Fixing the IRS's Outdated Payroll Tax Credit Procedures That Punish Small Businesses

NAPEO-Supported Legislation Would Protect Small Businesses by Modernizing How the IRS Processes Payroll Tax Credits Claimed by PEOs

The IRS has taken the position that third-party payers, such as professional employer organizations (PEOs)[1], are liable for improperly claimed payroll tax credits taken by their clients on their aggregate tax filings. This position is inconsistent with the statute and congressional intent in creating such tax credits.[2] Representatives Beth Van Duyne (R-TX) and Mike Thompson (D-CA) have introduced bipartisan legislation (H.R. 3223) that would address the ongoing processing and liability challenges that continue to plague American small businesses.

NAPEO strongly supports H.R. 3223 which provides clarity for PEOs and their clients and will also save the government billions of dollars by deterring tax fraud and discouraging improper claims. Thanks to Reps. Van Duyne and Thompson, PEOs can better serve American businesses and we can all rest assured that future tax credits will go to the businesses they were intended to help.

Background

PEOs and other third-party payors file their clients' payroll taxes on an aggregate employment tax return using the PEO's or other third-party payor's employer identification number (EIN). This process creates efficiencies for small businesses and helps ensure that payroll taxes are paid on time to the Internal Revenue Service (IRS). But it also means that these "aggregate tax filers" can find themselves submitting dozens of small businesses' claims for payroll tax credits on a single original or amended employment tax return. Examples of payroll tax credits include the employee retention tax credit (ERTC) and the qualified small business payroll tax credit for increasing research activities (R&D credit).

The IRS has taken the position that aggregate tax filers are liable for any fraudulent or mistaken claims they filed on behalf of clients, even when the error was the result of required but unverifiable information provided to the aggregate tax filer by the client. Further slowing the process down is the IRS policy of holding all claims on an aggregate tax return if there is a problem with one client's claim for a payroll tax credit. Together, these challenges have made it more difficult for small businesses to claim and receive payroll tax credits.

Given the increasing number of payroll tax credits targeted at small businesses – many of which depend on PEOs for payroll processing and employment tax reporting – it is critical that Congress clarify an employer's eligibility and liability for payroll tax credits so that small businesses can receive properly claimed credits on a timely basis. In these situations, the only fair and logical

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

[2] Internal Revenue Code section 3134(m)

outcome is that the liability for such claims belongs to the entity that initiates and benefits from the claim and is only expanded to an aggregate filer in cases of fraud or knowledge of an improper payroll tax credit claim.

H.R. 3223 Would Sensibly Resolve Ongoing Challenges with Payroll Tax Credit Processing

This bill would ensure that payroll tax credit claims filed on an aggregate return by third-party payors are not delayed due to problems with any one client's claim, and that the liability for any improper claims is assigned to the entity that initiates and benefits from the claim unless the third-party payor failed to take certain clear steps prior to filing the claim. By taking these actions, the federal government would save money by clarifying responsibility for payroll tax credits and deterring fraud and small businesses would receive their payroll tax credits in a more timely manner.

Specifically, this legislation would:

- Ensure that any IRS audit or examination of a small business client of an aggregate tax filer does not delay the processing of any payroll tax credits claimed by the PEO or other third-party payor on behalf of other small business clients.

- Confirm that, with respect to any employer payroll tax credit, the small business client benefiting from the payroll tax credit is liable, and the PEO or other third-party payor is not liable, for any improperly claimed credit amount, provided that the PEO or other third-party payor took certain clear steps including:

    - Verifying certain wage information of which the PEO or other third-party payor has direct knowledge and collecting a certification from the client that includes certain information.

    - Accurately reporting the credit in accordance with the information certified by the client.

    - Providing the IRS with any information in its possession that the IRS could require the employer to provide, if needed to audit the employer.

- Be business-model neutral with respect to entities that file aggregate employment tax returns, that is, available to PEOs, IRS-certified PEOs, and agents under Code section 3504.