Comparing Consequences of Obtaining Improper PPP and ERC Benefits: Taxpayers Might Be Surprised

HALE E. SHEPPARD, ESQ.

Taxpayers that got dual PPP and ERC relief are beginning to understand that enforcement actions, timeframes, and consequences differ for each.

Introduction

Congress realized that taxpayers desperately needed financial help during the economic crisis caused by COVID. Therefore, it created the Paycheck Protection Program ("PPP") and the Employee Retention Credit ("ERC"). Taxpayers cheered. Soon thereafter, Congress decided that taxpayers should be able to access *both* the PPP and ERC, provided that they did not claim double benefits based on the same payroll figures. Taxpayers cheered again. More recently, though, taxpayers that got dual PPP and ERC relief are beginning to understand that enforcement actions, timeframes, and consequences differ for each. They are also learning that PPP violations can trigger liabilities more than three times larger than the amounts originally received. They are further grasping that an audit of one item often leads to scrutiny of the other, particularly since both the PPP and ERC are linked to the same criteria, wages paid. These three lessons have converted cheers by taxpayers into groans.

This article, the latest in a multi-part series, explains the fundamentals of the PPP and ERC, interplay between the two, and distinct mechanisms used to recoup benefits that were improperly issued to taxpayers.[1]

Overview of Taxpayer Relief

Congress tried to help American individuals and businesses several ways dur-

Hale E. Sheppard, Esq. (B.S., M.A., J.D., LL.M., LL.M.T.) is a Shareholder in the Tax Controversy Section of Chamberlain Hrdlicka. He specializes in tax audits, tax appeals, and Tax Court litigation. You can reach Hale by phone at (404) 658-5441 or by e-mail at hale.sheppard@chamberlainlaw.com

ing the financial downturn triggered by COVID. Among other things, it enacted the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") in March 2020.[2] That legislation contained two items that have generated significant attention, the PPP and ERC.[3] The former is governed by the Small Business Administration ("SBA"), while the latter is overseen by the IRS. Why are two different governmental agencies necessary? This is because the PPP supplied relief to taxpayers through forgivable "loans." The ERC, by contrast, assuaged economic pain by granting tax incentives. Both measures helped taxpayers, but they accomplished their missions using different tools.

Employers had three major options when COVID struck, namely, apply for forgivable PPP loans, file ERC claims, or jettison employees. Determining the best financial alternative could be challenging, and it depended on several factors.[4] Assuming that businesses spurned the most drastic alternative (*i.e.,* firing or laying off their workforce), two possibilities remained.

Apply for Forgivable PPP Loans

Only certain businesses could benefit from the PPP.[5] They had to be in operation on February 15, 2020, generally had no more than 500 employees, and could certify that "the uncertainty of current economic conditions" made it imperative to apply for a PPP loan "to support ongoing operations." The SBA warned businesses not to take this certification lightly:

> All borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application. Although the CARES Act suspends the ordinary requirement that borrowers must be unable to obtain credit elsewhere, borrowers still must certify in good faith that their PPP loan is necessary . . . Borrowers must make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business. For example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to the SBA, upon request, the basis for the certification.[6]

The key feature of the PPP was that its loans might be "forgiven," meaning businesses might not have to repay them. Businesses applied for loans through a financial intermediary, which was often a bank authorized to process PPP solicitations. The loans were non-recourse, required no collateral, and were fully guaranteed by the SBA. The maximum interest rate was one percent initially. In terms of size, the first round of loans could reach up to 2.5 times the average monthly "payroll costs" of the business during the previous year, not to exceed $10 million. Loan recipients were obligated to use the funds to pay employee compensation and benefits, along with certain other expenses, such as rent, utilities and insurance premiums. Importantly, businesses could have their loans forgiven if they utilized the funds appropriately during the designated period and complied with other rules. For this reason, people often refer to amounts distributed under the PPP as "grants" instead of "loans."[7]

Sounds good, right? Businesses sure thought so. Indeed, they filed applications seeking nearly $350 billion in loans during the first two weeks. This opening surge essentially exhausted the initial funding. Congress, therefore, enacted new legislation modifying the PPP and authorizing additional money several times. By May 31, 2021, the last day that the SBA accepted new PPP loan applications, it had approved about 12 million loans totaling just shy of $800 billion, with a "b." To put this into perspective, the amount of money disbursed to businesses pursuant to the PPP in a matter of months nearly doubled the total funds approved by the SBA "in all of its programs, including disaster loans, during the last 29 years."[8]

When hundreds of billions of dollars are at stake, the SBA is trying to get financial relief to struggling small businesses as quickly as possible, and supervision is diffuse, shenanigans can occur at a large scale. They did. Early reports identified thousands of instances of bank fraud, wire fraud, identify theft, forgery, and more.[9] These transgressions were not surprising, though, as government watchdogs labeled PPP loans a "high risk" area from the outset and warned of the "potential for fraud, significant integrity risks, and need for much improved program management and oversight."[10] More recent data shows that the SBA disbursed around $64 billion in potentially fraudulent loans pursuant to the PPP.[11]

File ERC Claims

Congress passed four laws in less than two years concerning the ERC, and the IRS supplemented this by issuing multiple types of guidance. An overview follows.

