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In this article, Sheppard examines recent developments involving employee retention credits, including congressional and IRS guidance, the deadline for making claims, and the potential consequences for taxpayers and advisers engaged in improper behavior.

I. Introduction

In life, things often are going great, until they are not. This is true in the tax world, too. Congress introduced the employee retention credit in early 2020 to assist businesses struggling financially because of COVID-19. Optimism prevailed initially, but that positive sentiment waned quickly as various problems emerged. One major glitch was the filing of many ERC claims that were aggressive or downright fraudulent, depending on your perspective. The IRS fell into the latter camp, perceiving significant abuse around every corner. The predictable result has been increased IRS enforcement efforts against taxpayers and those who advised them in filing ERC claims. This scrutiny has already triggered finger-pointing in various directions, with more on the way.

This article explains congressional and IRS guidance regarding ERCs, the deadline for making claims, potential consequences facing taxpayers and advisers engaged in improper behavior, two recently filed ERC cases, and obscure issues sparked by those cases.

II. Legislative and Executive Guidance

Congress passed four laws in less than two years, and the IRS supplemented this by issuing multiple notices, revenue procedures, and other ERC guidance. An overview follows.[1]

Congress enacted the Coronavirus Aid, Relief, and Economic Security Act in March 2020.[2] It generally provided that an eligible employer could get an ERC against certain employment taxes equal to 50 percent of the qualified wages that it paid to each employee for each quarter, subject to a maximum.[3] An eligible employer in this context meant one that was carrying on a trade or business in 2020 and also met one of the following two tests. First, the employer's operations were partially or fully suspended during a quarter because of an order from an appropriate governmental authority that limited commerce, travel, or group meetings for commercial, social, religious, or other purposes due to COVID (the governmental order test).[4] Second, the employer suffered a significant decline in gross receipts during a particular quarter (the reduced gross receipts test).[5] Benefits

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[1]Readers seeking details about the ERC rules and their evolution should see the following articles by the same author: Hale E. Sheppard, "New ERC Guidance About Suspended Operations and Supply Chains," *Tax Notes Federal*, Aug. 28, 2023, p. 1413; Sheppard, "IRS Clarifies Limited Eligibility of Federal Credit Unions for ERCs," *Tax Notes Federal*, Sept. 4, 2023, 1615; Sheppard, "Employee Retention Credits: Analyzing Key Issues for Promoters and Other Enablers," *J. Tax'n* (coming 2023); Sheppard, "Employee Retention Credits: Analyzing Key Issues for Taxpayers Facing IRS Audits," *J. Tax'n* (coming 2023); Sheppard, "Employee Retention Credits: Analyzing Congressional and IRS Guidance From Start to Finish," *J. Tax'n* (coming 2023).

[2]Joint Committee on Taxation, "Description of the Tax Provisions of Public Law 116-136, The Coronavirus Aid, Relief, and Economic Security Act," JCX-12R-20 (Apr. 23, 2020).

[3]CARES Act section 2301(a).

[4]*Id.* section 2301(c)(2)(A)(ii)(I).

[5]*Id.* section 2301(c)(2)(A)(ii)(II).

were limited under the CARES Act. For example, the amount of qualified wages for any one employee could not exceed $10,000 for *all* applicable quarters combined in 2020. This meant that the maximum ERC per employee for the entire year was $5,000.[6] Moreover, eligible employers could only seek ERCs for second, third, and fourth quarters of 2020.[7]

Congress passed the Taxpayer Certainty and Disaster Tax Relief Act of 2020 in December 2020.[8] This legislation expanded the period during which eligible employers could benefit. They could claim ERCs not only for second, third, and fourth quarters of 2020 (as they could under the CARES Act), but also for first and second quarters of 2021.[9] Eligible employers also could get increased amounts of ERCs, as follows. Under the CARES Act, an eligible employer could claim ERCs for only 50 percent of qualified wages, with a cap of $10,000 per employee for all of 2020. Things changed in two ways thanks to the relief act. The figure increased from 50 to 70 percent of the qualified wages paid, *and* the amount was calculated per quarter, not per year. Accordingly, if an eligible employer were to pay an employee $10,000 in qualified wages in each of the first and second quarters of 2021, then the ERCs would total $14,000 (that is, $7,000 per quarter).[10]

Congress next passed the American Rescue Plan Act in March 2021.[11] That law further expanded the ERC, making it applicable to third and fourth quarters of 2021, too.[12] Thus, at that point, an eligible employer might claim up to $28,000 in ERCs per employee.

