



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF THE CHIEF COUNSEL

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The Honorable John Cornyn
United States Senator
5001 Spring Valley Road, Suite 1125E
Dallas, TX 75244

Attention:

Dear Senator Cornyn:

I'm responding to your July 18, 2022, inquiry on behalf of your constituent, _____ of _____. He asked about his company filing independently for the employee retention credit (ERC). He explained that his company uses a professional employer organization (PEO) to pay employment taxes and to file employment tax returns. You asked for a response to _____ concerns.

There is no requirement that an employer, including the taxpayer, use a PEO to pay employment taxes and satisfy employment tax return filing obligations. _____ mentions that many small employers choose to work with PEOs for the sake of convenience. The terms of the contract between a PEO and its clients govern their relationship. However, these clients are generally responsible for making sure that the PEO filed their tax returns and made their tax deposits and employment tax payments. This is true even if a PEO agrees to perform these acts. In many cases, both the PEO and the client remain liable if the third party fails to perform any required action.¹

Also, the Internal Revenue Service (IRS) has rules and regulations in place to help protect the interests of employees, employers, and PEOs. These rules help ensure the proper withholding and payment of employment taxes. As required by statute, the IRS issued guidance on the procedures PEOs use to claim the ERC on behalf of their clients. The ERC may only be claimed with respect to the qualified wages reported for clients on the Form 941 filed by the PEO, and only provided the employers are eligible for the ERC. (See Notice 2021-20, 2021-11 I.R.B. 922).

¹ See Internal Revenue Code (Code) section 3504 and Treas. Reg. 31.3504-2. Different rules apply to arrangements involving Certified Professional Employer Organizations, but those types of organizations were not mentioned in the letter.

When an employer uses a PEO to pay its employment taxes and satisfy its employment tax return filing obligations, the PEO is the taxpayer before the IRS. The PEO reports the wages, employment taxes, and credits on behalf of all its employer clients. If there is a refund owed to the PEO after applying the PEO's total credit amount for all clients to the PEO's total aggregate tax liability reported for all clients, the IRS will release the refund directly to the PEO. The IRS uses this process because the PEO deposits, pays, and reports the employment taxes under its own employer identification number (EIN) against which the PEO is claiming the ERC. How the PEO distributes the refund amounts to its clients is a contractual matter between the PEO and its clients.

As written by Congress, the ERC hinges on the depositing, payment, and reporting of employment taxes. A PEO is obligated to collect from its client any information regarding the client's eligibility for the ERC, including whether the client filed Form 7200, Advance Payment of Employer Credits Due to COVID-19, and received advanced payments. Either the PEO or the client may maintain the records which substantiate the client's eligibility for the ERC. However, if the client maintains the records, and if the IRS requests this information, the PEO must get it from the client and provide the tax records that support the client's eligibility for the ERC. The PEO uses this information to claim the credit on its client's behalf on the PEO's employment tax return. PEOs normally use Form 941, Employer's Quarterly Federal Tax Return,² and attach Schedule R detailing credit amounts claimed on behalf of each client.

Although a PEO provides client-by-client specified information concerning the ERC on the Schedule R it attaches to its employment tax return, a client can't claim the credit except through the PEO because the client doesn't deposit, pay, or report the employment taxes under its own EIN. In other words, when the client hires the PEO, the PEO becomes the taxpayer for the IRS's purposes. The IRS accepts the information concerning the qualified wages reported by the PEO for their clients on Form 941 and only the PEO can claim the ERC. After the IRS processes the ERC, the PEO is responsible for making sure each of its clients receives any credit or overpayment (including any ERC refund) owed to the client.

In accordance with their liability under the Code and applicable regulations, the client and the PEO will each be liable for employment taxes owed because of any improper ERC claim for employment taxes reported on the federal employment tax return the PEO filed claiming the credit. This joint liability isn't solely for the claiming of the ERC. In general, the client and the PEO are both liable for paying the client's employment taxes, filing returns, and making deposits and payments for the taxes reported.

² Employers who need to make a change or adjustment to a previously filed Form 941 use Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, to make those changes and adjustments. The same procedures (and the reasons for these procedures) apply whether the PEO files Form 941 to claim the ERC for its clients or Form 941-X to adjust the ERC amounts it previously claimed for its clients.

I hope this information is helpful. If you have questions, please call me at _____ or
a member of your staff may contact _____, general attorney, at _____.

Sincerely,

Rachel Leiser Levy, Associate Chief Counsel
Employee Benefits, Exempt Organizations,
and Employment Tax