First Law

The CARES Act generally provided that an "Eligible Employer" could claim ERCs against "Applicable Employment Taxes" equal to 50 percent of the "Qualified Wages" that it paid to each employee for each quarter, subject to a maximum.[12]

An Eligible Employer meant one that was carrying on a trade or business 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 ("Governmental Order Test").[13] Second, the employer suffered a significant decline in gross receipts during a particular quarter ("Reduced Gross Receipts Test").[14]

The term Applicable Employment Taxes in this context referred to the employer's share of amounts paid pursuant to the Federal Insurance Contributions Act.[15]

The notion of Qualified Wages under the CARES Act depended on the number of full-time employees working for an Eligible Employer before things went downhill. There were two categories: large and small. Where an Eligible Employer had an average of more than 100 full-time employees ("Large Eligible Employer"), Qualified Wages meant those

paid to any employee who was not providing services as a result of the Government Order Test or the Reduced Gross Receipts Test.[16] Conversely, where an Eligible Employer had an average of 100 or fewer full-time employees ("Small Eligible Employer"), Qualified Wages meant all wages paid during a quarter, whether or not the employees were actually working.[17] In addition to the amounts described above, Qualified Wages included the "Qualified Health Plan Expenses" paid by the Eligible Employer, which were allocable to the Qualified Wages.[18]

Benefits were limited under the CARES Act. In particular, the amount of Qualified Wages for any one employee could not exceed $10,000 for *all* applicable quarters combined in 2020. This meant that, after applying the 50 percent limit, the maximum ERC per employee for 2020 in its entirety was $5,000.[19] If the ERCs surpassed this threshold, then the excess would be treated as an employment tax *overpayment* and refunded to the Eligible Employer.[20]

Coverage of the ERC changed several times later, but it originally applied to Qualified Wages paid by Eligible Employers during the second, third, and fourth quarters of 2020.[21]

Second Law

Congress passed the Taxpayer Certainty and Disaster Tax Relief Act ("Relief Act") in December 2020.[22] That law modified the standards for being a Small Eligible Employer and Large Eligible Employer, thereby making it easier to claim ERCs for all wages paid to employees during certain quarters, not just to those who were not providing services.[23] In particular, Large Eligible Employers became those whose average number of full-time employees was more than 500 (instead of more than 100), while Small Eligible Employers were those with an average of 500 or less (instead of 100 or less).[24]

The Relief Act also 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.[25] Eligible employers could get increased amounts of ERCs, too. Under the CARES Act, an Eligible Employer could only claim ERCs for 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 percent 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 (i.e., $7,000 per quarter).[26]

Third Law

Congress introduced the American Rescue Plan Act ("ARP Act") in March 2021.[27] That law "codified" the ERC rules, making them Section 3134 of the Internal Revenue Code. The ARP Act expanded the ERC, allowing Eligible Employers to claim benefits for the third and four quarters of 2021.[28] Thus, at that point, the ERC was available with respect to Qualified Wages paid during second, third, and fourth quarters of 2020 (under the CARES Act), first and second quarters of 2021 (under the Relief Act), and third and fourth quarters of 2021 (under the ARP Act).[29]

Fourth Law

Things came to a close when Congress enacted the Infrastructure Investment and Jobs Act ("IIJA") in November 2021.[30] That legislation announced the end of the ERC and it retroactively shortened the periods for claiming 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 a grand total of $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. The IRS explained that advance ERC payments re-

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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, "Employee Retention Credits: What the IRS Did Not Do, Did, and Might Do," ___ *Tax Notes Federal* ___ (2023); Hale E. Sheppard, "Employee Retention Credits: Success Requires Mastery of Procedural and Substantive Rules," ___ *Tax Notes Federal* ___ (2023); Hale E. Sheppard, "Employee Retention Credits: Exploring Reasons for Prolonged Claims," ___ *Tax Notes Federal* ___ (2023); Hale E. Sheppard, "Employee Retention Credits: IRS Clarifies Limited Eligibility of Federal Credit Unions," 180(10) *Tax Notes Federal* 1615 (2023); Hale E. Sheppard, "Employee Retention Credits: Issues Arise as Finger-Point Begins," 180(11) *Tax Notes Federal* 1843 (2023); Hale E. Sheppard, "Government Orders, Suspended Operations, and Supply Chains, 180(9) *Tax Notes Federal* 1413 (2023); Hale E. Sheppard, "Employee Retention Credits: Analyzing Key Issues for [bsq]Promoters[esq] and Other [bsq]Enablers,[esq]" 139 *Journal of Taxation* 15 (November 2023); Hale E. Sheppard, "Employee Retention Credits: Analyzing Key Issues for Taxpayers Facing IRS Audits," 139 *Journal of Taxation* 32 (October 2023); Hale E. Sheppard, "Employee Retention Credits: Analyzing Congressional and IRS Guidance from Start to Finish," 139 *Journal of Taxation* 3 (September 2023).

