Professional Responsibility and the Employee Retention Credit

Internal Revenue Service (IRS) sent this bulletin at 03/07/2023 04:16 PM EST

Issue Number: 2023-02

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Since the Fall of 2022, the IRS has issued several warnings to employers to beware of third parties promoting improper Employee Retention Credit (ERC) claims. See IRS IR-2023-40 (Mar. 7, 2023); IRS IR-2022-183 (Oct. 19, 2022); COVID Tax Tip 2022-170 (Nov. 7, 2022). With tax filing season in full swing, tax professionals are requesting guidance to ensure they are meeting their Circular 230 professional responsibilities and the standards required to prepare and sign original tax returns, amended returns, or claims for refund relating to these credits.

I. Purpose and Operation of the ERC

The ERC is a refundable tax credit that Congress enacted in 2020 as part of the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act). The ERC was enacted for businesses (employers) who continued paying employees during a shutdown due to the COVID-19 pandemic or who experienced significant declines in gross receipts, from March 13, 2020, to December 31, 2021. Eligible employers may claim the ERC on an original or amended employment tax return for a period within those dates.

To be eligible for the ERC, employers must have:

- Sustained a full or partial suspension of their business operations in compliance with orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19 during 2020 or the first three quarters of 2021,
- Experienced a significant decline in gross receipts during 2020 or a decline in gross receipts during the first three quarters of 2021 because of COVID-19, or
- Qualified as a recovery startup business for the third or fourth quarters of 2021. (Only recovery startup businesses are eligible for the ERC in the fourth quarter of 2021.)

The amount of an employer's eligible ERC depends on several factors, including the number of employees, the amount of the employer's payroll and gross receipts, and whether the employer paid any sick or family leave wages. Significantly, the amount of the ERC reduces the employer's allowable wage deduction on its income tax return. In addition, eligible employers cannot claim the ERC for any quarter for which wages were reported as payroll costs in obtaining Payroll Protection Plan (PPP) loan forgiveness or were used to claim certain other tax credits.

In its news releases, the IRS warned employers that some third-party advisers were urging employers to claim the ERC without appropriately informing them of limitations on eligibility and the correct computation of the credit. Often this advice—for which these third-party advisers usually charge hefty upfront fees or a fee contingent on the amount of the refund—has led some employers to claim excessive ERCs based on improper positions. The IRS has urged affected employers to file amended returns to correct the excessive ERC claims and minimize interest charges and possible penalties.

In a related development, the IRS Criminal Investigation Division and the US Department of Justice have initiated criminal investigations and in some cases indictments against promoters (and other enablers) of excessive ERC claims.

II. Tax Professionals' Role in ERC Compliance

The IRS's outreach efforts to employers about possible excessive ERC claims have prompted requests from tax practitioners for the IRS—and, in particular, the Office of Professional Responsibility (OPR)—to provide guidance on their professional responsibility obligations in connection with clients' ERC claims, including prior federal tax returns claiming the ERC that the practitioners did not themselves prepare.

To fulfill their professional obligations to clients and to tax administration, practitioners —attorneys, certified public accountants, and enrolled agents—must meet the applicable provisions in [Circular 230, Regulations Governing Practice before the Internal Revenue Service (31 CFR Subtitle A, Part 10)](). Circular 230, which the OPR administers and enforces, has several provisions that are implicated when dealing with a client who has claimed or is seeking to claim an ERC.

A. Diligence as to Accuracy

Section 10.22(a) of Circular 230 requires a practitioner to exercise due diligence in preparing and filing tax returns or other documents on a client's behalf with the IRS and in ensuring the correctness of the practitioner's written or oral representations to clients and the IRS. Practitioners who prepare income, employment, and other tax returns for clients have a duty of due diligence to inquire of their clients with sufficient detail to ascertain the information necessary to determine clients' eligibility for the ERC and to claim the proper amount of the ERC on the clients' returns.

