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Payroll Insights

Employment tax news to guide you now and for the future

April 2023

John's *fresh take*: Employee Retention Credit fraud

Enacted three years ago on March 27, 2020 as part of the CARES Act, the Employee Retention Credit ("ERC"), was designed to benefit eligible employers who continued to pay wages during the COVID-19 pandemic shut down. Rules regarding eligibility and claiming the ERC was unclear to many taxpayers, as the Act contained many undefined terms with immediate application. The IRS's guidance was initially informal and evolved into Notice level safe-harbors. Some third parties have taken advantage of the ambiguity many taxpayers faced in determining the ERC and are falsely claiming that they can help taxpayers claim the ERC, even if the taxpayer is ineligible for the credit.

On November 7, 2022, the IRS issued its **first warning** advising employers to be careful of promoters advising them to claim the credit in these circumstances. These third parties are not only charging large upfront fees or a contingent fee on total credits claimed, but they are failing to notify business taxpayers that certain wage deductions claimed on the taxpayer's federal income tax return should be reduced by the credit. On March 7, 2023, the IRS issued a renewed warning, due to the increase of third parties aggressively advertising these schemes. The IRS is now conducting criminal investigations in relation to these claims and is strongly advising businesses to do their research before filing to claim the ERC on the Form 941-X, *Adjusted Employer's Quarterly Federal Tax Return of Claim for Refund*.

Businesses should be aware of these schemes, and the IRS is encouraging taxpayers to make sure they understand the credit prior to claiming it, without regard to any push they might receive from third parties. If a business is unsure about their eligibility for the ERC, they should consult with a tax professional, or refer to IRS guidelines.

Federal updates

IRS updates for reducing return processing times

Digital Intake Scanning Initiative

The IRS shut-downs in response to the COVID-19 pandemic exacerbated and highlighted the existing processing inefficiencies and outdated systems for processing paper tax forms. As reported in the January edition of Payroll Insights, the 2022 Annual Report to Congress issued January 11, 2023, by the National Taxpayer Advocate emphasized the backlog of paper tax returns and recommended that the IRS create additional e-filing capabilities. Instead, the IRS is concentrating on a "Digital Intake" scanning initiative and has claimed some success.

The Digital Intake is a multi-form, multi-solution scanning initiative intended to create efficiencies for both IRS processors and taxpayers. In a March 8, 2023 press release (IR-2023-41), the IRS Commissioner stated that, year to date, the IRS has processed more than 120,000 Forms 940, which is 20 times more than this time last year. The press release reports that the initiative is expanding to include Forms 1040 and 941.

Electronic Filing Mandates

While many tax returns may only be filed electronically by third parties, any taxpayer can file information returns, e.g., Forms W-2 and Forms 1099, electronically. A taxpayer is required to file these forms electronically if it is filing 250 or more forms, per form type, in a calendar year. In 2021, the Treasury Department began discussions for reducing the threshold in order to increase the number of forms filed electronically. Due to taxpayer concerns of registering for an e-file account and establishing the necessary systems and controls, the IRS postponed implementing lower thresholds.

On February 23, 2023, the Department of Treasury published Federal Register Document 2023-03710 amending the applicable Treasury Regulations to reduce the threshold for electronic submission of information returns from 250 to 10 or more forms. Further, the threshold is applied to all information returns filed by a taxpayer, not per-form type. The rules are effective with returns filed in 2024 (i.e., 2023 reporting forms).

Foreign per diem rates

On March 1, 2023, the U.S. Department of State published updated per diem rates for lodging, meals, and incidentals during international business travel.

Review of IRS processes and recommendations for Independent Contractor Classification Relief

The Treasury Inspector General for Tax Administration ("TIGTA") finalized the publication of its 2022 audit of the IRS Small Business/Self-Employment Division's internal controls for the selection and determination of employment tax examinations, with a specific focus on the process used to grant Section 530 relief. Report Number 2023-30-009 ("the Report") found that the Division lacked proper documentation and clear procedural guidelines for following through with examinations. As a result, worker classification reviews as part of some employment tax audits were inconsistent and lacked documentation for application of the same relief in subsequent employment tax audits of a taxpayer.