[2] Public Law 116-126; U.S. 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 (April 23, 2020).

[3] The PPP is part of Title I of Division A of the CARES Act, which is called "Keeping American Workers Paid and Employed Act." *See* Section 1102 of Public Law 116-126. The ERC is part of Title II of Division A of the CARES Act, which is known as "Assistance for American Workers, Families and Businesses." *See* Section 2302 of Public Law 116-126.

[4] Congressional Research Service. CARES Act for Employers and Employees – The Paycheck Protection Program, Employee Retention Tax Credits, and Unemployment Insurance Benefits (Part 2). Report IN11329 (April 21, 2020), pgs. 2-3.

[5] Various persons could apply for PPP loans, including sole proprietorships, independent contractors, self-employed persons, non-profit organizations, veteran organizations, tribal concerns, and small businesses. This article broadly refers to all as "businesses" for the sake of simplicity.

[6] Small Business Association, Frequently Asked Question #31, Updated as of June 13, 2023.

[7] Public Law 116-126, Section 1102 (March 27, 2020); Public Law 116-260, Section 276 (Dec. 27, 2020); Public Law 117-2, Section 5001 (March 11, 2021); *See also* Susan C. Morse, "Emergency Money: Lessons from the Paycheck Protection Program," 55(1) University of Michigan Journal of Law Reform 175, 180-183 (2021).

[8] Congressional Research Service. COVID-19 Relief Assistance to Small Businesses: Issues and Policy Questions. Report R46284 (March 1, 2023), pgs. 5 and 9.

[9] U.S. Government Accountability Office. Paycheck Protection Program – SBA Added Program Safeguards, but Additional Actions Are Needed. GAO-21-577 (July 2021), pg. 2.

[10] U.S. Government Accountability Office. Paycheck Protection Program – Program Changes Increased Lending to the Smallest Businesses and in Underserved Locations. GAO-21-601 (Sept. 2021), pg. 3. *See also* U.S. Small Business Administration, Office of Inspector General. COVID-19 Pandemic EIDL and PPP Loan Fraud Landscape. Report 23-09 (June 27, 2023) (explaining that the Office of Inspector General issued 22 reports related to identified weaknesses in SBA's control environment"), pg. 2.

ceived by most Small Eligible Employers for fourth quarter 2021 now constituted "erroneous refunds," which had to be repaid.[31]

Interplay between the PPP and ERC

The CARES Act initially provided that an Eligible Entity that received a PPP loan to cover "payroll costs" would *not* be entitled to ERCs.[32]

The second law, the Relief Act, made significant changes. Among other things, it eliminated the rigid rule preventing recipients of PPP loans from also accessing ERCs.[33] It explained that "payroll costs" for PPP purposes generally would *not* include Qualified Wages taken into account by employers when determining their eligibility for ERCs.[34] However, the Relief Act granted employers the option to elect to exclude some or all of their Qualified Wages for ERC purposes, such that they might be able to benefit from both the PPP and ERC to varying degrees.[35] The Relief Act also indicated that these changes were *retroactive*; that is, they applied as if Congress had originally included them in the CARES Act in March 2020.[36]

The IRS issued guidance regarding the interplay between the PPP and ERC, primarily via Notice 2021-20.[37] It contained several examples, including the following.[38]

Employer B received a PPP loan of $200,000. Employer B is an Eligible Employer and paid $250,000 of Qualified Wages that would qualify for the ERC during second and third quarters of 2020. In order to receive forgiveness of the PPP loan in its entirety, Employer B was required to report a total of $200,000 of payroll costs and other eligible expenses. Employer B submitted a PPP Loan Forgiveness Application reporting the $250,000 of Qualified Wages as payroll costs. Employer B received a decision in first quarter of 2021 forgiving the entire PPP loan amount of $200,000. Employer B is deemed to have made an election not to take into account $200,000 of the Qualified Wages for purposes of the ERC, which was the amount included as payroll costs on the PPP Loan Forgiveness Application. It may not include the $200,000 as Qualified Wages for ERC purposes. However, Employer B is not treated as making a deemed election with respect to $50,000 of the Qualified Wages (*i.e.*, $250,000 reported on the PPP Loan Forgiveness Application, minus $200,000 of loan forgiveness), and it may include that amount as Qualified Wages for ERC purposes.[39]

