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Comparing IRS Settlements: Easements and Employee Retention Credits

by Hale E. Sheppard

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Comparing IRS Settlements: Easements and Employee Retention Credits

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In this article, Sheppard examines the settlement opportunities offered by the IRS for conservation easement donations and employee retention credits and considers their pros and cons.

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I. Introduction

Things are dynamic when it comes to the employee retention credit. Among the most recent events is the introduction of the voluntary disclosure program (VDP), which is designed for taxpayers that previously filed ERC claims, got paid, later questioned their eligibility, and now want to give the money back with minimal financial downsides. The IRS says that it wants to help taxpayers victimized by aggressive marketing tactics or their own inexperience. Others, however, suspect that the VDP is more about the IRS's attempts to cope with the massive number of prior, pending, and future ERC claims with limited resources. The true rationale for the VDP is not terribly important, but understanding its precise terms, other recent settlement programs, and the pros and cons of participating sure is. This article, the latest in an ongoing series, compares methods used by the IRS in addressing conservation easement donations and ERCs and then poses some questions to consider.[1]

II. Easement Donations: IRS Methods

Lots of attention is now focused on ERC issues, but conservation easements dominated the headlines for a long time. The IRS has used many of the same tools in both scenarios.

A. Backstory

Taxpayers who own undeveloped property have several options. They might hold it as an investment and sell when the price is right. Another option is to figure out how to maximize profitability from the property and do that immediately, regardless of the negative effects it might have on others. Yet another possibility is voluntarily restricting future uses of the property to benefit society as a whole. The last option, known as donating a conservation easement, triggers tax deductions for donors.[2]

Congress has allowed tax deductions for conservation easement donations for more than

[1]Readers seeking more details about ERC rules and issues should see the following articles by the same author: Hale E. Sheppard, *Tax Notes Federal*, Feb. 19, 2024 (forthcoming); Sheppard, "ERC Enforcement Tactics: The IRS's Carrots and Sticks So Far," *Tax Notes Federal*, Feb. 5, 2024, p. 1017; Sheppard, "IRS Tries to Further Limit ERC Claims Under Governmental Order Test," *Tax Notes Federal*, Jan. 29, 2024; Sheppard, "Employee Retention Credits: What the IRS Didn't, Did, and Might Do," *Tax Notes Federal*, Oct. 23, 2023, p. 619; Sheppard, "Employee Retention Credits: Reasons for Prolonged Claims," *Tax Notes Federal*, Oct. 16, 2023; Sheppard, "Employee Retention Credits: Analyzing Key Issues for 'Promoters' and Other 'Enablers,'" 139 *J. Tax'n* 15 (2023); Sheppard, "IRS Clarifies Limited Eligibility of Federal Credit Unions for ERCs," *Tax Notes Federal*, Sept. 4, 2023, p. 1615.

[2]Section 170(f)(3)(B)(iii); reg. section 1.170A-7(a)(5); section 170(h)(1) and (2); reg. section 1.170A-14(a) and (b)(2).

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five decades.[3] This concept was codified in 1980 with the enactment of section 170(h).[4] Congress created this provision because it believes that "preservation of our country's natural resources and cultural heritage is important."[5]

Things are not all rosy, though. The IRS came to suspect that some taxpayers were abusing this incentive by claiming unwarranted or inflated tax deductions. Thus, in late 2016, the IRS announced in Notice 2017-10, 2017-4 IRB 544, that it intended to challenge what it coined syndicated conservation easement transactions (SCETs).[6] In addition to labeling them "listed transactions," the IRS featured SCETs on its "Dirty Dozen" list for years.[7] The IRS did not stop there; it took several other enforcement actions, with varying degrees of success. These included launching a compliance campaign, auditing every single tax return reflecting an SCET, filing an injunction action to halt certain activities, engaging in a media blitz, starting many promoter investigations, instructing revenue agents to issue more summonses, eliminating the multilayer review process before proposing penalties against appraisers, authorizing criminal investigations, making improper contacts with third parties, denying pre-litigation review of certain cases by the Independent Office of Appeals, and more.[8]

The IRS realized at some point that all its efforts in combatting SCETs were insufficient. The sticks, in other words, were not yielding the desired results. The IRS decided to switch gears and offer taxpayers carrots instead. These came in two forms, as described below.

