrow, limited exception,'" she said.

Dan Chodan of Trout CPA said that while the IRS's position in the memo isn't surprising, it's still helpful to get more specificity because it allows tax professionals to point their clients to something concrete to help address their situations.

"I think it makes it harder for anyone that was using these arguments on supply chains to do it with a straight face," Chodan said. "But frankly, again, I don't think it really changes . . . the IRS position. It's just more specificity and more clarity around the concepts that existed."

Having the IRS position out in the open provides ammunition to practitioners advising clients against the aggressive positions taken by so-called ERC mills, said Kenneth Dettman of EZ-ERC LLC. "Now their CPAs will have something concrete to point to, to better explain why these positions are incorrect," he said.

The IRS has repeatedly warned businesses to watch out for misleading claims and scams from aggressive promoters about the ERC. The agency has also prioritized the issue by adding staff and stepping up audit and criminal investigation work in the area.

With the latest guidance coming in the form of a legal advice memorandum, Dettman wondered whether those already taking advantage of the supply chain exception will defend their position by pointing to the long-standing language in those memos stating that they "may not be used or cited as precedent."

"We already know that there are many firms out there that basically choose to ignore certain parts of the IRS notices that they don't like on the basis that it doesn't rise to a sufficient level of tax authority hierarchy in order for it to be binding," Dettman said.

Dettman added that he is hopeful that the memo will at least reduce the number of prospective ERC claims made based on supply chain disruptions. ■