Things came to a close when Congress enacted the Infrastructure Investment and Jobs Act in November 2021.[13] That legislation announced the end of the ERC and retroactively shortened the periods for which eligible employers could claim benefits. Eligible employers, with one narrow exception, could no longer solicit ERCs for fourth quarter 2021. As a result, ERCs for most eligible employers could not surpass $26,000, an amount comprised of $5,000 for 2020 in its entirety, plus $7,000 for each of the first, second, and third quarters of 2021.

III. Until When Can ERC Claims Be Filed?

Eligible employers may solicit ERCs in several ways. The main one is by filing timely Forms 941, "Employer's Quarterly Federal Tax Return," for each relevant quarter in 2020 and 2021. Alternatively, they could, and in many instances still can, seek ERCs by filing Form 941-X, "Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund."[14]

How long will this last? A taxpayer normally must file a refund claim, including a Form 941-X seeking ERCs, within three years after filing the relevant Form 941, or within two years after paying the relevant taxes, whichever period expires later.[15] Forms 941 for all four quarters of a year are deemed filed on April 15 of the next year.[16] For example, Form 941 for second quarter 2020 had to be filed by July 31, 2020 (that is, the last day of the month following the end of the second quarter), but is deemed to have been filed nearly nine months later, on April 15, 2021.[17]

ERCs were available for second, third, and fourth quarters of 2020. Assuming that an eligible employer filed Forms 941 for these periods on time, the law would treat them as being filed on April 15, 2021. Thus, applying the three-year limit, an eligible employer could file Forms 941-X making ERC claims for 2020 until April 15, 2024.

ERCs were also available for first, second, third, and fourth quarters of 2021, though the last quarter was ultimately restricted to recovery start-up businesses. Again, assuming that an

[6] *Id.* section 2301(b)(1); JCT, *supra* note 2, at 38.

[7] CARES Act section 2301(m); *see also* Notice 2021-20, 2021-11 IRB 922.

[8] Division EE, section 207, of the Consolidated Appropriations Act, 2021; JCT, "Description of the Budget Reconciliation Legislative Recommendations Relating to Promoting Economic Security," JCX-3-21, at 66-70 (Feb. 8, 2021); Notice 2021-23, 2021-16 IRB 1113.

[9] Notice 2021-23, Section III.A.

[10] *Id.* Section III.D.

[11] ARPA section 9651; *see also* Notice 2021-49, 2021-34 IRB 316.

[12] Notice 2021-49, Section III.A.

[13] P.L. 117-58 (Nov. 15, 2021).

[14] Eligible employers also could have solicited ERCs on an accelerated basis by filing Form 7200, "Advance Payment of Employer Credits Due to COVID-19."

[15] Section 6511(a); reg. section 301.6511(a)-1(a); section 6511(b)(1); reg. section 301.6511(b)-1(a).

[16] Section 6501(b)(2); reg. section 301.6501(b)-1(b); section 6513(c); reg. section 301.6513-1(c).

[17] Reg. section 301.6501(b)-1(b).

eligible employer filed Forms 941 on time, the IRS would deem them filed on April 15, 2022. Taking into account the three-year restriction, an eligible employer could file Forms 941-X claiming ERCs for 2021 until April 15, 2025.

IV. A Peek at Potential Consequences

Many ERC claims are legitimate, of course. These valid requests for tax incentives should trigger no problems whatsoever. Other claims are more aggressive, so to speak. They might be based on incomplete data from potential eligible employers, combined with superficial due diligence by ERC advisers, exacerbated by fluid IRS guidance, and topped off with questionable practices fueled by large contingency fees. These factors create an environment for widespread noncompliance, ERC style. In those instances, the IRS has several tools it can use against taxpayers and their advisers. Only a few are described below.

A. Outcomes for Taxpayers

The IRS identified abuse right away, announcing just one year after Congress introduced the ERC that civil examinations and specialized enforcement activities were underway.[18] The IRS later indicated that it had prepared hundreds of revenue agents to scrutinize ERC claims.[19] The IRS also published training materials, thereby putting taxpayers on notice about what it plans to question.[20] More recently, the IRS said, repeatedly and through various outlets, that it has entered a "new phase" of enforcement, "ramped up" audit activity, and is "all-in" when it comes to halting ERC abuse.[21] These IRS pronouncements might be exaggerated, but serious enforcement efforts are clearly in motion, and many taxpayers claiming eligible employer status will be scrutinized.

