

NEWS & INSIGHTS

You have options: A guide to returning ERC refund payments to avoid an IRS audit

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Many small business owners and other employers were pressured or misled by unscrupulous employee retention credit (ERC) promoters to file ineligible ERC claims, and now the IRS is looking to help those caught up in the scams.

The IRS recently made available with two new programs for employers who filed ERC claims and later determined their businesses were not eligible. Both programs require employers to return some or all the ERC refund payments,

and in exchange for repayment, the IRS has agreed not to audit or impose penalties and interest on the employers. The first program is the Withdrawal Option, and the other more expansive program is the ERC Voluntary Disclosure Program (ERC-VDP). To decide which IRS program is best for your business, you need to first understand the pros and cons of each option.

What are ERC claims?

[ERCs are refundable tax credits](#) for an employer who either experienced a suspension of its business or a significant decline in its gross receipts due to the COVID-19 pandemic, and paid wages in 2020 and 2021. More specifically, the credits are available to eligible employers who paid qualified wages to some, or all, of their employees in Q2 of 2020 through Q3 of 2021. The credits reduce the employer's share of employment taxes for those quarters. An eligible employer can claim up to \$26,000 of credits per employee, so an ERC claim can result in a sizable tax refund to the employer.

To file an ERC claim, an eligible employer must amend its employment tax return (such as Form 941) for each tax quarter to reflect the application of ERCs. The deadline for claiming the ERCs is December 31, 2024, for 2020, and December 31, 2025, for 2021.

How does the Withdrawal Option Work?

The Withdrawal Option allows certain employers that filed an ERC claim to withdraw their submission and avoid future repayment, interest, and penalties but only if the employers have not received refund checks from the IRS or have received but not deposited their refund checks from the IRS. So long as the ERC claims were not fraudulent, the claims that are withdrawn by the employer will be treated by the IRS as if those claims were never filed. The IRS has agreed not to impose penalties or interests on the employers.

An employer may use the Withdrawal Option if all three of the following requirements are met:

- The employer made the ERC claim on an amended employment tax return and such return was amended only to claim the ERC,
- The employer must withdraw the entire amount of the ERC claimed for the tax quarter, no partial withdrawal, and
- The IRS has either not paid the ERC claim, or the IRS has paid the ERC claim, but the employer has not deposited the refund check.

For employers who have not been notified of an ERC audit, an ERC claim may be withdrawn by sending a copy of the amended employment tax return with the word "withdrawn" on the left margin of the first page along with the name, title, date, and the signature of an authorized person on the right margin of the first page. If the employer received a refund check, that check must be voided and sent to the IRS along with the withdrawn employment tax return. For employers under an ERC audit, the withdrawn employment tax return cannot be submitted to the IRS but

instead must be provided to the IRS examiner or included in the employer's response to the IRS audit notice.

What is ERC-VDP?

More recently, the IRS made available the ERC-VDP which is a more expansive program than the Withdrawal Option. However, this program is only available through March 22, 2024. If the program is successful, the IRS may extend this program, but there is no guarantee.

The ERC-VDP requires employers to voluntarily repay 80% of the ERC refund payment, cooperate with any requests from the IRS for additional information, and enter into a closing agreement with the IRS.

This is a very advantageous program for employers. If an employer qualifies and applies to the ERC-VDP:

- The employer is required to repay only 80% of the ERC refund payment, where the remaining 20% is not treated as taxable income to the employer,
- The employer is not required to repay any interest received on the ERC refund payment, or amend income tax returns to reduce wage expenses, which in most cases would have resulted in a higher tax,
- The IRS will not charge penalties or interest on the claimed ERC so long as 80% of the ERC refund is paid in full, and
- The IRS will not audit the ERC issue for the tax quarter(s) resolved under the ERC-VDP

In general, an employer is eligible to apply for the ERC-VDP if it meets all the following requirements:

- The ERC claimed on an employment tax return has been processed and the refund check deposited,
- The employer has determined that it was not eligible or entitled to any ERC,
- The employer is not under an employment tax examination (audit) or a criminal investigation by the IRS, and
- The IRS has not reversed or notified the employer of its intent to reverse the ERC claim to \$0 (e.g., the IRS notice disallowing ERC claim)

Even though the ERC-VDP is generally more beneficial to employers than the Withdrawal Option, there are still situations where the Withdrawal Option is still useful. For example, an employer under an IRS employment tax examination would not be eligible for the ERC-VDP but continues to be eligible for the Withdrawal Option.

Employers who filed ERC claims and later determined they were not eligible for those credits should take advantage of these IRS programs. Returning ERC refund payments to the IRS under these programs not only allows employers to avoid penalties and interests but also a potentially messy tax audit by the IRS. Since these repayment programs are now available to employers, the IRS will likely heighten its review and audit of all ERC claims and aggressively pursue employers found to be ineligible for the credits.

If you have any questions regarding how to navigate the ERC repayment programs, file ERC refund claims, or respond to an ERC audit notice, please [contact me](#) or any member of the [Saxton & Stump Tax and Tax Controversy](#)

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