B. Withdrawal Option

The IRS first encouraged individual partners of partnerships that engaged in SCETs to resolve their issues by filing qualified amended returns (QARs). This requires some explanation.

When a tax underpayment is attributable to one of several things, the IRS can assert an accuracy-related penalty.[9] For individual taxpayers, an "underpayment" ordinarily means the difference between the tax liability that taxpayers reported on their Form 1040, "U.S. Individual Income Tax Return," and the tax liability they would have reported if they had correctly completed their Form 1040 in the first place.[10] For instance, if the true tax liability was $100,000 but the taxpayers only reported $80,000 on their Form 1040, then the IRS could assert a penalty of $4,000 (that is, a $20,000 tax understatement multiplied by 20 percent).[11]

The QAR is an obscure mechanism allowing taxpayers to correct a tax underpayment after filing their original Form 1040 with the IRS. In essence, if an individual taxpayer files a Form 1040 and later realizes that it showed a tax underpayment, he has a limited opportunity to submit a QAR to rectify the situation proactively and avoid penalties.[12] The taxpayer obtains the benefit in the following manner: The tax liability shown on the original Form 1040 is deemed to include the additional tax reflected on the subsequent QAR.[13] Modifying the basic example above, if the taxpayer filed a Form 1040 showing a tax liability of $80,000 and later submitted a QAR indicating a revised liability of $100,000, then no underpayment would exist, and the IRS would have no grounds for asserting the penalty.

The purpose of the QAR rules is "to encourage voluntary compliance by permitting taxpayers to avoid accuracy-related penalties by filing a [QAR] before the IRS begins an investigation of the taxpayer or the promoter of a transaction in which the taxpayer participated."[14]

Turning back to SCETs, in late 2019, the IRS published an information release encouraging

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[3] Tax Reform Act of 1969, section 201; H.R. Conf. Rep. No. 91-782 (1969); *see also* Tax Reform Act of 1976, section 2124(e); *see also* Tax Reduction and Simplification Act of 1977, section 309.

[4] Tax Treatment Extension Act of 1980, section 6(a); S. Rep. No. 96-1007 (1980).

[5] *Id.* at 9.

[6] Notice 2017-10, preamble and section 1.

[7] *See, e.g.*, IR-2019-47.

[8] Sheppard, "30 Wrongs Do Not Make a Right: Revealing Extraordinary IRS Actions in Conservation Easement Disputes," 135 *J. Tax'n* 21 (2021).

[9] Section 6662(a).

[10] Section 6664(a); reg. section 1.6664-2(a). The definition of underpayment is considerably more complicated, but a simplified and abbreviated version suffices to make the critical points in this article.

[11] Section 6664(c)(1).

[12] Reg. section 1.6664-2(c)(3)(i).

[13] Reg. section 1.6664-2(c)(2).

[14] T.D. 9186, preamble, background.

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taxpayers to file QARs, with promises of penalty waiver in exchange for a full, voluntary concession of all tax benefits. In it, the IRS commissioner made the following proclamation:

> "If you engaged in any questionable [SCET], you should immediately consult an independent, competent tax advisor to consider your best available options. It is always worthwhile to take advantage of various methods of getting back into compliance by correcting your tax returns before you hear from the IRS.". . .
>
> Taxpayers may avoid the imposition of penalties relating to improper contribution deductions if they fully remove the improper contribution and related tax benefits from their returns by timely filing a [QAR] or timely administrative adjustment request.[15]