Wrongdoers likely will be obligated to repay employment taxes along with federal tax deposit penalties.[22]

Taxpayers that received unwarranted or inflated ERCs might have income tax liabilities, too. Why is that, when the ERC deals with employment taxes? An eligible employer's income tax deduction for the qualified wages it paid must be reduced by the amount of ERCs it receives.[23] A decrease in the wages-paid deduction can trigger an increase in the federal income tax liability. The IRS has warned that some companies promoting ERCs exacerbate the problem by purposely omitting that reality when making sales pitches to potential clients.[24] Many taxpayers appear to be neglecting this critical step, inadvertently or otherwise. Taxpayers that get ERCs but fail to adjust their federal income tax returns accordingly will face income taxes, and to those taxes the IRS likely will add a penalty for negligence at a minimum.[25]

The IRS can impose a much larger penalty — equal to a whopping 75 percent of the tax underpayment — if it can establish fraud.[26] As long as the IRS manages to demonstrate that any portion of a tax underpayment is the result of fraud, the entire underpayment ordinarily will be treated as fraudulent.[27] Depending on the circumstances, the IRS might assert civil fraud penalties for both the employment tax liabilities and income tax liabilities associated with ERCs.

Taxpayers with ERC violations will also be stuck with interest charges on both the tax liabilities and penalties. These run from the due date of the relevant return until the liability has been paid in full.[28]

[18] IR-2021-65 (Mar. 31, 2021).

[19] Nathan J. Richman, "IRS Readying Hard Look at Employee Retention Credit Claims," *Tax Notes Federal*, Oct. 31, 2022, p. 747; IRS, "Lesson 3: Tax Credit for Employee Retention," COVID Credits & Deferrals for Employment Tax, Student Guide (revised July 2022).

[20] IRS, *supra* note 19; Lauren Loricchio, "Documents Shed Light on IRS Scrutiny of Employee Retention Credit," *Tax Notes Federal*, Dec. 12, 2022, p. 1584; IRS, "COVID Credits and Deferral Training for Employment Tax" (May 11, 2023).

[21] *See* Loricchio, "IRS Zeroes In on Erroneous Employee Retention Credit Claims," *Tax Notes Federal*, July 31, 2023, p. 847; IR-2023-135 (July 26, 2023); Jonathan Curry, "Werfel Drops Hint, Seeks Early End to Employee Retention Credit," *Tax Notes Federal*, July 31, 2023, p. 845.

[22] Section 6656(a).

[23] Notice 2021-20, Section III, FAQ 60.

[24] IR-2022-183 (Oct. 19, 2022).

[25] Section 6662(a).

[26] Section 6663(a); section 7454(a); Tax Court Rule 142(b).

[27] Section 6663(b).

[28] Section 6601; section 6621.

B. Outcomes for Advisers

When the IRS thinks something is abusive, it normally issues warnings to those it believes are promoting or enabling taxpayer actions. The IRS followed this playbook with the ERC, featuring tough talk from the outset. For instance, it initially declared that the IRS "would not cease until every fraudulently obtained dollar is accounted for and the individuals behind the schemes are prosecuted to the fullest extent of the law."[29] Building on that theme, IRS representatives recently said that "there will be consequences for fraudsters and promoters of ERC-related schemes."[30] They did not specify what the repercussions might be, but the IRS has several tools at its disposal. Here are but a few.

The IRS can assess sizable promoter penalties under section 6700 against persons meeting certain criteria. Those persons either organize, or assist in organizing, a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement, or they participate (directly or indirectly) in the sale of ownership interests in that entity, plan, or arrangement.[31] The IRS defines the preceding concepts broadly, of course. In addition to organizing or participating in the sale of tax shelters, individuals must do something more to be punished. Specifically, they must personally make or furnish, or cause another person to make or furnish, a statement about the allowability of a tax deduction or credit, the excludability of any income, or the attainment of other tax benefits by a taxpayer. The persons also must know, or have reason to know, that the statement is materially false or fraudulent.[32] The size of the penalty depends on the behavior. In situations involving false or fraudulent statements, the penalty equals 50 percent of the income that the promoter has already derived, or will derive, from the activity.[33]