Another example centered on Employer D, which received a PPP loan of $200,000. Employer D is an Eligible Employer and paid $150,000 of Qualified Wages that would qualify for the ERC during second and third quarters of 2020. In addition to the Qualified Wages, Employer D had $100,000 of other payroll costs that are not Qualified Wages, and $70,000 of other eligible expenses. In order to receive forgiveness of the PPP loan in its entirety, Employer D was required to report $200,000 of payroll costs and other eligible expenses. Employer D submitted a PPP Loan Forgiveness Application reporting $130,000 of payroll costs and $70,000 of other eligible expenses. Employer D can demonstrate that the payroll costs reported on the PPP Loan Forgiveness Application consist of $100,000 of payroll costs that are not Qualified Wages and $30,000 of payroll costs that are Qualified Wages. Employer D received a decision in first quarter 2021 forgiving the entire PPP loan amount of $200,000. On one hand, Employer D is deemed to have made an election not to take into account $30,000 of Qualified Wages for ERC purposes, which was the amount of Qualified Wages included as payroll costs on the PPP Loan Forgiveness Application. On the other hand, Employer D is not deemed to have made an election with respect to the $120,000 of Qualified Wages that are not included as payroll costs on the PPP Loan Forgiveness Application. Employer D, therefore, may take into account the $120,000 of Qualified Wages (*i.e.*, $150,000 of Qualified Wages paid, minus $30,000 of Qualified Wages included as payroll costs reported on the PPP Loan Forgiveness Application) for ERC purposes.[40]

The Hammer Drops for PPP and ERC Violations

Most taxpayers and tax professionals have been focused on the ERC, but enforcement has started with respect to the PPP, too.

Early PPP Enforcement

The SBA has taken enforcement actions to halt improper loans and recoup funds. Specifically, as of May 2023, it had investigated over 1,500 cases, leading to approximately 1,000 criminal indictments, 800 arrests, and 530 convictions. The SBA still has over 90,000 "actionable leads" received through its hotline.[41]

The SBA is feeling fairly confident from a timing perspective because Congress recently granted it an entire decade to root out violations. The relevant law states that "any criminal charge or civil enforcement action alleging that a borrower engaged in fraud with respect to a [PPP loan] shall be filed not later than 10 years after the offense was committed."[42] As the SBA sees it, "thousands of investigations will ensue for years to come because of swift congressional action to increase the statute of limitations to 10 years."[43]

The SBA continues with enforcement actions today in its efforts to punish violations. It recently explained the following:

> For a PPP loan of *any size*, SBA may undertake a review *at any time*, before or after SBA remits a forgiveness payment to the lender, in SBA's discretion. For example, SBA may review a loan if the loan documentation submitted to the SBA by the lender or any other information indicates that the borrower may be ineligible for a PPP loan, or may be ineligible to receive the loan amount or loan forgiveness claimed by the borrower.[44]

Early ERC Enforcement

Not to be outdone by the SBA, the IRS recently announced that it had referred "thousands of ERC cases for audit" as of September 2023, and this occurred *before* the IRS even started its "enhanced compliance review" of all pending and future ERC claims.[45]

Contrasting PPP and ERC Enforcement Procedures

Taxpayers, accountants, and others often have a general understanding of the tax dispute process, at least when it comes

to federal income taxes. The problem, of course, is that neither the PPP nor the ERC deals with such taxes, and the normal procedures simply do not apply. This segment of the article explores the unique methods by which the SBA and IRS get their proverbial pound of flesh. These methods might surprise many loan and credit recipients, and not in a positive way.

Surprising PPP Procedures

The SBA, with the assistance of the Department of Justice ("DOJ"), is identifying and punishing PPP violations in several manners, including filing lawsuits under the False Claims Act ("FCA").

Overview of the FCA

Many taxpayers are unfamiliar with the FCA, which is logical because this law is *not* used in tax disputes. Indeed, the FCA expressly says that it "does *not* apply to claims, records, or statements" made under the Internal Revenue Code.[46] This is commonly known as the "tax bar."

The FCA centers on persons who engage in various problematic actions. Among the ones relevant to this article are (i) knowingly presenting, or causing others to present, a false or fraudulent claim for payment or approval, (ii) knowingly making, using, or causing others to make or use, a false record or material statement, or (iii) conspiring to commit either of the preceding.[47] Persons that fall into one or more of these three categories face significant financial downsides. They are liable for a civil penalty between $5,000 and $10,000 (which amount is increased for inflation) and, more critically, they must pay *three times* the amount of the damages sustained by the U.S. government because of the improper actions.[48] The latter is known as mandatory "treble damages," and it can be a big deal when it comes to PPP violations.

Terminology is important when it comes to applying laws, as words and phrases have distinct meanings in different contexts. For purposes of the PPP, the concept of "knowingly" means that the person has actual knowledge of the relevant information, acts in deliberate ignorance of the truth or falsity of the information, *or* acts in reckless disregard of the truth or falsity of the information.[49] Critically, the DOJ does not have the obligation to prove that the person had a "specific intent to defraud."[50]

The term "claim" in the PPP arena means a request or demand for money or other property that is presented to an officer, employee, or agent of the government. It also encompasses a request or demand to a contractor, grantee, or other recipient, if the money or property is to be spent to advance a governmental program and the government is obligated to reimburse the party.[51]

Finally, the term "material" means having a natural tendency or capability to influence a payment of money or other property.[52]