C. Settlement Initiative

The IRS later won a few Tax Court cases focused on supposed technical flaws in the easement-related documentation.[16] It then tried to capitalize on this momentum by introducing a settlement initiative in 2020, the key aspects of which are summarized below.[17]

1. Unanimous participation.

The IRS began by resolutely stating that the settlement initiative was only open to partnerships all of whose partners agreed to the terms. However, the offer letters sent to particular partnerships explained that the IRS "might consider" resolving cases in situations in which fewer than all partners agreed to settle. The IRS emphasized, though, that "greater penalties" might be imposed against the partners in those situations. Later IRS guidance exhibited some flexibility on this point. It revealed that the IRS might consider settling with just a group of partners, as long as that group represented a "significant percentage" of all the ownership interests in the partnership and other factors were met.[18]

2. Two types of partners.

The settlement initiative delineated two types of partners. Category one partners were those who engaged in any of the following activities or who met any of the following criteria for any SCET, even those in prior years: (1) participated, directly or indirectly, in organizing, selling, or promoting any SCET, issuing an appraisal, supplying legal or tax advice, or providing return preparation services; (2) was a material adviser to such a participant; or (3) was "related" to any person who engaged in any of the activities listed above. Partners were forced to consider all their past behavior, for all partnerships, to determine whether the IRS would deem them category one partners. By default, category two partners were those who were not category one partners.

3. Three costs.

Partnerships or partners concluding matters under the settlement initiative had to pay a settlement amount, which was composed of three parts: taxes, penalties, and interest.

Under the settlement initiative, the partnership could not claim, under section 170 or another federal tax provision, any of the charitable deductions that it originally claimed on its Form 1065, "U.S. Return of Partnership Income," for the SCET. Category one partners, moreover, could not claim a tax deduction for the cash or other property that they contributed to participate in an SCET. In other words, category one partners got a charitable deduction of $0 and lost their investment in the partnership. Category two partners had it a little better: They also suffered a charitable deduction of $0, but they were allowed to claim a tax deduction equal to the out-of-pocket amount they paid to participate in the SCET. Many SCETs offered a return of approximately $5 in tax deductions for each $1 of capital contribution, so category two partners

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[15] IR-2019-182; *see also* IR-2019-213.

[16] *See, e.g.*, *Dasher's Bay at Effingham LLC v. Commissioner*, No. 4078-18 (T.C. order Dec. 10, 2019); *Ogeechee River Preserve LLC v. Commissioner*, 2771-18 (T.C. order Dec. 10, 2019); *Riverpointe at Ogeechee LLC v. Commissioner*, No. 4011-18 (T.C. order Dec. 10, 2019); *River's Edge Landing LLC v. Commissioner*, No. 1111-18 (T.C. order Dec. 10, 2019).

[17] IR-2020-130; CC-2021-001; IR-2020-228; for details regarding the evolution of the settlement initiative, see Sheppard, "Questions Remain About the Conservation Easement Settlement Initiative," *Tax Notes Federal*, Sept. 21, 2020, p. 2219; and Sheppard, "Conservation Easement Settlement: More Guidance, More Questions," *Tax Notes Federal*, Nov. 16, 2020, p. 1085.

[18] CC-2021-001, Q&A B(2).

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could claim a charitable deduction of $1 instead of $5 under the settlement initiative. They could, in effect, pretend that they had made a cash donation to the United Way, Red Cross, Salvation Army, or another legitimate charity.

For category one partners, the highest penalty asserted by the IRS in the notice of final partnership administrative adjustment, or the highest penalty later asserted by the IRS attorney during Tax Court litigation, would apply. This normally was the 40 percent penalty for a "gross valuation misstatement" or the 75 percent penalty for civil fraud. For category two partners, the size of the penalty depended on the return-on-investment ratio, for which three possibilities existed. If the partner claimed a charitable deduction that was between 1 and 5 times their investment in the partnership, then the penalty was 10 percent of the tax underpayment. However, if the partner took a deduction that was between 5.1 and 8 times their investment, then the penalty increased to 15 percent. Finally, in situations in which the partner claimed a deduction that was more than 8.1 times their investment, the penalty jumped to 20 percent.[19]

The partnership had to aggregate and pay all interest for all partners and years, on both the tax liabilities and penalties.