The IRS also can sanction individuals under section 6701 for aiding and abetting a tax understatement related to ERCs. Penalties apply when a person assists in, procures, or advises in the preparation of any portion of a return, affidavit, claim, or other document, and knows (or has reason to know) that it will be used in connection with a material tax matter, and that it will result in a tax understatement.[34] The type of individual on whom the IRS may impose this penalty is quite broad; it is not limited to traditional accountants, enrolled agents, and other return preparers.[35]

The IRS, with assistance from the Department of Justice, can take more urgent actions. In particular, if the circumstances warrant, the Justice Department can file a lawsuit seeking an injunction. This legal mechanism prohibits a person from engaging in any action that would trigger promoter penalties under section 6700 or any violation of Circular 230, which governs practice before the IRS.[36] District courts have broad authority to impose equitable relief. They can, for instance, enjoin the conduct of a promoter, all actions by a promoter that might violate applicable law, or behavior that tends to impede the administration of tax laws.[37] They can also force promoters to disgorge, or relinquish, all or a portion of the money they made from their improper activities.[38]

The IRS's Office of Professional Responsibility has jurisdiction over attorneys, accountants, enrolled agents, actuaries, retirement plan agents, registered tax return preparers, and other professionals who practice before the IRS.[39] The idea of practice in this context is liberal, encompassing all matters connected with a

[29] IR-2021-65.

[30] Loricchio, *supra* note 21.

[31] Section 6700(a)(1)(A) and (B).

[32] Section 6700(a)(2)(A). Alternatively, the persons make or furnish, or they cause another to make or furnish, a "gross valuation overstatement" as to any material matter, but that is not relevant to this article. *See* section 6700(a)(2)(B).

[33] Section 6700(a) (flush language).

[34] Section 6701(a).

[35] *Nielsen v. United States*, 976 F.2d 951, 955 (5th Cir. 1992); TAM 200243057.

[36] Section 7408(c); IRS Large Business and International Division Process Unit, "Tax Shelter Promoter Investigations Under IRC 6700," PEN-P-005, at 28 (Dec. 14, 2021).

[37] JCT, "General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982," JCS-38-82, 213 (Dec. 31, 1982).

[38] Sections 7402, 7406, and 7408.

[39] 31 U.S.C. section 10.2(a)(5); 31 U.S.C. section 10.3.

presentation to the IRS about the rights, privileges, or liabilities of a taxpayer.[40] Likewise, the notion of a presentation broadly covers, among other things, (1) preparing and filing documents with the IRS, (2) giving written advice regarding any entity, transaction, plan, or arrangement "having a potential for tax avoidance or evasion," and (3) representing a client at conferences, hearings, or meetings.[41] OPR has the power to punish any practitioner who is incompetent or disreputable, violates any relevant standard, or willfully misleads a current or potential client.[42] Punishments vary depending on the conduct, but can consist of a temporary suspension, permanent disbarment, public censure, or a monetary penalty.[43] For the last item, OPR has latitude to impose a financial toll reaching the gross income that the person derived, or will derive, from the conduct giving rise to the penalty.[44]

The IRS might pursue tax return preparer penalties under section 6694 as part of ERC enforcement, and this category pertains to far more than just the individuals who actually sign forms 941 or 941-X. It generally means any person who prepares for compensation, or who employs other persons to prepare for compensation, any tax return or claim for refund, or a substantial portion thereof.[45] It encompasses both signing preparers (individuals who are primarily responsible for the overall substantive accuracy of a return or claim) and non-signing preparers (individuals, other than signing preparers, who prepare all or a substantial portion of a return or claim).[46] The IRS generally can penalize a return preparer in any one of the following circumstances: First, if the position on the return causing the tax understatement relates to a tax shelter or a reportable transaction, and it was not reasonable for the preparer to believe that the position would "more likely than not" be upheld if the IRS were to challenge it. Second, if the position does not involve a tax shelter or reportable transaction, but it was not properly disclosed to the IRS and it lacked substantial authority. Third, if the position does not implicate a tax shelter or reportable transaction and it was correctly disclosed, but there was no reasonable basis for it.[47] The basic penalty equals $1,000 or 50 percent of the income that the preparer derived (or will derive) from the relevant tax return or refund claim, whichever amount is larger.[48] The penalty increases, of course, when the preparer willfully tries to understate a liability or intentionally disregards applicable authorities.[49]

V. Latest Developments in the ERC World

As explained above, various enforcement actions are underway, and these have led to some early, interesting cases. Here are two from this year, with others sure to come.

