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# IRS BACKLOG PUTTING SMALL BUSINESSES AT RISK

*Small businesses forced to wait years for billions in owed tax credits putting millions of jobs at jeopardy*

Congress created the employee retention tax credit (ERTC) in the CARES Act to encourage small businesses to keep employees on the payroll during the COVID-19 pandemic, and later expanded both the eligibility for and amount a small business could claim as this tax credit. Even though the IRS has dedicated additional resources to process ERTC claims, the **backlog of applications for this credit has increased almost 350 percent** since early August 2022 – with nearly 500,000 returns awaiting processing. These **delays have already caused some small businesses to permanently close their doors** and threaten the operations of thousands of small businesses and the millions of Americans they employ.

In particular, the small business clients of professional employer organizations (PEOs) have experienced long delays in the processing of their applications – with some small businesses still waiting on claims filed in early 2021. The **National Association of Professional Employer Organizations (NAPEO), which represents the PEO industry, surveyed 27 PEOs and found that 13,369 small business PEO clients are waiting for the IRS to approve $2.885 billion worth of ERTC credits**. The small businesses awaiting these credits have told their PEOs they have had to take out loans, lay-off employees, and cut costs as they wait for these credits to be approved. Unfortunately, some small business clients of PEOs have closed because their ERTC claims were not processed by the IRS in a timely manner.

Congress needs answers from the IRS on how the Service plans to eliminate the backlog of ERTC claims and ensure that future claims of payroll tax credits can be filed and processed quickly and efficiently.

### BACKGROUND ON THE ERTC

Congress enacted the ERTC as part of the CARES Act to encourage businesses to keep employees on the payroll during the COVID-19 pandemic. The ERTC is a credit against payroll taxes that was initially made available with respect to wages paid by eligible employers after March 12, 2020 and before January 1, 2021. The Consolidated Appropriations Act, 2021 (CAA) retroactively made the ERTC available to many more small businesses by eliminating the prohibition on employers claiming the ERTC if they received a covered loan under the Paycheck Protection Program. Congress further expanded and extended the ERTC so that it was generally available for wages paid through September 30, 2021.

In 2020, eligible employers could claim a maximum ERTC of $5,000 per employee. In 2021, the potential credit amount was increased significantly so that eligible employers could generally claim up to $7,000 per employee *per quarter* (for a per-employee maximum ERTC of $21,000 over Q1-Q3 2021). Apart from those limits, there was generally no aggregate cap on the amount of ERTC an eligible employer could claim. (Different rules applied for employers that met the definition of a "recovery startup business.")

### CLAIMING THE ERTC

Because the ERTC is a credit against payroll tax, it is claimed using the IRS's employment tax system. Instead of creating a separate tax form or process to help streamline ERTC claims, the IRS revised its existing employment tax returns (the quarterly-filed Form 941, for most employers), and required eligible employers to include any ERTC claims on their Form 941 for the applicable calendar quarter(s). Thus, an employer that was eligible to claim the ERTC for each quarter would have generally needed to claim the credit on six separate Forms 941 (Q2 2020 through Q3 2021).

Unfortunately, many eligible employers were unable to determine their eligibility for the ERTC until after the deadline to file the Form 941. This meant the only option to claim the ERTC was to file an amended employment tax return (Form 941-X) for *each quarter* in 2020 and 2021 during which they were entitled to the ERTC. Unlike Form 941, which may be filed electronically with the IRS, the only option employers have to file Form 941-X at this time is on paper.

**CLAIMING THE ERTC ON AGGREGATE RETURNS:**

Many small businesses do not file their own employment tax returns and instead have their employment taxes reported along with those of other small businesses on an "aggregate" Form 941, including when a small business hires a professional employer organization (PEO).[1] PEOs provide payroll, employee benefits, and human resource services to almost 200,000 small and mid-sized businesses (client employers) with 4 million employees nationwide. When a PEO files an aggregate Form 941 on behalf of its client employers, it files under the PEO's employer identification number (EIN). And, when a PEO claims a payroll tax credit on behalf of a client employer, IRS procedures generally require the PEO to file Schedule R (Form 941) to provide client-level information regarding the client employer's tax credit claim.

Because the IRS chose to incorporate the ERTC claims process into existing employment tax reporting procedures, small employers who use PEOs and other aggregate filers were required to claim the ERTC through the aggregate filer's Form 941/941-X. Similar to employers that file their own employment tax returns, small businesses that use PEOs were often unable to determine their ERTC eligibility in time for the PEO to make a claim on the aggregate Form 941. This has resulted in PEOs needing to file numerous aggregate Forms 941-X—even with respect to the same quarter—to assist their small business clients in claiming a refund for the ERTC.

**THE MASSIVE BACKLOG IS HARMING MANY SMALL BUSINESSES**

ERTC claims have led to the filing of ***unprecedented*** numbers of Forms 941-X with the IRS. The IRS's employment tax systems and procedures were simply not equipped to handle this influx, and it has led to an immense backlog of unprocessed Forms 941-X. As illustrated by the backlog numbers provided below, despite showing some progress earlier in 2022, the backlog is currently worse than ever.

| **DATE** | **IRS BACKLOG OF UNPROCESSED FORM 941-X** |
|---|---|
| January 26, 2022 | 445,000 |
| August 10, 2022 | 135,000 (low point of numbers reported on IRS.gov) |
| January 25, 2023 | 468,000 |

**Far too many of these unprocessed Forms 941-X represent a small business that has been waiting in many cases up to a year, two years, or longer to receive its ERTC**. A single unprocessed Form 941-X filed by a PEO can represent hundreds, or even thousands, of small businesses waiting on this much-needed tax relief. These astonishing delays in receiving the ERTC have been financially devastating for too many small businesses.

[1] The term "PEO" refers to both IRS-certified PEOs (CPEOs) defined in Code section 7705 and non-certified PEOs.