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Mitigating Risk: Should Cannabis Businesses Withdraw ERC Claims?

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The IRS has recently made two significant announcements regarding Employee Retention Credit or “ERC” claims. First, on September 14th, 2023, the IRS announced an immediate moratorium on the processing of ERC claims through the end of the year, in response to a concern that a “substantial share of new claims...are ineligible and increasingly putting businesses at financial risk by being pressured and scammed by aggressive promoters and marketing.” Second, on October 19, 2023, the IRS announced a new ERC withdrawal process, allowing taxpayers who may be concerned about the accuracy of their claim, including eligibility, to withdraw the claims as though they were never filed, and avoid future tax penalties.

The ERC has been the subject of aggressive marketing by companies willing to file the forms, particularly on behalf of small businesses that may not have access to financial or legal advisors, in exchange for a percentage of the credit. Many taxpayers, including cannabis businesses, may have fallen victim to these “unscrupulous promoters” and may have filed claims without an understanding or even an analysis of their eligibility.

What is the ERC?

The ERC is a refundable tax credit for businesses and tax-exempt organizations, enacted as part of the CARES Act (Coronavirus Aid, Relief, and Economic Security) benefits to encourage employers experiencing a business downturn (see more details below) during the COVID-19 pandemic to keep employees on their payroll.

The qualification for eligibility is different depending on the quarters for which a business is claiming the credit, which can be claimed from March 13, 2020 through September 30th 2021. If a business is eligible, it can claim up to \$5000 per employee in 2020 and \$7000 per employee for each quarter of 2021. Cannabis businesses are not specifically excluded from claiming the credit, so many cannabis businesses have filed claims.

Who Qualifies?

There are specific eligibility requirements for the ERC. Eligible employers must have sustained a full or partial suspension of operations due to orders from a governmental authority or experienced a significant decline in gross receipts during 2020 and through the first three quarters of 2021. Not all cannabis businesses are eligible because many were allowed to operate as “essential businesses” during COVID and as a result,

experienced a surge in sales rather than a decline in gross receipts. Whether or not your cannabis business qualifies for ERC depends on the facts and circumstances of your business's operations, applicable governmental orders, and even the number of your employees.

Why is the IRS concerned?

The IRS both halted claim processing and created a withdrawal process amid a surge of potentially fraudulent submissions, filed by businesses unaware of the significant penalties for an improper claim. In its September 14th announcement (IR-2023-170), the IRS reminded taxpayers that any business with improper ERC claims must pay it back, with penalties and interest. That could leave your business in a worse position than if no claim had been filed, especially if the business paid a hefty fee to the promoter/preparer. Some reported fees have been in excess of 20% of the actual credit.

The consequences of failing an ERC audit can be significant. Penalties can range from the 20% accuracy-related penalty, the 75% fraud penalty, or even the 100% trust fund recovery penalty, depending on the circumstances. The IRS may even pursue criminal charges.

Many ERC promoters have failed to conduct one iota of due diligence or analysis to determine whether a business qualifies for the ERC. Some promoters have claimed they can determine a business's eligibility for the credit in mere minutes. This is impossible—accurately evaluating a business's qualification takes time and a thorough analysis. Some promoters failed to provide any documents supporting their calculations or the basis for a business's eligibility.

How to Determine if Your Cannabis Business Should Withdraw its ERC Claim?

If any of the above sounds familiar, and your business jumped on the ERC bandwagon without adequate analysis and substantiation, you might want to consider withdrawing your ERC claim. Now, the most important action a cannabis business can take is to conduct a true analysis of its eligibility, which is not a “one size fits all” approach, as the scammers might have you believe. It requires an in-depth review of the facts and circumstances surrounding the business's operations from March 2020 through September 2021, a review of the applicable governmental orders, and substantiation of the basis for any claim. We all know cannabis businesses are already highly scrutinized by the IRS, and in its the September 14, 2023 announcement the IRS stated it would conduct “more detailed” and “stricter” compliance reviews.

Other reasons you may want to withdraw your ERC claim include to avoid personal liability for trust fund taxes and to remove obstacles to selling your business that may exist if ERC clawbacks are a possibility.

What if My Cannabis Business Has Already Filed an ERC Claim?

On October 19th, 2023 the IRS announced (IR-2023-193) a special

withdrawal process for any taxpayer concerned about the accuracy of or its eligibility for the claim. If your business has already filed a claim you may be eligible to withdraw if **all** of the following apply:

1. You made the claim on an adjusted employment return (Forms 941-X, 943-X, 944-X, CT-1X).
2. You filed the adjusted return only to claim the ERC and made no other adjustments.
3. You want to withdraw the entire amount of their ERC claim.
4. If the IRS has not paid the claim, or the IRS has paid the claim but you haven't cashed or deposited the refund check.

If your cannabis business is not eligible to withdraw, your business may still reduce or eliminate its ERC claim by filing an amended return.

If you are not sure whether your cannabis business qualified for the ERC or you don't have any documentation substantiating the computations or the basis of your business's eligibility, the IRS encourages employers to work with a trusted tax professional (a credentialed professional like a certified public accountant, an attorney, or enrolled agent) who understands the complex ERC rules to determine a business's eligibility and to determine the amount of any claim. A trusted tax professional can also determine whether withdrawal of your ERC claim is advisable.

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