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In this article, Sheppard explores key timing issues, old and new, in the context of employee retention credit disputes.

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I. Introduction

Enforcement actions concerning employee retention credit claims likely will be on the uptick. One indicator of this is a recent IRS announcement saying that it plans to reject or further scrutinize approximately 80 percent of ERC claims because they are "high risk" or show an "unacceptable level of risk."[1] Assuming that challenges of many ERC claims will soon increase, a related question is exactly how long the IRS and Justice Department will have to carry out their missions. The normal rules on timing are straightforward, but things get complicated when one considers exceptions, special rules for certain quarters, potential changes that Congress is contemplating, and a novel decision recently issued by the Ninth Circuit that has received little attention. This article, the latest in an extensive series by the author, explores the key timing issues, old and new, in the context of ERC disputes.

II. Overview of Four Laws

Congress introduced the ERC in March 2020 when it enacted the Coronavirus Aid, Relief, and Economic Security Act.[2] That first ERC law covered the second, third, and fourth quarters of 2020.[3] It generally stated that an eligible employer could get an ERC against certain employment taxes equal to 50 percent of the qualified wages it paid to employees.[4] The CARES Act had some limits, among them that qualified wages for any one employee could not exceed $10,000 for all three relevant quarters combined. The maximum ERC for all of 2020, therefore, was just $5,000 per employee.[5]

The Taxpayer Certainty and Disaster Tax Relief Act came next.[6] It expanded ERC benefits to the first and second quarters of 2021.[7] Further, eligible employers could get more ERCs because the relief act increased the percentage of qualified wages on which they could claim ERCs from 50 to 70 percent. It also provided that the amount of qualified wages would be calculated per quarter, not per year.[8]

Next came the American Rescue Plan Act.[9] It increased benefits by allowing ERC claims for the

[1] IR-2024-169.

[2] Joint Committee on Taxation, "Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ('CARES') Act," JCX-12R-20 (Apr. 23, 2020); *see also* Notice 2021-20, 2021-11 IRB 922.

[3] CARES Act, section 2301(m).

[4] *Id.* at section 2301(a).

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

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

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

[8] *Id.* at Section III.D.

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

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third and fourth quarters of 2021.[10] That law also created another type of eligible employer — the recovery start-up business. Entities that began operating their businesses after February 15, 2020, and had average annual gross receipts of $1 million or less during the relevant period fell into this new category.[11]

The passage of the Infrastructure Investment and Jobs Act ended matters.[12] That law retroactively shortened the relevant periods, prohibiting ERC claims for the fourth quarter of 2021 for all eligible employers other than recovery start-up businesses.

III. Length of Exposure to IRS Challenges

Many taxpayers that filed aggressive ERC claims worry about several things, not the least of which is the period during which they remain at risk. In other words, they wonder how long the IRS has to take action. This issue is surprisingly complex already, with a chance for more intricacies in the future. An assortment of current and potential deadlines is explored below.

A. Normal Three-Year Rule

Eligible employers could have solicited ERCs on timely Forms 941, "Employer's Quarterly Federal Tax Return," or Forms 941-X, "Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund," for eligible quarters in 2020 and 2021.

One important foundational note is that Forms 941 for all four quarters of a particular year are deemed filed on April 15 of the next year.[13] For example, a Form 941 for the second quarter of 2020 had to be filed by July 31, 2020, but was deemed filed nearly nine months later, on April 15, 2021.[14] Likewise, Forms 941 for all quarters of 2021 were deemed filed on April 15, 2022.

