Businesses’ Wide Use of Covid Tax Break Alarms IRS

By Ruth Simon and Richard Rubin

A temporary tax break for small businesses has spawned a cottage industry of advisory firms tapping into federal pandemic aid, raising alarms at the Internal Revenue Service that some claims are going beyond what the law allows.

The Paycheck Protection Program and other federal aid programs long ago shut their doors. But small businesses and nonprofits battered by Covid-19 can still use a lesser-known lifeline, the employee-retention tax credit, or ERC. Businesses can claim up to $26,000 per employee in refunds by amending payroll tax returns from 2020 and 2021.

An array of firms has popped up with the express goal of getting more businesses to file ERC claims. They are using radio spots, online ads and cold calls to compete with one another and with traditional accounting firms, payroll companies and tax credit specialists. The IRS has already paid out more than $58 billion in ERC claims.

Howard Makler, chief executive of Innovation Refunds, said his firm spends nearly $10 million monthly on marketing and has completed more than 4,000 ERC filings totaling $1.35 billion. His business was focused on helping companies secure research and development tax credits when he learned about the ERC. “It was a larger opportunity,” he said. “We felt the ERC would be more valuable not only to ourselves, but to the companies that we serve.”

For small businesses that qualify, the ERC offers a welcome cash infusion as owners struggle with inflation, rising interest rates and tight labor markets. For those who stretch claims beyond the eligibility criteria, however, that move could be the first step toward a painful IRS audit.

The IRS had handled more than 450,000 claims through March and had up to 281,000 more to process as of early November. The agency says it views the ERC as a serious compliance issue; it has started audits, training 300 revenue agents on how to examine the credit. The IRS has sent some employers detailed requests for lists of employees and proof of eligibility, according to document requests viewed by The Wall Street Journal.

The IRS issued an October warning to employers to be wary of advertising, saying some advisers are taking improper positions on ERC eligibility and size. “It’s a bit of a gold rush,” said Gary Romano, president of Civitas Strategy, which has processed more than $125 million in ERC refunds for child-care providers.

Congress created the employee-retention credit in 2020 as a companion to the PPP, which provided forgivable loans. The idea: Reward employers who kept workers attached to their jobs.

Hal Cranmer, owner of A Paradise for Parents, which operates four assisted-living homes in Arizona, received more than $200,000 from the IRS in ERC after following up on a radio ad from Innovation Refunds. Mr. Cranmer paid 25% to Innovation Refunds for handling the claim. He said he used the money to provide bonuses to employees and to reinvest in his facilities.

Websites such as ERCadvisors.com, ERCfreefile.com and EnrollERC.com are soliciting small businesses. They have jumped into the market, saying that many accountants were too overwhelmed, too conservative or too unfamiliar with legislative changes to focus on ERC.

In the chase for clients, executives from ERC advisory firms insist they follow the rules while whispering about competitors cutting corners. The tax-credit boomlet, they warn, is filled with unqualified advisers charging exorbitant fees.

Kenny Dettman, an accountant who founded EZ-ERC, said his firm has submitted $513 million in claims. He said some rivals are using a cookie-cutter approach. “Copy, paste. Copy, paste. Copy, paste. Charge 35%,” he said. “It’s a hell of a business model until it catches up with you.”

To qualify for the ERC, employers must show a significant decline in gross revenue from 2019. They can also qualify if they experienced a full or partial suspension of operations because of government orders or were hurt by supply-chain disruptions caused by Covid-related government orders.

“The revenue decrease is science. The other two are art,” said David Goldin, managing member of Finance ERC.