Recent FCA Case Involving the PPP

The DOJ has filed many lawsuits against persons who improperly enriched themselves by obtaining unwarranted PPP loans. One example is *United States v. Suppey and Adubofour,* a case in which the DOJ alleged the following.[53] The defendants, with the assistance of an unidentified individual, filed four fraudulent PPP loan applications. Specifically, they completed the applications using inflated or false income figures and payroll costs, signed the applications attesting to their accuracy, and submitted them. They also utilized fake tax returns and bank records to support the applications. Consist with this behavior, the defendants executed loan agreements with financial companies falsely certifying the accuracy of the materials supplied. As a result, the defendants received four "loans," and the government paid financial companies the corresponding "processing fees" of $2,500 each. Things did not improve for the government from there. The defendants defaulted

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[11] U.S. Small Business Administration, Office of Inspector General. COVID-19 Pandemic EIDL and PPP Loan Fraud Landscape. Report 23-09 (June 27, 2023), pgs. 8, 11

[12] Public Law 116-126, Section 2301(a).

[13] Public Law 116-126, Section 2301(c)(2)(A)(ii)(I).

[14] Public Law 116-126, Section 2301(c)(2)(A)(ii)(II).

[15] Public Law 116-126, Section 2301(c)(1). These consist of Social Security and Medicare taxes.

[16] Public Law 116-126, Section 2301(c)(3)(A)(i).

[17] Public Law 116-126, Section 2301(c)(3)(A)(ii)(I) and (II). Please note that these standards later changed from 100 to 500 full-time employees. *See* Public Law 116-260, Division EE, Section 207 (Dec. 27, 2020) and Notice 2021-23, Section III, E.

[18] Public Law 116-126, Section 2301(c)(3)(C)(i).

[19] Public Law 116-126, Section 2301(b)(1); U.S. 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 (April 23, 2020), pg. 38.

[20] Public Law 116-126, Section 2301(b)(3)(A); Section 6402(b); Treas. Reg. § 301.6402-1; Section 6413(b).

[21] Public Law 116-126, Section 2301(m); *See also* Notice 2021-20.

[22] Public Law 116-260, Division EE, Section 207 (Dec. 27, 2020); U.S. Joint Committee on Taxation. Description of the Budget Reconciliation Legislative Recommendations Relating to Promoting Economic Security. JCX-3-21 (Feb. 8, 2021), pgs. 66-70; *See also* Notice 2021-23.

[23] Public Law 116-260, Division EE, Section 207(e) (Dec. 27, 2020).

[24] Notice 2021-23, Section III, E.

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

[26] Notice 2021-23, Section III, D.

[27] Public Law 117-2, Section 9651 (March 11, 2021); *See also* Notice 2021-49.

[28] Public Law 117-2, Section 9651(a) (March 11, 2021).

[29] Public Law 117-2, Section 9651(a) (March 11, 2021) (*see* Section 3134(n)).

[30] Public Law 117-58 (Nov. 15, 2021); *See also* Notice 2021-65.

[31] Notice 2021-65, Section III, B.

[32] Public Law 116-126, Section 2301(j) (referencing Section 1102); U.S. 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 (April 23, 2020), pg. 42.

[33] Public Law 116-260, Division EE, Section 206(c)(2)(B)(Dec. 27, 2020).

[34] Public Law 116-260, Division EE, Section 206(c)(1)(Dec. 27, 2020).

[35] Public Law 116-260, Division EE, Section 206(c)(2)(Dec. 27, 2020); U.S. Joint Committee on Taxation. Description of the Budget Reconciliation Legislative Recommendations Relating to Promoting Economic Security. JCX-3-21 (Feb. 8, 2021), pg. 67; *See also* Notice 2021-20, Notice 2021-49, Section III(F), and Revenue Procedure 2021-33.

[36] Public Law 116-260, Division EE, Section 206(e)(1)(Dec. 27, 2020).

[37] Notice 2021-20, Section III(I); *See also* Internal Revenue Service, Lesson 3 – Tax Credit for Employee Retention, Tax Notes Document No. 2022-38592, pgs. 3-51 through 3-56.

[38] The author has shortened, clarified, paraphrased or otherwise modified the original IRS language in order to make the information more understandable for readers.

[39] Notice 2021-20, Section III(I), Example 2.

[40] Notice 2021-20, Section III(I), Example 6.

[41] U.S. Small Business Administration, Office of Inspector General. COVID-19 Pandemic EIDL and PPP Loan Fraud Landscape. Report 23-09 (June 27, 2023), pg. 7.

on some loans, and they managed to get others forgiven based on additional false information. Either way, the government, and thus U.S. taxpayers as a whole, were out the loan amounts, plus the processing fees, plus interest charges.

The DOJ filed a lawsuit against the defendants raising multiple counts, or violations. These included (i) violating the FCA by knowingly presenting false or fraudulent claims, (ii) infringing the FCA, again, by knowingly making or using false records, and (iii) conspiring to violate the FCA. The DOJ asked the court to make the defendants pay "treble damages" (*i.e.,* three times the amount of financial damage suffered by the government), plus civil penalties.

