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Did You Receive a Notice of Claim Disallowance for Your Employee Retention Credit Refund Claim? If So, Now What?



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During the last few weeks, the IRS sent about 28,000 Notices of Claim Disallowance – Letters [105C](#) or [106C](#) – to businesses rejecting their claims for the Employee Retention Credit (ERC) and will send more disallowance notices in the upcoming months. I suspect many business owners receiving these notices were confused and had many questions, including “**What does this mean?**”, “**Why me?**”, or “**Now what do I do?**”. Unfortunately, a number of the notices were not clear or did not include information on the businesses’ appeal rights. [Taxpayers need to know](#) what happens if they file a protest requesting Appeals consideration.

Quick Background

Congress authorized the ERC to provide financial relief to businesses and other entities during the COVID-19 pandemic by providing an incentive to retain employees they may otherwise have chosen to lay off. However, the ERC’s complex eligibility framework, often-lucrative value, and an unregulated preparer industry has made it vulnerable to infiltration by unscrupulous actors who aggressively marketed scams and misled business taxpayers under the guise of lawful services, often for large fees.

Due to concerns about erroneous claims, the IRS:

- Implemented compliance enforcement initiatives;
- Drastically slowed ERC processing for stricter review; and
- Imposed a moratorium on processing ERC claims filed on or after September 14, 2023.

The IRS pivoted from processing ERC claims to using analytics to help review and assess the risk of ERC claims. When it imposed the moratorium, the IRS had a backlog of over 665,000 ERC claims, and only five percent were over 120 days old. Over ten months later, the total number of unprocessed ERC claims has doubled to over 1.4 million, with almost **97 percent** over 120 days old. Although slowing ERC claim processing may aid the IRS in protecting against improper claims, the deliberately slow pace has caused significant delays and harm to many businesses.

For many months I have been advocating for the IRS to lift the moratorium and pay the valid claims for the many businesses still waiting to receive their refunds. I was glad to see on August 8, 2024, the IRS announced that it [will start processing claims](#) filed through January 31, 2024, and will be sending over 50,000 refunds to businesses that filed claims prior to the moratorium. I encourage the IRS to continue on this track and move quickly toward either approving claims or, if necessary, requesting taxpayers provide supporting information.

Although the IRS believed these were the low-hanging fruit among both the qualifying and non-qualifying claims, initial responses from some practitioners indicate that some of these disallowed claims are likely to qualify. In addition, some of the disallowance letters failed to inform taxpayers of their appeal rights or the basis for the disallowance, [which the IRS acknowledges was a mistake](#). I discuss this issue in more detail later in the blog and provide recommendations as to how the IRS can right this wrong.

What Taxpayers Should Know If They Received a Notice of Claim Disallowance

The manner in which the IRS generated this most recent batch of ERC disallowances and the process the IRS will use to review taxpayers’ responses to these denials deviates significantly from normal IRS procedures. Typically, the IRS issues a notice of claim disallowance after conducting an examination (audit) of the taxpayer’s claim. During this examination, the taxpayer can provide support for their refund claim. If the IRS disallows a taxpayer’s claim, the taxpayer can choose to have the examiners’ determination reviewed by the IRS’s Independent Office of Appeals (Appeals) by submitting a protest requesting an administrative review of the IRS’s determination, which under IRS administrative rules should generally be submitted 30 days from the date on the notice of claim disallowance. As the 30 day period is only an administrative deadline, **we recommend that the IRS provide additional time** for taxpayers to submit a protest. Considering the long delay in processing these claims and the errors in the notices of claim disallowance the IRS should be flexible.

By contrast, the IRS did not subject disallowed ERC claims to an examination; rather, the IRS conducted a risk-scoring analytic process. For these disallowed claims, the IRS’s analytics determined the claim showed a high risk of being incorrect without first conducting an examination. Another stark difference from normal IRS processes is the processing pipeline in which a taxpayer’s response to a notice of claim disallowance will travel. In fact, it almost turns normal IRS processes on its head. Specifically, when a taxpayer responds to a notice of claim disallowance they believe they are submitting a protest of the denial to Appeals, which is standard practice. However, this response will generally first be reviewed by the IRS and sent to a Revenue Agent for consideration.