Another key piece of knowledge in the ERC context is that a taxpayer normally must file a refund claim, including a Form 941-X, within three years after submitting the relevant Form 941, or within two years after paying the relevant taxes, whichever period expires later.[15] This confuses many people, but filing a refund claim does not create a new assessment period, and it generally does not extend the existing assessment period for the original Form 941.[16] The IRS clarified this point in the employment tax context, explaining that "filing an amended Form 940 or [Form 941-X] does not affect the period of limitation for assessment."[17]

The IRS, in accordance with directions from Congress, issued regulations addressing its ability to scrutinize ERC claims.[18] The regulations explain that section 6201 grants the IRS general authority to make the inquiries, determinations, and assessments of all taxes, but does not expressly allow it to assess any nonrebate portion of an erroneous refund of a refundable credit like the ERC. Consequently, the government ordinarily recovers these amounts through voluntary repayment by the taxpayer or litigation.[19] The CARES Act and ARPA expressly contemplate "administrative recapture" when it comes to the ERC. The IRS carried out this congressional mandate by releasing regulations confirming its authority concerning improper ERCs.[20] The regulations state that a "refund, credit, or advance of any portion of [ERCs] to a taxpayer in excess of the amount to which the taxpayer is entitled is an erroneous refund for which the IRS must seek repayment."[21] IRS officials summed up matters by saying that the new regulations allow the IRS to "treat what is normally an erroneous refund as an

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

[11] *Id.* at Section III.D.

[12] *See also* Notice 2021-65, 2021-51 IRB 880.

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

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

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

[16] *Badaracco v. Commissioner*, 464 U.S. 386, 393 (1984); IRS, "Employment Tax Returns: Examinations and Appeals Rights," Publication 5146, at 6 (revised Mar. 2017).

[17] Publication 5146, *supra* note 16, at 5.

[18] REG-111879-20; T.D. 9904; REG-109077-21; T.D. 9953, Background, Section V.

[19] Section 6201(a); T.D. 9953, Background, Section V.

[20] T.D. 9904, Explanation of Provisions.

[21] T.D. 9904, Background, Section III; T.D. 9978; reg. section 31.3111-6(b) and (c); reg. section 31.3134-1(a) and (b); reg. section 31.3221-5(b) and (c).

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underpayment of tax subject to regular assessment and administrative collection practices."[22]

The IRS arguably has the power to challenge ERC claims, but by when? It ordinarily has three years from the date on which a tax return is actually or deemed filed to identify it as problematic, conduct an audit, and propose changes.[23] Thus, for ERC claims, the normal assessment period for Forms 941 for any quarter of 2020 expired on April 15, 2024, while the period for Forms 941 for 2021 will not end until April 15, 2025.[24]

B. Five-Year Rule for Certain Quarters

ARPA granted the IRS more time to audit taxpayers that might have filed improper ERCs for the third or fourth quarters of 2021. It gives the IRS five years (instead of three) from the date on which the relevant Form 941 was actually or deemed filed to challenge an eligible employer.[25] For instance, if an eligible employer filed a timely Form 941 for the third quarter of 2021 claiming ERCs, it is deemed filed on April 15, 2022, and the assessment period will stay open until April 15, 2027.

C. Endless Scrutiny When Fraud Appears

As noted, the IRS generally has three years from the date on which a taxpayer files a return to assess additional taxes and penalties concerning that return.[26] This standard period expands in certain situations. The IRS may assess at any time if a return is found to be intentionally false or fraudulent.[27] A few cases have explored the pivotal issue of who, exactly, must commit the fraud for the extended assessment period to apply. The cases have concluded that the IRS merits an indefinite period if the applicable return is fraudulent, regardless of whether the taxpayer, the return preparer, or another person was the cause.[28]

D. Possible Six-Year Rule

The Tax Relief for American Families and Workers Act (H.R. 7024) was introduced shortly after the IRS commissioner met with Senate Finance Committee members to ask for additional tools for enforcement efforts related to the ERC.[29] The head of the IRS also testified before the House Ways and Means Committee, again emphasizing the need for legislative tweaks to assist the IRS in combatting improper ERC claims and those endorsing them.[30] The House approved the act in January, but the Senate has not yet followed suit.[31]

The act, if someday passed, will create several changes for ERC claims. These include the expansion of the assessment period from three years to six. From the perspective of eligible employers that filed ERC claims, six years, by itself, seems bad enough. However, a further look demonstrates that things might be worse than they initially appear. This is because the act states that the six-year clock does not start ticking against the IRS until the date on which the relevant Form 941 was actually filed, when the Form 941 was deemed filed, or when the credit or refund regarding the ERC is made, whichever occurs later.[32] The IRS has held a massive number of ERC claims for years because of the moratorium and enhanced review process. Under the standards in the act, if the IRS were to grant some of those pending ERC claims in, say, January 2025, it would have until January 2031 to challenge them.