Later, the DOJ filed a Motion for Summary Judgment, essentially asking the court to decide the case in its favor immediately, without the need for a trial.[54] The DOJ argued that the treble damages *and* civil penalties under the FCA applied if the following elements were satisfied: The defendants presented a claim to the government or caused one to be presented; the claim was false or fraudulent; the defendants knew this; the claim was material; and it caused the government to pay. The DOJ then proceeded, as one would expect, to plod through the analysis, applying the facts in the case to the provisions of the FCA and relevant precedents.

The DOJ spent considerable time on whether the defendants "knowingly" engaged in the bad behavior. It emphasized that the FCA broadly defines this concept to include actual knowledge that the information is false, deliberate ignorance of its truth or falsity, or reckless disregard of its veracity. The DOJ also reminded the court that the FCA explicitly states that it is *not* required to prove that the defendants had a "specific intent to defraud." The DOJ then turned to the evidence. It explained that the defendants admitted during pre-trial depositions that the income figures they presented in their PPP loan applications were inflated, they knew that lending decisions were based on the certifications made in such applications, they did not analyze or discuss the eligibility criteria for obtaining PPP loans, they did not verify the accuracy of the data in the loan applications, and they never even read the applications before filing them. The DOJ went on to point out that the defendants signed and initialed in various spots in the PPP loan applications, supplied the names and Taxpayer Identification Numbers for the pertinent companies, made false certifications, personally transmitted the applications to the financial institutions, and, in some instances, provided pictures of themselves for identification purposes. Together, argued the DOJ, the actions and inactions by the defendants constituted "reckless disregard" and "deliberate ignorance."

The DOJ argued that the defendants violated the FCA six times, between the four initial loan applications and two subsequent loan-forgiveness applications. These transgressions supposedly cost the government a total of $73,725. This figure was comprised of two items. First, the government had to pay the financial institutions the processing fee of $2,500 for each loan, totaling $10,000. Second, the government repaid the financial institutions the principal and interest where loan forgiveness or default occurred. This cost the government $63,725.

The DOJ sought a total of $302,233 from the defendants, calculated as follows. The government was forced to pay financial institutions $73,725, and tripling this figure results in $221,175. Moreover, the FCA allowed for six civil penalties, which reached $81,408 in this case.[55] The DOJ also urged the court to make the defendants pay an additional civil penalty of $13,508 for one broad count of conspiring to violate the FCA.

The court fully agreed with the DOJ, granting its Motion for Summary Judgment. It ordered the defendants to pay several things, including a total of $315,731 in FCA violations (*i.e.,* $302,233 plus $13,508).[56] To be clear, the defendants in *United States v. Suppey and Adubofour* obtained $63,725 in improper loans under the PPA, and ended up with a liability to the government of $315,731 under the FCA.

Another Recent FCA Case Involving the PPP

The case described above is not an aberration. On the contrary, it is becoming the norm. Take, for instance, another PPP case also resolved in 2023, *United States v. Bailey's Trucking, LLC et al.*[57] There, the defendant improperly obtained a loan of $143,738, but ended up with a judgment against him of $482,329. How did the liability get so high? The government had to pay the financial institution the loan principal, interest, and processing fee, totaling $151,771. Multiplying that amount by three, as the FCA requires, results in damages of $455,313. To that number the court added a civil penalty of $13,508 for each of two FCA violations, generating another $27,016.

Surprising ERC Procedures

IRS disputes over the ERC do not implicate the FCA, but they can be surprising in other ways. For starters, actions might arise in multiple manners, the following four among them. First, relying on new procedures created by recent regulations, the IRS might conduct civil examinations of Eligible Employers who received credits or refunds, including advance payments. Second, the IRS might use a tool called "administrative offset" to take overpayments by Eligible Employers in one context and apply them to satisfy employment tax underpayments stemming from ERCs. Third, the DOJ might adhere to the traditional path by filing erroneous refund lawsuits. Finally, another possibility is that Eligible Employers whose ERC claims were rejected or ignored by the IRS might file refund lawsuits. Each of these methods is discussed below.

Civil Examinations by the IRS

Regulations promulgated in September 2023 indicate that improper ERCs that were credited or refunded to Eligible Employers will be treated as *underpayments* and assessed and collected by the IRS in the same manner as employment taxes.[58] Thus, one assumes that the IRS will use the following procedure, or a variation thereof. The IRS will initiate an audit of questionable Forms 941 (Employer's Quarterly Federal Tax Return) and Forms 941-X (Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund). To the extent that Revenue Agents identify what they believe are

undeserved ERCs, they will issue Examination Reports proposing tax liabilities and perhaps penalties. Eligible Employers might challenge the Examination Reports by filing Protest Letters and seeking reconsideration by the Appeals Office. Assuming that Eligible Employers cannot reach an agreement with the Appeals Office, the IRS will "assess" the taxes and penalties. This means that the IRS will essentially record a debt on its books, and collection actions can commence.