For purposes of exercising due diligence, section 10.34(d) allows a practitioner to generally rely, in good faith and without verification, on information from the client. Good-faith reliance, however, contemplates that a practitioner will make reasonable inquiries of a client to confirm eligibility for the ERC and to determine the correct amount of the credit. A practitioner may accept the client's responses at face value if it is reasonable. But a practitioner may not ignore the implications of information the practitioner knows or has received from the client. If the information from the client appears to be incorrect, incomplete, or inconsistent with other facts the practitioner knows, the practitioner cannot simply accept the client's information but must make further inquiries of the client to reconcile the incomplete, incorrect, or inconsistent facts.

If the practitioner cannot reasonably conclude (consistent with the standards discussed in this guidance) that the client is or was eligible to claim the ERC, then the practitioner should not prepare an original or amended return that claims or perpetuates a potentially improper credit.

Additionally, if a practitioner learns that a current client did not comply with the ERC requirements in a prior tax year, the practitioner must, under section 10.21, promptly inform the client of the "noncompliance, error, or omission" and any penalty or penalties that may apply.

B. Standards for Tax Returns and Other Documents

When a practitioner assists or advises a client in reporting income or other items on a tax return, in filing amended returns or claims for refund, or with positions taken on a return or claim for refund, the standards in section 10.34 apply to the practitioner's activities. For example, section 10.34(b) prohibits advising a client to take a position that lacks a reasonable basis or is an unreasonable position under section 6694(a)(2) of the Internal Revenue Code. Additionally, section 10.34(c) requires a practitioner to advise a client of any potential penalties likely to apply to a position taken on a tax return the practitioner prepares for the client or when the practitioner has advised the client about the position taken. Under section 10.34(c), a practitioner must also inform the client of any opportunity to avoid penalties through adequate disclosure by, for example, filing Form 8275, *Disclosure Statement*.

In the context of an ERC, a practitioner acting as a preparer or adviser to a client may determine that the client had previously claimed an excessive ERC. In addition to meeting their obligation under section 10.21, as a best practice, the practitioner should consider advising the client of the option of filing an amended return. The practitioner is not obligated to prepare the amended ERC claim unless asked by the client and then only if the practitioner feels competent to do so (see section 10.35 of Circular 230).

C. Written Advice

A related provision—section 10.37(a)(3) concerning written advice provided by a practitioner—allows the practitioner in their advice to a client to rely on the advice of others only if the reliance is reasonable under all the facts and circumstances, including whether the other adviser had a conflict of interest within the meaning of section 10.29. Thus, if the other adviser, who may have advised the client to claim the ERC, has a conflict because of the amount or character of the fee the adviser charged for the advice at the time, then the practitioner's reliance on that advice may not be reasonable. Practitioners should note that section 10.27 separately limits the circumstances in which an adviser, if a practitioner, may charge a contingent fee.

III. Conclusion

When a practitioner enters into an engagement with a client who has claimed the ERC, wants to claim it, or asks about the possibility, the practitioner needs to have or gain an in-depth knowledge of the credit, especially its eligibility criteria. The practitioner must also follow Circular 230's requirements of: (1) due diligence in the practitioner's advice and in preparing and filing returns (including the specific standards in section 10.34); (2) full disclosure to a client of their tax situation; and (3) reasonable reliance on client-provided information and on any advice provided by another tax professional.

If a practitioner has reason to believe that a client's excessive ERC claim is owing to the client's reliance on erroneous or improper advice from another practitioner, tax return preparer, or other third party, the practitioner should, consistent with Circular 230 and the guidance above, advise the client of the overstated claim and any additional tax and penalties that could apply and, if requested, competently assist the client in correcting or mitigating the problem. The practitioner should also consider informing the client of the opportunity to file a complaint about the other adviser using Form 14242, *Report Suspected Abusive Tax Promotions or Preparers*.

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