

## IRS Cites Progress as House Committee Hearing Seeks Solutions to Employee Retention Tax Credit Woes

JULY 31, 2023

On Thursday, July 20, the House Committee on Ways and Means Chairman Jason Smith (R-MO-08) and Oversight Subcommittee Chairman David Schweikert (R-AZ-01) announced the Subcommittee's hearing on "The Employee Retention Tax Credit Experience: Confusion, Delays, and Fraud" to be held the following Thursday. The announcement served to kick-off an unusually busy seven days of Employee Retention Tax Credit (ERTC) related activity in Washington and beyond. This included the publication of new guidance, public outreach, and the hearing itself.

As suggested by its title, the focal topics of the hearing were dissatisfaction with the complexity of the law and lack of available guidance, the significant backlog of unprocessed applications, and a proliferation of unscrupulous promoters offering ERTC refunds that are too good to be true. Perhaps not by coincidence, the IRS published materials addressing each of these in the week prior to the hearing.

### Additional Guidance

In a Generic Legal Advice Memorandum ([AM 2023-005](#)) issued on July 21, the IRS provided clarification regarding the ability of certain employers to claim eligibility for the ERTC on the basis of supply chain disruptions. The memorandum presents five generic scenarios representing known taxpayer positions and explains why each hypothetical employer is ineligible for the credit. While the memorandum does not present truly new information, it does illustrate the IRS's position that eligibility claims based on supply chain disruptions must be supported by detailed documentation and must satisfy the narrow requirements previously published in IRS Notice 2021-20, i.e., that a critical supplier suspended operations due to a government order and that the employer's own operations were suspended as the result of being unable to obtain critical supplies from an alternative supplier.

The IRS also published finalized regulations ([TD 9978](#)) authorizing the assessment of erroneous refunds and clarifying how the IRS will move forward with collecting overpayments of ERTC refunds to employers in the future. Notably, the regulations confirm that erroneous refunds to employers shall be treated as an underpayment of taxes and may be assessed and collected in the same manner (including the potential assessment of penalties).

# Beware of Scams (and the Backlog)

Public education efforts during the week included a public webinar and warnings via news release for taxpayers to beware of summer tax scams on social media. More directly on point, however, were Commissioner Werfel's comments at a meeting of tax professionals in Atlanta on July 25, where he noted the IRS has successfully cleared the backlog of valid ERTC claims and will shift efforts to deal with fraud in the program. As described in a July 26 news release, the IRS has made substantial progress on these claims this year, with 99 percent of remaining claims approximately three months old as of mid-July.

## Subcommittee on Oversight Hearing

The Subcommittee on Oversight hosted the hearing regarding "the backlog of the Employee Retention Tax Credit (ERTC) processing, IRS response to inquiries about ERTC credits, and the impact of fraud on those legitimately trying to claim the credit" for approximately two hours on July 27. Witnesses included tax practitioners and representatives from the National Association of Professional Employer Organizations (NAPEO) and the New Jersey Center for Nonprofits (NJ Nonprofits). The general themes of discussion were as advertised. In addition, discussion surrounding a possible amnesty program for certain employers that filed erroneous ERTC claims on the advice of promoters emerged as a substantive topic. A selection of highlights on each includes the following.

### *Complexity and Lack of Guidance*

Ways and Means Chairman Jason Smith (R-MO-08) in his opening statements commented that businesses have found the eligibility rules confusing, and guidance both insufficient and untimely. This position was generally echoed by the witnesses. Larry Gray, a CPA, made the point that small business owners looking to the IRS website for guidance would find FAQs labeled "historical" and leave without a clear understanding of where to look for guidance. Mr. Gray noted that the recently published memorandum on supply chain disruption had been helpful in persuading clients to not take unwarranted positions, but both committee members and witnesses commented that clear guidance should have been available earlier.

### *Backlog and Delays*

Pat Cleary, president and CEO of NAPEO challenged the IRS's claims that the backlog had been cleared. He argued that the backlog had again increased since June and that the number of claims is approximately 488,00 as of July 19. Moreover, he argued that this number is understated due to the IRS's method counting claims and that many small businesses are still waiting to receive refunds from claims filed in 2020.

Witnesses and committee members repeatedly identified the requirement that Forms 941-X be submitted on paper as a major contributor to the backlog. Committee members from the Democratic party, including Bill Pascrell (D-NJ-09) and Judy Chu (D-CA-28) argued that insufficient technology was the result of many years of inadequate funding, which the Inflation Reduction Act is intended to remedy.

### *Promoter "Mills" & Fraud*

Both witnesses and members appeared to agree that additional enforcement was necessary and that the ERTC has become a target for bad actors that take advantage of small businesses to file meritless claims and take a portion of the refund as payment. Linda M. Czipo, president and CEO of NJ Nonprofits noted that the complexity of the program empowered bad actors and put smaller organizations without spare capacity to learn the rules at risk of victimization.

Both witnesses and members recounted stories of being personally approached by ERTC "mills." Notably, committee member Beth Van Duyne (R-TX-24) played a voicemail that she received from a promoter identified only as "Deb" claiming that the congresswoman "was actually scheduled to receive about \$26,000 for every W-2 employee you have on your payroll."

### *Discussions Regarding a Possible Amnesty Program*

In his written statement, witness Roger Harris commented that one of the problems tax practitioners will confront in correcting an erroneous ERTC claim is that the taxpayer is asked to return the entire amount of the credit claimed when in fact they only received a portion of the money because of the fees paid to the third-party promoters. In response to a question from Brad Schneider (D-IL-10), himself the son of a CPA, asking how Congress can help taxpayers who have fallen victim to ERTC promoters get back into compliance, Mr. Harris answered that Congress needs to provide a way out for businesses that have been trapped in this situation.

Oversight Subcommittee Chairman David Schweikert (R-AZ-01) also posed the question of how to “unwind the charities and businesses that have functionally been scammed.” Ideas discussed by witnesses included an amnesty program that would offer some forgiveness in exchange for cooperation with investigations of promoters or allow participants to pay back some portion of erroneous refunds later (or not at all). In a closing statement Chairman Schweikert asked the witnesses and others to submit additional ideas to the committee.

If you have any questions regarding the Employee Retention Tax Credit with respect to your business, or the likely next steps that the IRS will take in enforcement activity, please contact the authors.

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## Authors

[James N. Mastracchio](#)

[Susan Elizabeth Seabrook](#)

[Nicholas Netland](#)

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James N. Mastracchio



Susan Elizabeth Seabrook



Nicholas Netland

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