[22] Lauren Loricchio, "New ERC Withdrawal Process Coming From IRS," *Tax Notes Federal*, Oct. 23, 2023, p. 745.

[23] Section 6501(a).

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

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

[26] Section 6501(a).

[27] Section 6501(c)(1); *Payne v. Commissioner*, 224 F.3d 415 (5th Cir. 2000), *supplemented by* T.C. Memo. 2001-231; *Neely v. Commissioner*, 116 T.C. 79 (2001).

[28] *See, e.g.*, *Allen v. Commissioner*, 128 T.C. 37 (2007); *See Eriksen v. Commissioner*, T.C. Memo. 2012-194; *Finnegan v. Commissioner*, 926 F.3d 1261 (11th Cir. 2019); *Ames-Mechelke v. Commissioner*, T.C. Memo. 2013-176; *Murrin v. Commissioner*, T.C. Memo. 2024-10.

[29] Doug Sword and Cady Stanton, "Werfel Pitches Senators on Three Legislative Fixes for ERC Fraud," *Tax Notes Federal*, Jan. 15, 2024, p. 527; Loricchio, "Tax Deal Would Bring ERC Claims to Earlier End and Curb Abuse," *Tax Notes Federal*, Jan. 22, 2024, p. 732.

[30] Sword and Stanton, "Mixed Reviews for Werfel on ERC, 1099-K Reporting, and More," *Tax Notes Federal*, Feb. 19, 2024, p. 1498.

[31] Efforts to attach the act to unrelated legislation to reauthorize the Federal Aviation Administration failed in early May. *See* Stanton, "Wyden to File Tax Bill as Amendment to FAA Reauthorization," *Tax Notes Federal*, May 13, 2024, p. 1273.

[32] Tax Relief for American Families and Workers Act of 2024, section 602(i).

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E. Possible Comprehensive Five-Year Rule

ARPA granted the IRS five years to audit ERC claims for the third and fourth quarters of 2021. The Biden administration has advocated for broadening this five-year period to cover all possible quarters. It released its budget proposal for 2025 (the green book), which offered several suggestions for improving tax compliance.[33] One of the recommendations was prolonging the audit period for three reasons. The green book first suggested that having a "consistent rule" regarding assessment periods "would assist with IRS compliance and enforcement efforts." It also explained that many ERC claims were made on Forms 941-X long after the relevant quarters closed, and taxpayers continue to file Forms 941-X with additional ERC claims. Finally, the fact that filing a Form 941-X does not serve to restart the assessment period "makes it difficult for the IRS to ensure compliance," particularly when it believes that many recent ERC claims are improper.[34] The green book proposed to make the assessment period for all ERC claims (for both 2020 and 2021) five years, as opposed to three.[35]

F. Assessment Periods at a Glance

Below is a summary of the existing and potential assessment periods for ERC claims:

- For ERC claims for the second, third, and fourth quarters of 2020, the normal, three-year period expired April 15, 2024.
- For ERC claims for the first and second quarters of 2021, the normal, three-year period will expire April 15, 2025.
- For ERC claims for the third and fourth quarters of 2021, the extended, five-year period will expire April 15, 2027.
- For fraudulent ERC claims for any quarters in 2020 or 2021, the period will never expire.
- If Congress were to pass the Tax Relief for American Families and Workers Act, the extended, six-year period would start on the date on which the relevant Form 941 was actually filed, the date on which the Form 941 was deemed filed, or the date on which the credit or refund is made, whichever occurs later.
- If Congress were to adopt the recommendations in the green book, the extended, five-year period for ERC claims for all quarters in 2020 would expire April 15, 2026, while the extended, five-year period for ERC claims for all quarters in 2021 would expire April 15, 2027.