The IRS is not calling this review an examination, but if it looks like a duck and walks like a duck... Based upon the response the IRS can allow the claim, request additional documentation from the taxpayer, or uphold the denial after considering all available documentation and forward the response to Appeals. It is only after this quasi-exam that the taxpayer’s response would be sent to Appeals.

The IRS is still working to finalize this process, but taxpayers should receive a letter from the IRS informing them a review of their response has been conducted and their case is being forwarded to Appeals. I recommend the IRS provide a detailed explanation of the basis for the disallowance and provide taxpayers an opportunity to respond to issues or questions identified during the IRS review process. This letter should include a deadline by which the taxpayer can provide additional information in response to the IRS’ determination. This process would more closely mirror the examination process of a Revenue Agent issuing a Revenue Agent Report and allowing the taxpayer an opportunity to respond to issues and conclusions in the report. If taxpayers do not respond to this letter or if the IRS is still not persuaded after receiving even more information from the taxpayer, the IRS should forward the case to Appeals.

Taxpayers Should Be Aware: Appeals is Not a Finder of Facts

Under current procedures, Appeals does not consider new information the IRS did not review first. Thus, if the IRS does not allow the taxpayer the opportunity to respond to the IRS’s conclusion after reviewing the taxpayer’s response to the notice of claim disallowance, the IRS may ultimately treat the taxpayer’s case like a ping-pong ball. Specifically, if the IRS does not afford the taxpayer the opportunity to provide new information as part of the IRS review process, the taxpayer may do so once in Appeals. In this case, Appeals would send the case back to the IRS review function for further consideration of the new facts. This back-and-forth would undoubtedly elongate an already lengthy IRS process.

Taxpayers Need To Be Prepared that this Process Will Be Lengthy

It is important for taxpayers and practitioners to understand that any IRS process involving a review of facts and circumstances, along with a referral to Appeals for its consideration, is going to be lengthy. Taxpayers should anticipate it will take many months, or even longer, before the IRS makes a determination prior to forwarding the protest to Appeals. Additionally, once the case is assigned to Appeals, it can take up to five months or longer to hold an initial Appeals conference.

Taxpayers who qualify may want to request an [Appeals Fast Track](#) (FT). However, there is a question as to whether taxpayers who are responding to this batch of ERC notices of disallowance will qualify. FT is designed to quickly resolve a dispute between IRS Exam and the taxpayer. As mentioned above, taxpayers who respond to these notices of claim disallowance are going to be subject to an “exam-like” review, thereby potentially disqualifying them from seeking FT. Because the IRS is employing what is effectively an exam process, and having most of these taxpayer responses reviewed by a Revenue Agent, it should exercise its administrative authority and allow these taxpayers to request an FT.

Taxpayers Have Two Years to File Suit in the U.S. District Court or the U.S. Court of Federal Claims

If a business who received a claim disallowance does not wish to contest the ERC disallowance, they do not have to do anything further. But if the business wants to pursue its claim in the courts, they may file suit in a U.S. district court or the U.S. Court of Federal Claims after receiving the notice of claim disallowance, whether or not they’ve first sought review of their claim in Appeals.

Taxpayers who wish to file suit must do so within two years of receiving the notice of claim disallowance. The two-year period runs from the date on the top right-hand corner of the first page of the notice of claim disallowance. Not only does the taxpayer only have two years to file suit, but the IRS cannot issue the taxpayer a refund beyond this two-year period. In other words, if the taxpayer goes to Appeals, and Appeals agrees with the taxpayer but the two-year period has expired, the IRS cannot issue a refund because any such refund would be considered erroneous. It is important to note that going to Appeals does not extend this time period to file suit or for the IRS to issue a refund. However, the time period can be extended if the IRS and taxpayer agree and sign a Form 907.

Filing suit can be an expensive option. Before taxpayers take this journey, they should first ask themselves whether the claim disallowance is appropriate and the IRS is correct, or if they have compelling arguments as to why they are entitled to the ERC that deserve further review. The ERC rules are complex, so determining eligibility may not be a quick and simple answer. Depending on the basis for the disallowance, the taxpayer may need to consult with a tax professional to review the merits of their claim before making a decision to move forward with litigation.