4. Full payment.

The partnership, or group of participating partners, had to fully pay the settlement amount upon executing the closing agreement.[20]

5. No modifications.

The IRS halted any thoughts of partnerships and partners customizing terms based on their unique circumstances. Indeed, it explained that "no provision" of the closing agreement "was subject to negotiation."[21]

6. No criminal waiver.

The offer letters emphasized that participation in the settlement initiative would not affect the IRS's ability to later assert criminal penalties, promoter penalties, appraiser penalties, return preparer penalties, or any other penalties. If that were not clear enough, the offer letters went on to state that nothing in the settlement initiative "precludes the [IRS] from investigating any associated criminal conduct or recommending prosecution of any individual or entity that participated in, or assisted or advised others in participating in, [an SCET]."

7. Ongoing cooperation.

The partnership and the partners had to "fully cooperate" with the IRS, which included supplying the IRS with items designed to facilitate the audit or investigation of others involved with SCETs. These consisted of correspondence, emails, and other communications and documents exchanged between a partner and other partners, representatives or agents of the partnership, promoters, appraisers, return preparers, tax advisers, and so on.[22]

III. ERCs: IRS Methods

It seems that few have noticed, but the methods used by the IRS in the ERC context are quite similar to the ones it employed earlier when combatting SCETs. Take a look.

A. Backstory

Congress first enacted the Coronavirus Aid, Relief, and Economic Security Act in March 2020.[23] The law generally provided that an eligible employer could get ERCs against certain employment taxes equal to 50 percent of the qualified wages it paid to each employee, subject to various limitations.[24] Things were positive at the outset. The IRS published several items in early 2020 notifying taxpayers of various tax benefits introduced by Congress for businesses harmed by COVID-19, including the ERC.[25] Other early pronouncements from the IRS were uplifting; they told taxpayers that the ERC had

[19] The IRS warned that these penalty percentages might increase slightly if not all partners agreed to participate in the settlement initiative. *See* CC-2021-001, Q&A B(3) and C(7)(b).

[20] *Id.* at Q&A F(1).

[21] *Id.* at Q&A E(1)(a).

[22] *Id.* at Q&A D(1)(b).

[23] Joint Committee on Taxation, "Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security Act," JCX-12R-20 (Apr. 23, 2020); *see also* Notice 2021-20, 2021-11 IRB 922.

[24] CARES Act, section 2301(a).

[25] IR-2020-62; FS-2020-05; IR-2020-89; IR-2020-221.

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been extended three times by Congress, making benefits available throughout 2021.[26]

Things went downhill from there. Marking the first anniversary of the ERC's introduction, the IRS explained that criminal investigations and civil examinations were underway.[27] It later disseminated a tax tip with a straightforward message: "Watch Out for Employee Retention Credit Schemes." It explained that the IRS had been warning taxpayers about promoter scams for a long time, yet taxpayers not meeting the eligibility standards continued filing ERC claims.[28] The IRS continued down this path, later announcing that improper ERC claims not only made it onto the "Dirty Dozen" list, but topped it.[29] More recently, IRS enforcement officials acknowledged that the ERC constitutes a "substantial compliance issue" because of the huge number of claims and the high incidence of noncompliance, with "much of it bordering on fraud."[30]

Similar to what occurred in the SCET context, the IRS realized that its sticks (including warnings, investigations, and examinations) were insufficient. Therefore, dusting off its normal playbook, the IRS dangled the following two carrots.