A. First Event: Taxpayer Sues Accountants

A district court case involving a disgruntled taxpayer and those on whom it relied in making ERC claims began in May.[50] The initial pleadings indicate that an accounting firm approached a landscaping company, which agreed to supply its business information to ascertain whether, or to what extent, it was entitled to ERCs. The engagement letter contemplated a contingency fee payment to the accounting firm equal to 20 percent of any tax reduction or refund. The accounting firm gave the landscaping company a questionnaire whose express purpose was to "document a full or partial suspension of operations as a result of a governmental order restricting commerce, travel, or group meetings." The landscaping company completed the questionnaire fully and truthfully. The accounting firm did not engage in further discussions, did not seek additional data, and did not ask if certain supply chain interruptions noted by the landscaping company triggered a suspension of

[40] 31 U.S.C. section 10.2(a)(4).

[41] 31 U.S.C. section 10.2(a)(4); T.D. 9359.

[42] 31 U.S.C. section 330(b); 31 U.S.C. section 10.50.

[43] *Id.*

[44] *Id.*; Notice 2007-39, 2007-1 C.B. 1243.

[45] Section 7701(a)(36)(A).

[46] Reg. section 301.7701-15(b)(1) and (2).

[47] Section 6694(a)(1) and (2).

[48] Section 6694(a)(1).

[49] Section 6694(b)(1) and (2).

[50] *Acer Landscape Services LLC v. Lasiter & Lasiter PC*, No. 3:23-cv-00531 (M.D. Tenn. 2023).

its business operations. Based solely on the responses to the questionnaire, the accounting firm reasoned that the landscaping company had suffered a qualifying suspension because of a supply chain interruption. This, it concluded, would yield the landscaping company ERCs of around $1.5 million. The accounting firm prepared and filed Forms 941-X for the landscaping company seeking that amount.

After filing Forms 941-X, the landscaping company consulted a different accountant, who explained that it was not eligible for ERCs. Many IRS notices have warned employers about companies misleading employers and the consequences of filing inaccurate ERC claims. Heeding these warnings, the landscaping company plans to return the $1.5 million to the IRS, and it wants the accounting firm to give back the contingency fee of about $300,000, which is 20 percent of the ERC refund. The landscaping company sent a termination letter to this effect, in response to which the accounting firm asserted that it was owed the contingency fee, despite the landscaping company's refusal to accept the IRS refund.

The landscaping company has asked the district court to rule: (1) that the accounting firm violated the state's Consumer Protection Act, (2) that it is not entitled to the fee of about $300,000, (3) that it breached its contract by not performing services "with reasonable care and in a diligent and competent manner," and (4) that it committed professional negligence because it owed the landscaping company a duty of reasonable care in providing accounting advice and return preparation services.

B. Second Event: Criminal Charges and Fraud

The IRS arrested a return preparer in July for allegedly seeking nearly $125 million in improper ERCs based on approximately 1,400 false or fraudulent claims. The return preparer supposedly told his clients that they were eligible for ERCs simply because they operated a business, and that the IRS was giving away "free money." Then, "without consulting with his clients," he filed forms 941 and 941-X with the IRS that "grossly overstated" the number of employees or the amount of wages paid. In some instances, the return preparer filed Forms 941 for workers who were not even employees, but rather independent contractors. He typically charged his clients 10 or 15 percent of the ERC refunds for his services. The return preparer was charged with mail fraud, as well as aiding and assisting in the preparation of false tax returns.[51]

VI. Interesting Issues Triggered by Two Events

These two very recent cases, combined with IRS enforcement activities focused on eligible employers and their advisers, generate many interesting issues. Some important ones have drawn little attention.

A. Tax Treatment of Contingency Fees

The first case, involving the dispute between the landscaping company and the accounting firm over the contingency fee, is a variation on a theme about which the IRS cautioned taxpayers. Enforcement officials previously described harsh outcomes for susceptible taxpayers: "The [ERC] mills are selling the idea that nearly anyone can qualify for the ERC in exchange for 25 percent of the refund, *and then absconding with their share [which] leaves taxpayers potentially subject to full repayment, penalties, and interest without access to the facilitators and their 25 percent*."[52] (Emphasis added.) An interesting question is how eligible employers that claimed ERCs, received them, and decided to return them to the IRS, should treat any fees that they cannot recoup from their advisers. This precise issue was raised at a recent congressional hearing:

> There have and will continue to be situations where a tax professional, relying on OPR guidance, will decide not to file a [Form 941-X] out of fear that it would perpetuate an improper credit, and will advise the client to return the original ERC. The question then arises, that if the client returns the ERC received, can the fee paid to the third-party mills be claimed as a business deduction? One of the

[51] *See* Justice Department release announcing arrest of tax return preparer for fraudulently seeking over $124 million in COVID-19 employment tax credits (July 31, 2023); criminal complaint, *United States v. Leon Haynes*, Magistrate No. 23-MJ-11127 (D.N.J. 2023).

