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CARES Act COVID-19 Employee Retention Credit: Understanding Your Risk

Maximize Credit.
Minimize Risk.
Be Audit-Ready.

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Minimizing the Risk of Future Audit

While the risk of audit can never truly be zero, there are some proactive steps you can take to protect yourself as much as possible.

This begins with the way you extract the data and qualify wages. Having a methodical approach can be the shield you need to protect your claim. TCC takes a four-tiered approach to minimize this risk:

- Tier 1: This is the lowest hanging fruit; time that is charged to a COVID code in your payroll, while the employee was not providing actual services for the company.
- Tier 2: Also low hanging fruit; where no COVID code exists, but the wages can be tied to a well-documented company policy.
- Tier 3: Represents higher risk of audit than the previous tiers; where no easy way to identify qualified wages exist, however there is a decrease in relevant KPIs or operational metrics.
- Tier 4: Represents the highest risk of audit; qualified wages are extrapolated using an interview process and/or statistical sampling of a select group of employees, and then applied over the greater employee population.

One of the most important components of your tier 3 and 4 wages is the survey and interview process you use to extract and qualify the information.

Interview Best Practices

You'll want to design these interviews and survey questions up front, to ensure accuracy and efficiency. Your ability to defend your claim in the event of an audit is directly tied to the quality of the information you receive, how you went about documenting it, and if it is consistent with the guidelines set out by the IRS FAQ.

In addition, this survey will need to be easily navigated by both the interviewer and interviewee (employee). It should be easy, unambiguous and take only a few minutes to complete.

Tip: There's a great deal of psychology involved with conducting an interview process of this nature. It can be extremely difficult to extract accurate information when employees need to answer the question "Please tell me how much time you spent not working."

In order to improve your results, have a "Product Champion." This person is a well-liked, respected individual who can help set the tone by communicating to employees in advance the importance of honesty and accuracy — and that they will not be penalized as answers will remain anonymous.

Here are some additional measures you can take to ensure the survey and interview process are successful:

Before you create the survey, start off with some initial questions with a department head, such as;

- What were your tasks pre-COVID?
- What were your tasks post-COVID?
- How has your role changed, and how are you replacing that time?
- What is the value of these activities?

"The key to a successful interview comes down to two things: tell the truth and conduct your interview in a way that seeks only to elicit the facts."

— **Peter Mehta**
Managing Director of R&D, Tax Credit Co
Former Managing Director of Tax Controversy Services, Deloitte

Have someone present who is well versed in complex tax credits like the ERC, and can help provide context and answer questions.

One of the most damaging decisions you can make as a company when claiming your ERC is not understanding the risk associated with each tier outlined above. A great tax credit service partner will give you complete visibility into risk/reward scenarios before the credit is calculated.

Cost-Benefit Analysis — Understanding Your Risk

Making key business decisions every day is about deciding between trade-offs — in order to get “Y” you must give up “X”. Calculating and claiming your ERC is not much different.

Before you even start the process of calculating, verifying and documenting your ERC you need to know your risk tolerance as it pertains to each tier of qualified wages (see above). Your tax services partner should be able to give you insight into what that might look like.

For example, in order to go after an additional $3 million in potential tax credits, you’re going to have to interview 100 people, extrapolate the results through stat sampling and assume “X” amount of audit risk.

In fact, you may be more interested in avoiding unwanted surprises than maximizing your credit, and having a high level of transparency is *essential* in being able to make conscious, rational decisions.

Your ideal tax services partner will give you key insight into:

1. What kind of positions you are taking
2. Why you’re taking them
3. Why they’re relevant, and
4. What the possible risk is

One of the biggest potential risks you face is a lack of transparency from your tax credit service partner. ROI doesn’t just mean maximizing your credit, but also limiting your exposure financially, operationally and legally.

Your return on investment is threatened when you assume too much risk. The benefits you receive are diminished when audit fees reach 30–50% or more of what you spent on the initial credit services.

Having Multiple Checkpoints to Mitigate Risk

Adding an additional layer of risk mitigation will be essential for companies to be able to adjust on the fly and reassess their strategy.

Consider taking a gated approach, and assess the level of risk at each stage:

Gate one: This is your planning phase; before doing any field work at all, putting together the methodology needed. This is based on an understanding of your company and payroll where you can assess the following questions:

- Where are my low risk areas of eligibility and what methodology should be used?
- Where are my high risk areas of eligibility and what methodology should be used?
- What is the expected operational burden to accomplish this?

Gate two: This is where credit has been calculated; once you understand what the number is and what key assumptions were made in order to calculate it, it's time to put it on a return.

Gate three: This is where you deliver all of the backup and supporting documentation; think of this as your final delivery and presentation meeting.

These three gates exist to ensure that you're thinking about methodology and assumptions constantly - in this way you can better assess where to pivot if needed, and where the "juice is worth the squeeze."

IRS Audit Expectations — Looking Ahead

This guide has been designed to help you protect your credit in the event of an audit, but what happens in that possibility that your business is put on the short list?

How will the recent events of the pandemic affect how "sympathetic" the IRS is to both small and large employers?

While there is no way to know for certain, there are a few things to consider.

IRS FAQ and Legislation

The employee retention credit was legislated in order to react quickly to a fast moving, widespread pandemic — which means that it was both rushed and written with ambiguity.

With service providers taking very different positions on what qualifies and doesn't qualify under the ERC, expect the audit experience to reflect this.

You'll also need to keep a keen eye on how legislation changes throughout the coming weeks and months.

Temporary Sympathy

While corporate audits are at their lowest point in 10 years, expect that this will not be the case moving forward.

This has largely been due to challenges caused by the pandemic for conducting in-person audits, however the IRS is making exceptions in order to accommodate for this, with an expansion of remote auditing capabilities.

Federal and State Budgets

The main question here is “what resources does the IRS really have to audit this?”

If the IRS is limited by budgets, they may opt to identify “trends” or common denominators for greater efficiency. Essentially, that means looking for certain positions that companies took in their claim, red flagging it and going after those ones first. In addition, with the federal gross debt being nearly $27 trillion you should expect a certain level of “buyer's remorse." The government may need to recoup as much of the credit as possible that it has awarded companies throughout the pandemic.

Maximize Credit. Minimize Risk. Be Audit-Ready.

Although the IRS has been easing up on audit activity as businesses across the United States face unprecedented challenges due to the COVID-19 pandemic, audits or corrective guidance will inevitably occur sometime in the future.

The CARES Act COVID-19 Employee Retention Credit (ERC) presents a window of opportunity for businesses of all types and sizes, as it is intended to be an incentive for employers that have done right by their employees.

By partnering with the right experts, companies can minimize risk and maximize their tax credit benefits but also stay on top of every development, adjust their claim accordingly, and ultimately ensure the maximum allowable credit in the end.

Tax Credit Co.

The Best Defense Against Future Audit

TCC is a tax incentive services company with over 25 years of experience helping clients with complex tax credits.

Our full-service ERC option uses a technology-focused approach, combined with consulting expertise. Experts come with experience from leading national providers such as Fortune 500 companies, Big 4 Accounting Firms, top SAAS, Technology and Security companies, and the IRS.

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