B. Withdrawal Option

The IRS announced in September 2023 that it would soon introduce a special withdrawal option for taxpayers that previously filed ERC claims, have not yet received the tax benefits, and want to reverse course with the IRS on the most favorable terms possible.[31] The IRS officially unveiled the program a month later.[32] Its objective was to "help small business owners and others who were pressured or misled by ERC marketers or promoters into filing ineligible claims."[33] The IRS also suggested that the withdrawal option was designed "to help honest taxpayers" who "mistakenly claimed the ERC."[34]

The withdrawal option functions as follows: An employer can apply if (1) it made an ERC claim on an amended employment tax return, such as a Form 941-X, "Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund"; (2) it filed that return solely for purposes of claiming the ERC; (3) it wants to retract the entire ERC claim, not just reduce it; and (4) the IRS has not yet issued the ERC, or the employer has not yet cashed or deposited the check.[35]

The withdrawal option features distinct methods for three categories of employers — namely, those that have not received ERC refunds and have not been notified by the IRS of an audit, those that have not received ERC refunds but have been advised of an audit, and those that have received ERC refund checks but are holding them.[36]

The IRS indicates that it will send applicants a letter "about whether their withdrawal request was accepted or rejected." It does not mention any specific reasons why particular employers might be rebuffed, but one assumes that this might occur if the IRS has prior indications of intentional misconduct, civil fraud, criminality, or the like.[37] Consistent with that idea, the IRS expressly warns that an employer that filed fraudulent ERC claims, assisted in doing so, or conspired to do so would not be exempt from criminal investigation and prosecution simply by applying for the withdrawal option.[38]

Some practitioners predicted that participation by employers in the withdrawal option would be "underwhelming" because many are unaware of its existence or believe in good faith that their pending ERC claims are legitimate. The IRS commissioner acknowledged

[26] IR-2021-21; IR-2021-74; IR-2021-65.

[27] IR-2021-65.

[28] IRS Tax Tip 2023-44.

[29] IR-2023-49.

[30] Nathan J. Richman, "Employee Retention Credit Claimants May See Help From IRS," *Tax Notes Federal*, June 12, 2023, p. 1862.

[31] IR-2023-169.

[32] IR-2023-193; Joseph DiSciullo, "Fact Sheet Explains How to Withdraw Claims for Employee Retention Credit," *Tax Notes Federal*, Oct. 30, 2023, p. 883.

[33] IR-2023-193.

[34] FS-2023-24.

[35] *Id.*

[36] *Id.*

[37] *Id.*

[38] *Id.*

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that early interest in the withdrawal option was low.[39]

C. Settlement Initiative

The IRS indicated in September 2023 that it planned to introduce a settlement program later in the year.[40] True to its word, the IRS formally announced the VDP for ERCs in December 2023.[41]

1. Eligibility standards.

Not all employers are eligible for the VDP; the IRS had to draw the line somewhere. It explained that an employer can apply only if it meets all the following criteria: (1) The employer is not under IRS criminal investigation; (2) the employer has not already been notified that the IRS intends to start a criminal investigation; (3) the IRS has not received information from a third party alerting it to the employer's noncompliance; (4) the IRS has not acquired information of noncompliance directly from an enforcement action; (5) the employer is not under an employment tax audit by the IRS for any tax period for which it is applying for the VDP; and (6) the employer has not previously received a notice and demand from the IRS for repayment of all or a portion of an ERC claim.[42]

The IRS clarified that an employer that uses a third-party payer, like a professional employer organization, can apply for the VDP. However, the third-party payer must submit the application on its behalf.[43]

2. Application process and settlement terms.

Here is what an employer must do to apply for the VDP: (1) complete, sign under penalties of perjury, and electronically file a Form 15434, "Application for Employee Retention Credit (ERC) Voluntary Disclosure Program" by March 22; (2) return to the IRS 80 percent of the ERCs it previously received; (3) execute a closing agreement; (4) make full payment electronically before signing the closing agreement, or apply for an installment agreement; (5) if entering into an installment agreement, pay the taxes, applicable penalties, and interest charges; (6) if the ERC claims involve any quarters in 2020, grant the IRS additional time by executing Form SS-10, "Consent to Extend the Time to Assess Employment Taxes"; and (7) supply detailed information to the IRS about any individual, business, or organization that assisted the employer in making ERC claims.[44]