The preceding paragraph is incomplete without some commentary about time limits. The IRS generally has three years from the date on which a tax return is filed (or deemed to have been filed) to identify it as problematic, conduct an audit, and make assessments.[59] Accordingly, the normal assessment-period for Forms 941 and Forms 941-X for any quarter of 2020 will expire on April 15, 2024, while the standard assessment-period for any quarter of 2021 will not end until April 15, 2025.[60]

The rules further favor the IRS when it comes to ERC claims for third and fourth quarters of 2021.[61] The ARP Act granted the IRS more time to audit taxpayers who might be misbehaving. It gives the IRS five years (instead of three years) from the date on which the relevant Form 941 is actually or deemed filed to challenge an Eligible Employer.[62] For instance, if an Eligible Employer filed 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 would stay open until April 15, 2027.

The IRS has repeatedly warned that many unscrupulous companies are urging taxpayers to take ERC positions that range from extremely aggressive to downright fraudulent.[63] The Internal Revenue Code provides that the IRS can assess taxes "at any time" in situations involving a false or fraudulent return.[64] Accordingly, the IRS might argue that the assessment-periods are *endless* with respect to the most egregious ERC claims.

Eligible Employers have a few potential remedies once the IRS "assesses" employment taxes. They can wait, for instance, for the IRS to issue a post-lien notice or pre-levy notice, file a request for a collection due process hearing, participate in a conference with the Appeals Office, and then lodge a Petition with the Tax Court to challenge an unfavorable Notice of Determination.[65] Alternatively, Eligible Employers can pay the required amount and then file a refund suit with the proper District Court or Court of Federal Claims.[66]

Administrative Offsets by the IRS

The Internal Revenue Manual describes several types of erroneous refunds, one of which is when "a taxpayer submits an amended return requesting a decrease in tax," and the IRS allows it "even though the [IRS] makes only a hasty review of the return or inadvertently fails to screen the entire return to determine if the reduction in tax should be made."[67] Various reports by watchdogs indicate that this happened often, particularly in the early days of the ERC, because of insufficient staffing, unclear rules, and pressure on the IRS to get funds into the hands of struggling businesses swiftly.[68] The good news for the IRS is that it might be able to exercise self-help in recouping amounts that it should not have released in the first place. As long as the IRS makes a timely assessment, it does not necessarily have to track down the Eligible Employer for payment. Rather, it can "offset" the liability by automatically applying tax overpayments by the Eligible Employer in other contexts.[69]

Erroneous Refund Suits by the DOJ

The recent regulations expressly stated that the special ERC procedures supplement, not usurp, existing methods for recouping improper refunds issued to taxpayers.[70] This means that the government might opt for a traditional method, civil litigation. An erroneous refund of "any portion of a tax imposed by" the Internal Revenue Code, including

NOTES

42 Public Law 117-166, Section 2; U.S. House of Representatives, PPP and Bank Fraud Enforcement Harmonization Act of 2022, 117th Congress, 2nd Session, Report 117-328 (May 17, 2022).

43 U.S. Small Business Administration, Office of Inspector General. COVID-19 Pandemic EIDL and PPP Loan Fraud Landscape. Report 23-09 (June 27, 2023), pg. 24.

44 Small Business Association, Frequently Asked Question #39, As of June 13, 2023 (emphasis added).

45 IR-2023-169 (Sept. 14, 2023).

46 31 U.S.C. § 3729(d).

47 31 U.S.C. § 3729(a)(1)(A) through (C).

48 31 U.S.C. § 3729(a)(1).

49 31 U.S.C. § 3729(b)(1)(A).

50 31 U.S.C. § 3729(b)(1)(B).

51 31 U.S.C. § 3729(b)(2)(A).

52 31 U.S.C. § 3729(b)(3).

53 *United States v. Suppey and Adubofour*, U.S. District Court, Eastern District of Virginia, No. 1:22-cv-00279-CMH-IDD, Complaint filed March 16, 2022, and Amended Complaint filed May 5, 2023.

54 *United States v. Suppey and Adubofour*, U.S. District Court, Eastern District of Virginia, No. 1:22-cv-00279-CMH-IDD, Motion for Summary Judgment and Memorandum of Law filed July 25, 2023.

55 The penalty was $10,000 at time of enactment, but it has increased to $13,508 as a result of inflation. Thus, six violations now generate a total sanction of $81,408.

56 *United States v. Suppey and Adubofour*, U.S. District Court, Eastern District of Virginia, No. 1:22-cv-00279-CMH-IDD, Order filed August 21, 2023.

57 *United States v. Bailey's Trucking, LLC and Xavier Bailey*; individually, U.S District Court, Northern District of Mississippi, No. 3:22cv109-GHD-RP. Complaint filed June 10, 2022, and Memorandum Opinion filed September 15, 2023.

