

Employee retention tax credit (ERC) updates for 2020 and 2021 tax returns

By: National Association of Tax Professionals

VERY IMPORTANT!!!! If you are a business and had an outside firm file amended 941-Xs in order to claim the much talked about **Employee Retention Tax Credit**, we will need to get copies of those 941-Xs, **as well as the Income Tax Returns where the eligible wages were reported.** According to the IRS, in order to give tax practitioners guidance as to how to treat the refunds:

Notice 2021-49 stated that if a taxpayer files a Form 941-X, *Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund*, to claim the ERC, **the taxpayer must file an amended federal income tax return to reduce the deduction for the wages on which the credits were claimed.**

What this is saying is, if a taxpayer's 941 for a prior year is amended, you will also most likely need to amend the related business return to account for a reduction in wages. You will not be able to make the wage adjustment, for example, on the 2021 business return, if an amended 2020 payroll report was filed to claim the ERC. The wage adjustment will need to be made on an amended 2020 business return.

If we prepared your income tax returns for which wages were used for the ERC, all we need are the 941-Xs and the letters that the IRS sent you with the adjustments. If we did **NOT** prepare the returns, then we will have to have a copy of those tax returns as well for us to amend them

Those amended returns will be done as time permits and most likely won't be done until after tax season. The good news is that the IRS has said that there would not be any penalties and interest assessed on those tax liabilities.

An important item to be aware of is that the statute of limitations on ERC claims is extended from three to five years (based on Notice 2021-49). For example, if the Form 941 for quarter four of 2021 claiming the ERC is treated as filed on April 15, 2022, the return could be audited with respect to the ERC as late as April 14, 2027.

Lastly, Notice 2021-49 delivered some disappointing news to many practitioners and their clients. In the majority of cases, wages paid to a more than 50% owner of a corporation, partnership or other entity are ineligible for the ERC. The same would apply generally to wages paid to a spouse of a more than 50% owner of a corporation, partnership or other entity.

There were a lot of "Scam Companies" that only wanted the high fees that they were charging, regardless of how accurate the work was. Very few, if any, told taxpayers that they would most likely owe taxes on their personal income tax returns. If the wages deducted on a tax return were \$10,000 and you received a \$5,000 ERC refund of 50% for 2020, we will have to adjust the wages amount by the \$5,000, so your deduction on that tax return would effectively be \$5,000, which is like adding \$5,000 of income to that tax return. The taxpayer will owe taxes on that additional \$5,000 at whatever tax bracket that return falls into.