What is the IRS offering to induce participation by employers? If an employer repays 80 percent of the ERCs previously received, the IRS will waive all penalties and interest on the amount returned. In addition, the IRS will not characterize as income the 20 percent that an employer gets to retain. Lastly, an employer can claim a wages-paid deduction for income tax purposes for 100 percent of the relevant wages, even though it is only paying 80 percent thanks to the VDP.[45]

3. No criminal waiver.

The IRS expressly states that applying to the VDP is not a panacea. It indicates that executing a closing agreement under the VDP "does not preclude the IRS from investigating any associated criminal conduct or recommending prosecution for violation of any criminal statute, and does not provide immunity from prosecution."[46]

4. No second-guessing the IRS.

The IRS emphasizes that it has the last word on eligibility; it says that denial of a VDP application "is not subject to judicial review or administrative appeal."[47] It also explains that an employer that does not agree to the terms of the closing agreement after being accepted into the VDP cannot engage in mediation with the IRS. Moreover, participation in the VDP requires the

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[39] Jonathan Curry, "IRS Expects Interest in ERC Withdrawal to Pick Up Soon," *Tax Notes Federal*, Dec. 18, 2023, p. 2231.

[40] IR-2023-169.

[41] Announcement 2024-3, 2024-2 IRB 364; Lauren Loricchio, "IRS Launches ERC Voluntary Disclosure Program," *Tax Notes Federal*, Jan. 1, 2024, p. 188.

[42] Announcement 2024-3, section 2.

[43] *Id.*

[44] Announcement 2024-3, section 3.

[45] *Id.*

[46] Announcement 2024-3, section 4.

[47] *Id.*

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execution of a closing agreement, the terms of which cannot be appealed in any manner.[48]

5. Ongoing cooperation.

The IRS indicates that an employer must cooperate with the IRS after filing the VDP application, which includes, but is not limited to, responding in a timely and accurate manner to all requests by the IRS. The IRS warns that lack of cooperation will deprive an employer of all VDP benefits and might lead to "civil and criminal interest and penalties."[49]

IV. Participation Levels and Considerations

Settlement efforts by the IRS in the two areas have yielded different questions and results.

A. Settlement Initiative for SCETs

The IRS introduced the settlement initiative for SCETs amid lots of noise but later eliminated it quietly. It appears that the IRS simply stopped sending offer letters to partnerships at some point in 2021 and never released statistics regarding participation levels. The IRS tends to broadcast absolutely anything that it considers a victory, so the abrupt termination of the settlement initiative and subsequent silence left many speculating that most partners were not tempted by the IRS's olive branch.

There were several reasons for their not participating. For starters, many partnerships could not convince all partners to embrace the settlement initiative, as required — particularly the category one partners who were facing a tax deduction of $0, a loss of their capital contribution to the partnership, and penalties of 40 percent (if the IRS alleged a gross valuation misstatement penalty) or 75 percent (if the IRS alleged a civil fraud penalty). Another reason is that not all partners had enough cash to pay the taxes, penalties, and interest, even if they wanted to end things. Lastly, a significant number of category two partners were simply unwilling to accept a severely limited tax deduction, plus penalties of 10, 15, or 20 percent, without a fight. This desire for their day in court increased in instances in which their partnerships had conducted substantial due diligence before engaging in the SCET, obtained one or more compelling appraisals, relied on various specialized professionals, secured transactional documents devoid of serious technical flaws, and counted on a sizable defense fund or tax defense insurance.