Section 530 of the Revenue Act of 1978 provides taxpayers relief from worker misclassification under audit. Section 530 allows a taxpayer to continue to classify workers as independent contractors without penalty, even if the IRS determines the worker should be classified as an employee under the common law tests. In order to qualify for this relief, the company must have met the following conditions: 1. reporting consistency, 2. substantive consistency, and 3. reasonable basis.

In response to the Report (Appendix II), the IRS Small Business/Self-Employment Division Commissioner has agreed to implement a series of corrective measures, such as developing proper documentation, performing managerial reviews, creating a desk guide containing guidelines for granting Section 530 relief, and issuing a policy alert providing examiners standard language to explain the results of worker classification exams. These corrective measures are to be implemented by November 15, 2023.

State updates

California Appeals Court upholds Prop 22

On March 13, 2023, a California appeals court upheld most of Proposition 22 ("Prop 22"), also known as the Protect App-Based Drivers and Services Act, in a 2 to 1 decision. California voters passed Prop 22 in November 2020. Prop 22 provides for an exemption for certain app-based driving companies, such as Uber and DoorDash, from the California "ABC test" used to classify workers as employees or independent contractors for employment tax purposes. Instead, the workers will be classified as independent contractors if certain conditions are met by the hiring company, outlined in California BPC Section 7451.

The appeals court reversed the lower court's ruling that Prop 22 is not legal because it does not comply with the state constitution's restriction on the legislature's ability to regulate the state's workers compensation system and separation of powers principle. While the appeals court agreed that certain restrictions were violated, it ruled that the portion of the law exempting the app-based drivers from the ABC test is upheld.

While it is anticipated that the Service Employees International Union will appeal the decision to the California Supreme Court, the exemption provided by Prop 22 will remain in effect while the legal arguments continue.

Oregon Paid Family and Medical Leave ("PFML") Insurance

Effective January 1, 2023, Oregon has implemented requirement for contributing to the state PFML insurance program. Unless the employer carries an equivalent plan and files an application to be exempt from the state program, contributions and reports will be due quarterly by the last day of the month following the end of the quarter. For employers with fewer than 25 employees, contributions of 0.6% of the first $132,900 of wages should be collected. For employers with 25 or more employees, there is an employer contribution requirement of 0.4% of the first $132,900 of wages.

Updates to State Unemployment Insurance

AL issued its unemployment insurance tax rates for 2023. Rates range from 0.2% to 5.4%, a significant reduction from prior years. The taxable wage base is unchanged from 2022 at $8,000.

IN released its 2023 Employer Handbook reporting tax rates ranging from 0.5% to 7.4% with the new employer rate unchanged at 2.5%. The taxable wage base is also unchanged from 2022 at $9,500.

MD confirmed there will be no changes to the unemployment insurance taxable rates (1% to 10%) or wage base ($8,500) for 2023.

NM released its unemployment insurance tax rates and taxable wage base for 2023. Rates range from 0.33% to 5.4%. The taxable wage base increased from $28,700 to $30,100.

NY released its unemployment insurance tax rates and taxable wage base for 2023. Rates range from 2.1% to 9.9% with the new employer rate set at 4.1%. The taxable wage base increased from $12,000 to $12,300.

TN confirmed there will be no changes to the unemployment insurance taxable rates (0.01% to 10%) or wage base ($7,000) for January 1, 2023 through June 30, 2023.

TX released its unemployment insurance tax rates and taxable wage base for 2023. Rates range from 0.23% to 6.23%. The taxable wage base is unchanged from 2022 at $9,000.

Meet one of our Employment Tax Professionals: Danielle Norris

Danielle Norris is an Associate with our team in Atlanta, Georgia and has been with the firm since 2021. Danielle assists clients with state payroll tax issues, notice resolution and annual reporting compliance at the federal, state, and local levels. Danielle enjoys travelling to her hometown in the British Virgin Islands and is looking forward to getting in as much time at the beach as possible this summer.

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