[52] Richman, "Employee Retention Credit Claimants May See Help From IRS," *Tax Notes Federal*, June 12, 2023, p. 1862.

problems tax practitioners will confront in correcting an erroneous ERC claim is that the taxpayer is asked to return 100 percent of the ERC claimed when they only received a portion of the money because of the fees paid to the third-party mills. Not allowing the deduction only penalizes the small business owner who is trying to do the right thing and return an improper ERC that they might have been initially misled to take. Additional guidance or clarification from the IRS on this deductibility issue is needed to help both tax practitioners as well as taxpayers.[53]

B. Actions of Preparers Attributed to Taxpayers

The second case, dealing with charges against a return preparer for filing false forms 941 and 941-X and seeking millions in ERCs, should intrigue eligible employers for several reasons. One critical fact, which might be overlooked or unappreciated by many, is that the return preparer filed the ERC claims without consulting his clients. This type of behavior could affect assessment periods.

Forms 941 for all four quarters of a particular year are deemed filed on April 15 of the next year.[54] For example, Forms 941 for second quarter 2021 had to be filed by July 31, 2021, but they are deemed to have been filed nearly nine months later, on April 15, 2022.[55] The IRS generally has three years from the date on which a tax return is filed (or deemed filed) to identify it as problematic, conduct an audit, and propose changes.[56] Turning to the case above, the standard assessment period for 2021 would end April 15, 2025. The IRS still has time to audit forms 941 and 941-X claiming ERCs, even under the most restrictive time frame.

The ARPA granted the IRS more time to audit taxpayers that might be misbehaving; it allows the IRS five years (instead of three) from the date on which the relevant Forms 941 are actually filed or treated as filed to challenge an eligible employer.[57] Take this example: If an eligible employer files a timely Form 941 for third quarter 2021 claiming ERCs, it is deemed to have been filed on April 15, 2022, and the assessment period stays open until April 15, 2027. This extended assessment period applies only to ERC claims for third and fourth quarters of 2021.[58]

If a taxpayer files a false or fraudulent return with intent to evade tax, the IRS may assess tax at any time.[59] The assessment period, in other words, is endless. The IRS has repeatedly warned that unscrupulous companies are urging taxpayers to take ERC positions that range from extremely aggressive to downright wrong. Thus, one must assume that the IRS will argue that the assessment periods are perpetual when it comes to egregious forms 941 or 941-X.[60] That eventuality is widely understood, but eligible employers may not be aware that the IRS might take an even broader stance, arguing that improper actions by their advisers, taken without their knowledge or consent, might give the IRS forever to audit their ERC claims.

The seminal case on this obscure issue is *Allen*.[61] There, the taxpayer was a delivery driver, who retained Gregory D. Goosby to prepare his Forms 1040 for 1999 and 2000. The taxpayer provided Goosby with certain tax-related information, consisting of his Form W-2, "Wage and Tax Statement," his section 401(k) retirement plan statement, mortgage interest statement, and property tax statement. Goosby then prepared the Forms 1040, claiming false and fraudulent itemized deductions on Schedule A.[62]

The IRS later began a criminal investigation of Goosby that resulted in a conviction on 30 counts of willfully aiding and assisting in the preparation of false and fraudulent tax returns. The taxpayer's Forms 1040 for 1999 and 2000 were *not* used by the

[53] Statement of Roger Harris, president of Padgett Business Services, at the July 27, 2023, House Ways and Means Oversight subcommittee hearing on the ERC.

[54] Section 6501(b)(2); reg. section 301.6501(b)-1(b); section 6513(c); reg. section 301.6513-1(c).

[55] Reg. section 301.6501(b)-1(b).

[56] Section 6501(a).

[57] ARPA section 9651(a); Notice 2021-49, Section III.G.

[58] Notice 2021-49, Section III.G.

[59] Section 6501(c)(1).

[60] Section 6501(c)(1) and (2); reg. section 301.6501(c)-1(a) and (b).