58 "IRS Publishes Proposed Regs on Recapture of Coronavirus Credits," 2020 Tax Notes Federal Today 143-28 (July 29, 2020); REG-111879-20; T.D. 9904; "Proposed Regs Permit Assessment of Erroneous Refunds," 2021 Tax Notes Today Federal 173-9 (Sept. 10, 2021); REG-109077-21; T.D. 9953, Background, Section V – Assessment Authority; Treas. Reg. § 31.3111-6(b) and (c); Treas. Reg. § 31.3134-1(a) and (b); Treas. Reg. § 31.3221-5(b) and (c).

59 Section 6501(a).

60 Treas. Reg. § 301.6501(b)-1(b).

61 Notice 2021-49, Section III, G.

62 Public Law 117-2, Section 9651(a) (March 11, 2021); Notice 2021-49, Section III, G.

63 *See, e.g.*, News Release 2021-65 (March 31, 2021); News Release 2022-183 (October 19, 2022); IRS Tax Tip 2023-44 (April 4, 2023); Information Release IR-2023-105 (May 25, 2023).

64 Section 6501(c)(1); Treas. Reg. § 301.6501(c)-1(a).

65 Section 6330(c)(2)(B) (stating that a taxpayer "may also raise at the hearing challenges to the existence or amount of the underlying tax liability for any tax period if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability"); Treas. Reg. § 301.6330-1(e)(1); Section 6330(d)(1); *Salazar v. Commissioner*, T.C. Memo 2008-38.

66 *See* Internal Revenue Service, Employment Tax Returns – Examinations and Appeal Rights, Publication 5146 (Rev. 3-2017); Internal Revenue Manual § 4.23.4 (Employment Tax – General Procedures and Workpapers); American Bar Association, Section of Taxation. Effectively Representing Your Client Before the IRS, Volume 1, Fourth Edition, Chapter 8 (2009); David M. Richardson et al. Civil Tax Procedure, LexisNexis, Chapter 5 (2005).

67 Internal Revenue Manual § 25.6.7.2.1 (10-1-2007).

employment taxes, can be recovered by a civil action by the government.[71] In terms of timing, the government generally must initiate the lawsuit within two years after making the refund. This period extends from two years to five years, though, "if it appears that any part of the refund was induced by fraud or misrepresentation of material fact."[72] As mentioned above, the IRS believes that many ERC claims are false or fraudulent, which means that the DOJ might rely on the five-year period in bringing erroneous refund cases.

Refund Suits by Eligible Employers

Some taxpayers filed Forms 941 *not* claiming ERCs and paid all the normal employment taxes. They later learned about the opportunity, or Congress amended the law in their favor with retroactive effect. In those instances and others, taxpayers might have submitted Forms 941-X claiming refunds, yet they did not receive them. The IRS has no legal duty to respond to refund claims: "If a refund claim is filed within the applicable statute of limitations, the IRS has the discretion to accept and pay the claim, to deny part or all of it, or to simply ignore it."[73] If the IRS formally denies a refund claim by issuing a Notice of Disallowance, then the taxpayer can seek help from the courts by initiating a refund suit in the proper District Court or Court of Federal Claims.[74] The taxpayer can also file a refund suit if the IRS simply ignores the taxpayer, failing to respond to the refund claim for at least six months.[75]

Conclusion

The possible overlap of PPP and ERC benefits, combined with aggressive enforcement actions by the SBA and IRS, plus extended assessment-periods, should have taxpayers thinking. Among those thoughts should be that they need to hire qualified, unbiased tax counsel soon to assist with analyzing their situations and preparing for the scrutiny coming their way. ●

NOTES

[68] *See* Treasury Inspector General for Tax Administration. Interim Results of the 2020 Filing Season: Effect of COVID-19 Shutdown on Tax Processing and Customer Service Operations and Assessment of Efforts to Implement Legislative Provisions. Reference Number 2020-46-041 (June 30, 2020); Treasury Inspector General for Tax Administration. Implementation of Tax Year 2020 Employer Tax Credits Enacted in Response to the COVID-19 Pandemic. Report No. 2021-46-043 (July 9, 2021); Treasury Inspector General for Tax Administration. Delays Continue to Result in Businesses Not Receiving Pandemic Relief Benefits. Report No. 2022-46-059 (August 31, 2022).

[69] Section 6402(b); Treas. Reg. § 301.6402-1; Treas. Reg. § 301.6402-3(a)(6). The IRS takes the position that the common law right of setoff applies to non-rebate erroneous refunds. *See* Service Center Advice 200014033 (April 7, 2000).

[70] T.D. 9953, Explanation of Provisions; T.D. 9978, Summary of Comments and Explanation of Revisions.

[71] Section 7405(b).

[72] Section 6532(b); Treas. Reg. § 301.6532-2.

[73] David M. Richardson et al. Civil Tax Procedure, LexisNexis, Chapter 9 (2005), pg. 218.

[74] Section 6532(a)(1); Treas. Reg. § 301.6532-1(a); Section 7422(a).

[75] *Id.*