IV. Length of Exposure to the DOJ Challenges

Eligible employers that filed questionable ERC claims need to be concerned not only about the IRS but also about the Department of Justice. An erroneous refund of "any portion of a tax imposed by" the IRC, including employment taxes, can be recovered in a civil action by the government.[36] The Justice Department conducts this type of litigation.

In terms of timing, the Justice Department must generally initiate the lawsuit within two years "after the making of such refund."[37] This period extends from two to five years, though, "if it appears that any part of the refund was induced by fraud or misrepresentation of material fact."[38] For example, if an eligible employer timely filed Forms 941 for all quarters of 2021, they would be deemed filed April 15, 2022. That means that the eligible employer could file Forms 941-X claiming ERCs until April 15, 2025. Let's say that occurred. Further assume that the IRS did only a cursory review and issued the refunds on May 15, 2026. Finally, suppose that the IRS, after taking additional time to reflect, determined that the Forms 941-X filed were fraudulent. In that case, the Justice Department would have until May 15, 2031, to file suit to reclaim the erroneous refund.[39]

[33] Treasury, "General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals" (Mar. 11, 2024).

[34] *Id.* at 203.

[35] *Id.* at 203-204. The green book also recommended extending the assessment period for the IRS to impose additional income taxes on taxpayers that filed ERC claims but failed to make the corresponding decrease to their wages-paid deduction on their income tax returns.

[36] Section 7405(b).

[37] Section 6532(b); reg. section 301.6532-2.

[38] Section 6532(b); reg. section 301.6532-2.

[39] The date might be later, depending on when the eligible employer deposits a check and it clears. *See United States v. Page*, No. 21-17083 (9th Cir. 2024).

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V. Recent Case Clarifying Starting Point

Page, a recent case of first impression, might favor the IRS and Justice Department when it comes to challenging improper ERC claims.[40]

The taxpayer in *Page* filed his Form 1040 for 2016 seeking a refund of about $3,500. Because of a clerical error, the IRS sent him a refund check of around $491,000 on May 5, 2017. Eleven months later, on April 5, 2018, the taxpayer cashed the check. The IRS then discovered the mistake and began sending the taxpayer notices demanding that he return the excess money. The taxpayer gave back less than half of the funds, so the Justice Department initiated an erroneous refund suit to recoup the remainder on March 31, 2020.

The taxpayer did not respond to the complaint filed with the district court. Therefore, the Justice Department filed a motion for a default judgment in its favor. This seemed to backfire in that the district court, without any prompting by the taxpayer, denied the motion and issued an order to the Justice Department instructing it to demonstrate why the case should not be dismissed altogether because it was filed too late.

Ultimately, the district court dismissed the case on the grounds that the two-year period for filing the complaint started to run against the Justice Department on the date the taxpayer received the refund check (that is, the check receipt date), not the date on which the check cleared the bank (that is, the check clearance date). Even though the taxpayer did not prove the specific date he received the check, the court held that "common sense" indicates that a check from the IRS dated May 5, 2017, would have been received more than two years before the Justice Department began the erroneous refund suit on March 31, 2020.

The Justice Department appealed the decision, and the Ninth Circuit started, as one would expect, by summarizing the two most relevant tax provisions. It said that "any portion of a tax" imposed by the IRC that is erroneously refunded to a taxpayer can be recovered by way of civil litigation by the Department of Justice.[41] In terms of deadlines, the provisions generally indicate that "recovery of an erroneous refund by suit . . . shall be allowed only if such suit is begun within two years after the *making of such refund*" (emphasis added).[42]

The Ninth Circuit, after reviewing applicable law and two prior cases, held that "the date the check clears is the more appropriate benchmark for defining when a refund is paid or, put another way, the date the check clears is the date the refund is made." It provided several reasons for its decision. First, the Ninth Circuit explained that this interpretation of the law ensures parity; the statute of limitations does not begin to run against the Justice Department until its right to sue has been triggered. It pointed out that the Justice Department could not have sued the taxpayer based on a refund if the taxpayer had returned the check or shredded it, or if the government had canceled the check before the taxpayer had a chance to deposit or cash it.