[61] *Allen v. Commissioner*, 128 T.C. 37 (2007).

[62] *Id.* at 38.

IRS as the basis for any criminal conduct in Goosby's case.

In 2005, the IRS issued the taxpayer a notice of deficiency regarding his Forms 1040 for 1999 and 2000. Notably, the notice of deficiency did not assert civil fraud penalties, or any other penalties for that matter. The parties stipulated as part of the Tax Court dispute that (1) the itemized deductions on the taxpayer's Schedules A were false and fraudulent, (2) the taxpayer did not intend to evade taxes, and (3) only Goosby had that intent.[63]

The taxpayer argued that the normal assessment period for 1999 expired on April 15, 2003, and for 2000 on April 15, 2004. The IRS did not issue its notice of deficiency until 2005, thereby making it too late. The IRS maintained that the fraudulent intent of Goosby was sufficient to keep the assessment periods open indefinitely, making the notice of deficiency timely. The taxpayer countered that only his intent, and not that of Goosby, was relevant to the analysis.

The Tax Court began by reviewing the applicable tax provisions. As noted, the IRS normally has three years from the date on which a taxpayer files a Form 1040 to conduct its audit and assess any additional amounts. However, under section 6501(c)(1), this period may be extended indefinitely "in the case of a false or fraudulent return with the intent to evade tax." The Tax Court held that (1) nothing in the plain language of the statute suggests that the assessment period is only extended when the fraud is committed by the taxpayer, and (2) the statute links the extension of the assessment period to the fraudulent nature of the Form 1040, not to the identity of the person who engaged in fraud, and (3) assessment periods are strictly construed in favor of the IRS.[64] The Tax Court continued:

> We do not find it unduly burdensome for taxpayers to review their returns for items that are obviously false or incorrect. It is every taxpayer's obligation. [The taxpayer] cannot hide behind an agent's fraudulent preparation of his returns and escape paying tax if the [IRS] is unable to investigate fully the fraud within the limitations period. The [IRS] has just as much need for an extended limitations period to investigate and examine taxpayers who sign and allow to be filed returns that greatly overstate expenses or include fictitious expenses, whether the fraud was committed by the taxpayer or the taxpayer's preparer. To find otherwise would allow a taxpayer to receive the benefit of a fraudulent return by hiding behind the preparer.[65]

What does all this mean? Based on *Allen*, in situations in which ERC advisers, accountants, or others issue reports, studies, analyses, computations, etc. that contain false or fraudulent conclusions about ERC eligibility or amounts, the IRS might take the position that it has forever to audit the forms 941 or 941-X, disallow ERC claims, and assert penalties, even if the taxpayers themselves had no personal involvement in, or knowledge of, the improprieties. The IRS has taken similar approaches in various contexts in the past.[66]

C. Return Preparer Penalties

Persons falling into the category of tax return preparers are susceptible to penalties under section 6694. The tax professionals in the two cases described above clearly were tax return preparers because, well, they prepared forms 941 or 941-X for taxpayers and filed them with the IRS. However, one must assume that in other disputes, particularly those involving ERC advisers who are not accountants or enrolled agents, or who do not actually prepare, sign, or file returns with the IRS claiming ERCs, the answer might not be so apparent.

The term "non-signing tax return preparer" is broadly defined.[67] It means any return preparer who does not sign, but who prepares all or a substantial portion of a return or claim for

[63] *Id.*

[64] *Id.* at 39-40.

[65] *Id.* at 41-42.

[66] *See Eriksen v. Commissioner*, T.C. Memo. 2012-194; and *Finnegan v. Commissioner*, 926 F.3d 1261 (11th Cir. 2019); *but see BASR Partnership v. United States*, 795 F.3d 1338 (Fed. Cir. 2015).

