

ERC Updated FAQs

Cross References

- <https://www.irs.gov/coronavirus/employee-retention-credit>

The IRS has updated its frequently asked questions (FAQs) about the Employee Retention Credit (ERC). The ERC is a refundable tax credit for certain eligible businesses and tax-exempt organizations. The IRS website contains an FAQ which provides general information about eligibility, claiming the credit, scams, and other issues.

The following FAQs were recently updated.

Q. Does the ERC affect my income tax return (updated March 20, 2025)?

A. Yes.

The amount of your ERC reduces the amount that you are allowed to report as wage expense on your income tax return for the tax year in which the qualified wages were paid or incurred.

Generally, most taxpayers claim wage expense as a deduction on their income tax returns. However, for some taxpayers, wage expense is properly capitalized to the basis of a particular asset or as an inventory cost.

You can amend your income tax return to reduce the amount of your original wage expense if that adjustment has not yet been made by:

- Reducing the prior wage deduction, or
- Reducing the prior amount capitalized (and making any resulting adjustment, such as reducing a depreciation deduction).

However, if you're affected by either of the situations below, the simplest solution for you is to follow the instructions in the income tax and ERC section.

- You didn't reduce your wage expense on your income tax return and your claim was allowed
- You reduced your wage expense but your claim was disallowed

Q. Should I have reduced my wage expense on my income tax return when I filed for the Employee Retention Credit (ERC) (added March 20, 2025)?

A. Yes. The amount of your ERC reduces the amount of your wage expense on your income tax return for the tax year in which you paid or incurred the qualified wages.

Generally, a taxpayer can't deduct an expense as an ordinary and necessary business expense if they have a right or reasonable expectation of reimbursement at the time they paid or incurred the expense.

Taxpayers who are eligible for the ERC have a right or reasonable expectation of reimbursement for qualified wage expense in the amount of the ERC. For additional information, see Notice 2021-20 (in particular section II.F and questions 60 and 61 in section III.L).

The subsequent questions in this section explain how to resolve issues with income tax returns if you:

- Didn't reduce your wage expense and your ERC claim was allowed, or
- Reduced your wage expense and your ERC claim was disallowed.

As further described in news release IR-2022-89, taxpayers may be eligible for penalty relief related to ERC claims.

Q. I claimed the ERC but didn't reduce my wage expenses on my income tax return. The ERC claim was paid in a subsequent year. What do I do (added March 20, 2025)?

A. You should address your overstated wage expense. Under these facts, you're not required to file an amended return or, if applicable, an administrative adjustment request (AAR) to address the overstated wage expenses. Instead, you can include the overstated wage expense amount as gross income on your income tax return for the tax year when you received the ERC.

Example

Business A claimed an ERC of \$700 based on \$1,000 of qualified wages paid for tax year 2021 but did not reduce its wage expense on its income tax return for 2021. The IRS paid the claim to Business A in 2024, so Business A received the benefit of the ERC but hasn't resolved its overstated wage expense on its income tax return.

Business A does not need to amend its income tax return for tax year 2021. Instead, Business A should account for the overstated deduction by including the \$700 in gross income on its 2024 income tax return.

If the taxpayer capitalized wages or did not otherwise experience a reduction in tax liability for the overstated wage expense, the taxpayer might not need to include the overstated wage expense amount in gross income on the income tax return for the tax year in which the taxpayer received the ERC. Instead, the taxpayer may need to make other adjustments such as a reduction in basis for capitalized wages.

Why you need to include this amount in gross income. Under the tax benefit rule, a taxpayer should include a previously deducted amount in income when a later event occurs that is fundamentally inconsistent with the premise on which the deduction is based. If you received the ERC and did not reduce your wage expense on your income tax return for the year the wage expense was paid or incurred, your ERC claim and income tax return are inconsistent and you may be claiming an unwarranted double benefit. Application of this rule corrects a taxpayer's excess wage expense on the income tax return for the year in which it received the ERC, rather than limiting corrections to income tax returns for the prior year in which the ERC was claimed.

Q. What can I do if my ERC claim was disallowed and I'd already reduced my wage expense on my income tax return by the amount of ERC I expected (added March 20, 2025)?

A. If your ERC was disallowed and you had reduced the wage expense on your income tax return for the year the ERC was claimed, you may, in the year your claim disallowance

is final (meaning you are not contesting the disallowance or you have exhausted your remedies to argue against the disallowance), increase your wage expense on your income tax return by the same amount that it was reduced when you made your claim. Alternatively, you may, but are not required to, file an amended return, AAR, or protective claim for refund to deduct your wage expense for the year in which the ERC was claimed.

Example

Business B claimed the ERC for tax year 2021 and reduced its wage expense on its income tax return for tax year 2021 because it expected the credit would be allowed and paid. In 2024, the IRS disallowed Business B's ERC claim. Business B does not challenge the denial of the ERC claim and, accordingly, the disallowance is final.

Business B does not need to amend its income tax return for tax year 2021. Instead, Business B can address this adjustment on its 2024 income tax return by increasing its wage expense by the amount of the previously reduced wage expense from its 2021 income tax return.

Because taxpayers have a limited amount of time to file amended returns or AARs, if applicable, this process prevents the need for taxpayers to file protective claims for years where the time to file an amended return or AAR is quickly coming to a close. This process also gives relief to taxpayers who previously reduced wage expenses in tax years for which the assessment period has expired, and the taxpayer did not file a protective refund claim.

Why you can address the wage expense from your disallowed claim in a later tax year. The special statutory rules for the ERC treat a claimed ERC as a right or reasonable expectation of reimbursement for qualified wage expense, which serves as the basis for computing the ERC.

Therefore, you may be able to deduct the wage expense in a later year if you didn't get the expected reimbursement – in this case the ERC. You should treat the failure to receive the ERC the same way taxpayers can treat the failure to receive any other reasonably expected reimbursement that prevented them from deducting a business expense in the year they paid or incurred the expense.

The "special statutory rules" referred to here are:

- Section 2301(e) of the CARES Act for qualified wages paid between March 13, 2020, and June 30, 2021.
- IRC section 3134(e) for wages paid between July 1, 2021, and December 31, 2021.

Q. How do I report fraud regarding ERC (updated March 20, 2025)?

A. The IRS encourages people to report:

- Tax-related illegal activities relating to ERC claims
- Individuals who promote improper and abusive tax schemes
- Tax return preparers who deliberately prepare improper returns

To report tax-related illegal activities relating to ERC claims, take these steps.

- 1) Complete Form 14242, *Report Suspected Abusive Tax Promotions or Preparers*
- 2) Include with your form any supporting materials
- 3) Provide your contact information: This is optional but will be helpful if we have questions and will let us acknowledge receipt of your referral
- 4) Send your form and materials by fax or U.S. mail to the IRS Lead Development Center in the Office of Promoter Investigations

Mail:

Internal Revenue Service
Lead Development Center MS7900
1973 N. Rulon White Blvd.
Ogden, UT 84404
Fax: 877-477-9135