FINAL First Friday Hot Issues Summary – April 04, 2025

What we Want You to Know

ERC Update Question 1:

Q1. 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)

A1. 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 (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.

Q2. 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)

A2. 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.

Q3. 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)

A3. 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 ending. 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.
- Section 3134(e) of the Internal Revenue Code for wages paid between July 1, 2021, and Dec. 31, 2021.

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Unclaimed Refunds:

IR-2025-31, March 11, 2025

WASHINGTON — The Internal Revenue Service announced today that over 1.1 million people across the nation have unclaimed refunds for tax year 2021 but face an April 15 deadline to submit their tax returns.

The IRS estimates that more than $1 billion in refunds remain unclaimed by taxpayers who have not filed their Form 1040, Federal Income Tax Return, for the 2021 tax year. The IRS estimates the median refund amount is $781 for 2021. That means half of the refunds are more than $781 and half are less. This estimate does not include the Recovery Rebate Credit or other credits that may be applicable.

Under the law, taxpayers usually have three years to file and claim their tax refunds. If they don't file within three years, the money becomes the property of the U.S. Treasury.

The state-by-state table below shows the number of people who are potentially eligible for these refunds and the estimated median refund by state.

By missing out on filing a tax return, people stand to lose more than just their refund of taxes withheld or paid during 2021. Many low- and moderate-income workers may be eligible for the Earned Income Tax Credit (EITC). For 2021, the EITC was worth as much as $6,728 for taxpayers with qualifying children. The EITC helps individuals and families whose incomes are below certain thresholds. The thresholds for 2021 were:

- $51,464 ($57,414 if married filing jointly) for those with three or more qualifying children.
- $47,915 ($53,865 if married filing jointly) for people with two qualifying children.
- $42,158 ($48,108 if married filing jointly) for those with one qualifying child, and.
- $21,430 ($27,380 if married filing jointly) for people without qualifying children.

The IRS reminds taxpayers seeking a 2021 tax refund that their refunds may be held if they have not filed tax returns for 2022 and 2023. In addition, any refund amount for 2021 will be applied to amounts still owed to the IRS or a state tax agency and may be used to offset unpaid child support or other past due federal debts such as student loans.

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Current and prior year tax forms (such as the tax year 2021 Forms 1040 and 1040-SR) and instructions are available on the IRS.gov Forms & instructions page or by calling toll-free 800-TAX-FORM (800-829-3676).

Payment Options:

Pay your tax balance due, estimated payments or part of a payment plan. Penalties and interest will continue to grow until you pay the full balance.

Pay from your bank account

Pay now or schedule payments up to a year in advance.

Direct Pay with bank account

Debit card, credit card or digital wallet

For individuals and businesses. Processing fees apply. Not for payroll taxes.

Pay by card or digital wallet

Pay from your IRS account

Sign in or create an account to pay now or schedule a payment.

Individual Online Account

- Pay balance due, payment plan, estimated tax and more
- View amount due, payment plan details, payment history and scheduled payments

Pay in online account

Business Tax Account

- Make federal tax deposit payments
- Make balance due payments
- View payment history

Pay in business tax account

Electronic Federal Tax Payment System (EFTPS)

- Enrollment required to use this option

- Make payments from your bank account
- Make tax deposits; pay estimated taxes, Offer in Compromise (OIC) or other types of payments

Pay through EFTPS

Other ways you can pay

- Same-day wire — Bank fees may apply
- Check or money order — Through U.S. mail
- Cash — Through a retail partner and other methods
- Electronic funds withdrawal — During e-filing only

Prior Issues

Issue: TIGTA Report 020425 Erroneous Refunds

- A Computer Programming Change Is Needed to Delay the Erroneous Issuance of Refunds Based on Dishonored Checks
- Recommended that the IRS should ensure that a computer programming change is completed to delay the issuance of refunds based on payments for two cycles to provide the IRS time to receive dishonored check information from financial institutions.

Response: Effective 03/2025 Taxes paid by check will experience a 2-cycle delay in refund.

Status: CLOSED

Issue: IRS Online Installment Agreement Application within Tax Pro Account not working, practitioners are forced to go outside account to set up agreements.

Status: ELEVATED

Issue: Erroneous refunds created with individual bankruptcy estate tax returns, due to processing error:

- Per IRM and Publication 908 an individual bankruptcy estate tax return F1041 are filed together
- The 1041 is the cover sheet for the F1040 (where the tax calculations are made).
- Written at the top of the 1040 “attachment to F1041 – DO NOT DETACH

- The forms are separated in processing, initiating a CP268 "Overpayment of taxes" and subsequently an erroneous refund.

Status: ELEVATED

Please keep your feedback coming. Remember feedback requires identifying barriers AND providing possible solutions. Please send both to Area 4 (AR, FL, GA, LA, MS, PR, SC, TX, and U.S. VI) CL.SL.Area.4@irs.gov

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