[67] Reg. section 1.6694-1(b)(1); section 7701(a)(36); and reg. section 301.7701-15(a).

refund.[68] The term also encompasses those who provide advice (written or oral) to a taxpayer (or to another tax return preparer) when that advice leads to a position or entry that constitutes a substantial portion of the return or claim.[69] Importantly, an individual may be characterized as a tax return preparer for these purposes, including a non-signing tax return preparer, regardless of his educational qualifications and professional status requirements.[70] The individual, in other words, does not have to be an accountant, enrolled agent, or similar professional to fall within the realm of tax return preparer. An example in the regulations builds on this notion:

> Attorney A, an attorney in a law firm, provides legal advice to a large corporate taxpayer regarding a completed corporate transaction. The advice provided by A is directly relevant to the determination of an entry on the taxpayer's return, and this advice leads to a position(s) or entry that constitutes a substantial portion of the return. A, however, does not prepare any other portion of the taxpayer's return and is not the signing tax return preparer of this return. A is considered a non-signing tax return preparer.[71]

As indicated, a person must complete a substantial portion of a return or claim to be deemed a return preparer. The regulations contain four relevant points in this regard, namely: (1) a person who renders tax advice on a position that is directly relevant to the determination of the existence, characterization, or amount of an entry on a return will be regarded as having prepared that entry; (2) whether a schedule, entry, or other portion of a return is substantial is based on whether the person knows, or reasonably should know, that the tax attributable thereto is substantial; (3) a single tax entry may constitute a substantial portion of the tax required to be shown on a return; and (4) factors to consider in determining whether a schedule, entry, or other portion of a return is a substantial portion include, but are not limited to, the size and complexity of the item relative to the taxpayer's gross income and the size of the tax understatement attributable to the item compared with the taxpayer's reported tax liability.[72]

Experience dictates that future cases might involve some ERC advisers arguing that they are exempt from return preparer penalties under section 6694 because they are not accountants or enrolled agents and they did not prepare, sign, or file any forms 941 or 941-X claiming ERCs for anyone. The IRS will probably raise the following succinct counterargument: So what?

D. Exposure to OPR Authority

As noted, OPR regulates professionals who practice before the IRS.[73] The notion of practice is broad, but there is uncertainty regarding whether, or precisely when, OPR would gain power over some ERC advisers. For OPR purposes, practicing before the IRS includes (1) preparing and filing documents with the IRS, (2) giving written advice regarding any entity, transaction, plan, or arrangement "having a potential for tax avoidance or evasion," and (3) representing a taxpayer at conferences, hearings, or meetings.[74] A former OPR director suggested that, as a result of two court decisions issued a decade ago, OPR might not have jurisdiction over so-called ERC mills that limit themselves to devising ERC claims in exchange for contingency fees.[75] However, she underscored that OPR would assume authority if "those ERC professionals agreed to defend a taxpayer's claim once the IRS starts auditing it."[76]

Why mention potential skirmishes with OPR in this article? Because OPR is already focused on

[68] Reg. section 301.7701-15(b)(2)(i). For these purposes, a claim for refund generally includes a claim for credit against any tax. *See* reg. section 301.7701-15(b)(4)(ii).

[69] Reg. section 301.7701-15(b)(2)(i).

[70] Reg. section 301.7701-15(d).

[71] Reg. section 301.7701-15(b)(2)(ii), Example 1.

[72] Reg. section 301.7701-15(b)(3)(i).

[73] 31 U.S.C. section 10.2(a)(5); 31 U.S.C. section 10.3.

[74] 31 U.S.C. section 10.2(a)(4); T.D. 9359.

[75] Loricchio and Richman, "IRS May Face Constraints in Quest to Curb ERC Abuse," *Tax Notes Federal*, July 31, 2023, p. 839 (citing *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014); and *Ridgely v. Lew*, 55 F. Supp. 3d 89 (D.D.C. 2014)).

[76] Loricchio and Richman, *supra* note 75.

ERC matters. It recently issued an alert to practitioners involved with ERC claims.[77] It reminded them that they must make reasonable inquiries of their clients to confirm their eligibility for, and the correct amount of, ERCs. The alert also explained that if a practitioner discovers that a current client violated ERC requirements in a prior year, he must inform the client of the noncompliance and related penalties.[78] The alert then told practitioners that all tax positions, including ERC claims, must have at least a reasonable basis. Lastly, the alert warned that practitioners might not be able to rely on opinions, reports, analyses, computations, and similar documents prepared by others when it comes to making ERC claims. It explained that, if the ERC adviser has a conflict of interest with the client because of the amount or type of fee charged (for example, a contingency fee), then the practitioner might not be able to reasonably rely on the documents from that adviser.

VII. Conclusion

The IRS has warned of ERC problems for a few years, enforcement actions are now in motion, and the predictable blame game is getting underway. The issues will evolve, of course, just like the ERC guidance from Congress and the IRS did. ■

[77] OPR, "Professional Responsibility and the Employee Retention Credit," Issue No. 2023-02 (Mar. 7, 2023).

[78] *Id.*