B. Voluntary Disclosure Program for ERCs

The VDP for ERCs does not close until March 22, 2024, so the degree of participation by employers is unknown at this point. Those reflecting on the issue will have much to consider. On the one hand, certain aspects of the VDP support accepting the deal, such as the following:

- the employer is only required to repay 80 percent of the ERC amount;
- the IRS will not classify the 20 percent retained by the employer as income;
- the employer can claim a wages-paid deduction for income tax purposes for 100 percent of the wages, even though it is only paying 80 percent of them;
- participation in the VDP generally will eliminate a long list of potential civil penalties often threatened by the IRS, including those for late payments, improper federal tax deposits, and inaccurate returns; and
- after the parties execute a closing agreement, the IRS will adjust its internal accounts to reflect the retracted ERC amount, so that the employer is not required to prepare and submit additional Forms 941-X for each applicable quarter.

On the other hand, some factors weigh in favor of not applying for the VDP. Here are a few that employers might be considering:

- the need to repay 80 percent of the ERC claims;
- payment immediately, or in the short term under an installment agreement;
- imposition of late-payment penalties and interest if an installment agreement is necessary;
- the negative financial effect of making a large payment on the current and future operations of the employer;

[48] IRS, "Frequently Asked Questions About the Employee Retention Credit Voluntary Disclosure Program" (last updated Jan. 8, 2024).

[49] *Id.*

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- the VDP does not feature a "pre-clearance mechanism," meaning that an employer essentially must state to the IRS, under penalties of perjury, that its earlier ERC claims were invalid without any assurance that it will benefit from the VDP's protection;
- the IRS has sole discretion to determine whether an employer is eligible, and the IRS has authority to later jettison an employer from the VDP and revoke all benefits if, in its opinion, an employer has not adequately cooperated with all aspects of the VDP;
- litigation is underway to determine whether Notice 2021-20 (and by extension other IRS guidance about the ERC) is invalid because it was issued in violation of the Administrative Procedure Act;
- under many contracts, the repayment of ERCs will not trigger the right to a refund of contingency fees from the professionals that assisted in procuring the ERCs;
- voluntarily repaying the IRS without first determining the appropriateness of ERC claims through an audit, administrative appeal, or tax litigation could weaken or eliminate any potential cause of action by an employer against any party that allegedly misadvised it;
- participation in the VDP does not ensure a lack of criminal charges;
- the possible obligation to continue interacting with the IRS even after participating in the VDP, such as being required to provide data or serve as a witness in future IRS examinations or investigations focused on other parties;
- the massive number of ERC claims already processed by the IRS, pending with the IRS, or soon to be submitted to the IRS;
- the limited human resources available to the IRS and Justice Department for ERC enforcement activities;
- the relatively short period during which the IRS can audit and propose adjustments under the normal three-year assessment period, or even the extended five-year period for the third and fourth quarters of 2021, as well as the temporal restraints on the Justice Department initiating an erroneous refund suit after payment of ERCs; and
- the challenges the IRS faces in penalizing employers that relied in good faith on third parties in light of the announcements indicating that the IRS created the withdrawal option and the VDP "to help businesses that found themselves victims of aggressive promoters," it sees "a variety of ways that promoters can lure businesses, tax-exempt groups, and others into applying for the credit," and it recognizes that the ERC is "a complex claim with precise requirements," "an incredibly complex claim," and "a very technical area of the law."[50]

V. Conclusion

The previous settlement initiative for SCETs had low levels of participation by eligible partnerships and partners, and it is too early to gauge public interest in the VDP for ERCs. At least two certainties exist today, though. The first is that employers have many factors to ponder in deciding whether applying for the VDP is the right choice for their particular situation. The second is that, regardless of how many employers throw in the proverbial towel by participating in the VDP, there are bound to be lots of ERC battles in the future. The legal and tax issues are too complicated, the IRS's resources are too strained, some of the standards are too subjective, and the amount of money at stake in many cases is too large for any other outcome. ■

[50] IR-2023-169; *see also* IRS, "Employee Retention Credit Eligibility Checklist: Help Understanding This Complex Credit" (Sept. 14, 2023).

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