Recommendation and word of caution: Be diligent in selecting an advisor to help you determine the strength of your case and next steps. If you believe your claim qualifies, don’t give up. But as you make that assessment, be realistic and remember the adage, “if it sounds too good to be true, it probably is.”

At the end of this blog, I am providing links to IRS publications that may assist in determining eligibility.

Problems With IRS Notices of Claim Disallowance Caused Confusion

As I mentioned towards the beginning of this blog, the IRS’s notices of claim disallowance had problems causing many taxpayers to be confused. Specifically, taxpayers reported these notices omitted language explaining their rights and offered unclear explanations of the reason(s) for the disallowance. Although in the IRS’s August 8, 2024, announcement, it stated that more than 90 percent of the notices of claim disallowance were “validly issued,” this doesn’t mean they didn’t contain errors – rather, it only means the IRS believes the errors did not invalidate the notices. Thus, I suspect it’s possible – if not *likely* – that many of the notices, even if valid, contained errors. The IRS acknowledged in its August 8, 2024, news release,

“The IRS learned that some of the recent early mailings have inadvertently omitted a paragraph highlighting the process for filing an appeal to the IRS or district court, and the agency is taking steps to ensure this language is mailed to all relevant taxpayers. Regardless of the language in the notice, the IRS emphasizes taxpayers have administrative appeals rights available to them...”

Another complaint TAS has heard from taxpayers and practitioners involves incorrect explanations of the basis on which the IRS denied the claim. This indicates the IRS may have a problem with its risk-scoring filters. These errors have left taxpayers in a precarious situation. For instance, if taxpayers believed the explanation in the notice of claim disallowance is incorrect, do they only provide documentation to respond to what they believe is an incorrect conclusion? Or do they provide enough documentation to support the ERC claim more broadly? This is the tough predicament the IRS has put taxpayers in. This is further complicated by the lack of information the IRS has made available regarding the process for reviewing taxpayer responses to the notices of claim disallowance, and when these responses will reach Appeals. It is my understanding that the IRS intends to send letters to taxpayers recognizing that some notices of claim disallowance

contained errors and reiterate a taxpayer's right to seek review of the IRS's determination from Appeals. These letters should also correct any errors related to the explanation of the disallowance, while clearly setting out the IRS's process for reviewing taxpayer responses to the disallowances and forwarding cases to Appeals. In this letter, the IRS should provide these taxpayers additional time for submission of their claim disallowance protest.

Conclusion

I understand the challenges the IRS is facing. But as I speak to taxpayers, practitioners, and others in the tax community, I hear all too often that they are confused and frustrated by the IRS's delays and its approach in addressing ERC claims. Undoubtedly, the ERC was a large credit designed to assist businesses during an unprecedented time in our nation's history, and some aggressive advisers or bad actors have wrongfully claimed those businesses are eligible for that assistance. I also understand the IRS's objective is both to protect the government fisc and to process and approve legitimate claims. But all taxpayers who have filed ERC claims are entitled to clear and concise information regarding when it will process claims, where their claim is in the processing pipeline, why their claim was denied, and what they can do to appeal a denial. The IRS needs to apply an all-hands-on deck approach in processing these claims and be creative in moving them toward finality. Businesses have waited too long for these much-needed funds provided by Congress.

Recently, the IRS has been posting more information about its ERC procedures on [IRS.gov](#). Therefore, if you have received a notice of claim disallowance denying your ERC claim, I encourage you to check the IRS website periodically to determine whether the IRS has made any decisions or changes in policy that may affect your claim.

Resources

- [TAS Tax Tip: How Taxpayers Can Respond to Notices of Claim Disallowance on Their ERC Claim](#)
- [Frequently asked questions about the Employee Retention Credit](#)
- [IRS moves forward with Employee Retention Credit claims: Agency accelerates work on complex credit as more payments move into processing; vigilance, monitoring continues on potentially improper claims](#)
- [Employee Retention Credit Eligibility Checklist: Help understanding this complex credit](#)
- [IRS provides details of second Employee Retention Credit Voluntary Disclosure Program; program for improper claims open through Nov. 22](#)
- [Fast Track](#)

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