Second, the Ninth Circuit emphasized that the check clearance date provides the necessary certainty. It is a "documented, ascertainable event," as the date on which a particular taxpayer receives a refund check sent by regular mail is often unknowable or unprovable. According to the Ninth Circuit, "the check-clearance rule thus gives the parties and courts the most clarity when calculating the statute of limitations."

Third, citing precedent from the Supreme Court, the Ninth Circuit confirmed that it is obligated to construe statute of limitations matters in favor of the government, including the IRS and Department of Justice.

Fourth, the decision to stick with the check clearance date as opposed to the check receipt date prevents the creation of "perverse incentives" for taxpayers. The Ninth Circuit offered this real-life illustration:

> If the statute of limitations started when a taxpayer receives a refund check, then the taxpayer could — as [the taxpayer] did here — hold an erroneous check for a year

[40] *Page*, No. 21-17083; Chandra Wallace, "Late Cashing of Mistaken $491,000 Refund Check Saves IRS Suit," *Tax Notes Federal*, July 1, 2024, p. 137.

[41] Section 7405.

[42] Section 6532(b); reg. section 301.6532-2.

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before cashing it and eat up half the limitations period before the government even discovers the erroneous payment. A taxpayer might hold a check in good faith before cashing it for many reasons, but he could also do so to gain a strategic advantage. Using the check-clearance date prevents such gamesmanship.

Fifth, the Ninth Circuit underscored the importance of making decisions consistent with prior ones by other judicial bodies of equal rank. It explained that two other courts of appeals — the First Circuit and Seventh Circuit — had previously addressed similar legal issues, and both chose to rely on the check clearance date.[43]

Rooted in these rationales, the Ninth Circuit reversed the decision by the district court and remanded the case for further proceedings consistent with the notion that the check clearance date governs. It noted that the erroneous refund complaint filed by the Justice Department was timely because, while the IRS sent the taxpayer the refund check on May 5, 2017, the taxpayer did not cash it until April 5, 2018, and the Justice Department took action just short of the two-year mark, on March 31, 2020.

VI. Conclusion

Announcements from the IRS indicate that certain taxpayers — concerned that they might not have qualified for the ERCs they received — have decided to hold refund checks temporarily to see how things play out. Indeed, in introducing a "claim withdrawal process," the IRS said taxpayers could apply if "the IRS has not paid their claim, or the IRS has paid the claim, but they haven't cashed or deposited the refund check."[44] The reality that some taxpayers are not immediately processing ERC refund checks, because of uncertainty or otherwise, increases the significance of *Page*. It holds that the two-year deadline for the Justice Department to file erroneous refund suits to recoup ERCs does not start until the check clearance date, which is the date on which a refund is "made." That case might favor the IRS, too. As explained, the Tax Relief for American Families and Workers Act, if passed by Congress at some point, will expand the assessment period for the IRS to six years. That longer period would not begin to run until the relevant Form 941 was actually filed, when it was deemed filed, or the date on which the credit or refund is "made," whichever occurs later. The IRS proclaimed in June that approximately 80 percent of ERC claims fall into categories of "high-risk" or "unacceptable level of risk," thereby warranting rejection or additional scrutiny.[45] Based on those statistics, taxpayers should be aware of the recent ruling in *Page* and how it might affect the length of their exposure to various ERC enforcement actions. ■

[43] *United States v. Commonwealth Energy System*, 235 F.3d 11 (1st Cir. 2000); *United States v. Greene-Thapedi*, 398 F.3d 635 (7th Cir. 2005).

[44] FS-2023-24.

[45] IR-2024-169.

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