



707 North St. Asaph Street  
Alexandria, VA 22314  
703-836-0466  
www.napeo.org

## **The National Association of Professional Employer Organizations (NAPEO) Statement for the Record**

**Pat Cleary  
President and CEO**

**U.S. House of Representatives  
Committee on Ways and Means  
Subcommittee on Oversight**

**Hearing on The Employee Retention Tax Credit Experience: Confusion,  
Delays, and Fraud**

**July 27, 2023**

The National Association of Professional Employer Organizations (NAPEO) thanks Chairman Schweikert and Ranking Member Pascrell and members of the Oversight Subcommittee for holding this important hearing on the Employee Retention Tax Credit (ERTC). Today's hearing is critical in shining a light on and getting the Internal Revenue Service (IRS) to do more to ensure small businesses can fully realize the assistance Congress provided in the ERTC. Continuing delays in the IRS's processing of ERTC claims mean that some small businesses that did the right thing and retained their employees during difficult economic times are still waiting for the help they were promised.

NAPEO recently surveyed 43 of its professional employer organization (PEO) members and found among those respondents that nearly 18,000 small business clients are still waiting for the IRS to approve at least \$3 billion in ERTC credits that were filed before 2023. That is real money, owed to real employers, who retained real employees—and these figures represent only a fraction of all employers who have yet to receive their credits. How much longer do these small businesses need to wait?

NAPEO represents approximately 230 PEOs that provide payroll, benefits, risk management, regulatory compliance assistance, and other HR services to nearly 200,000 small and mid-size businesses employing four million people. Our members account for more than 90 percent of the industry's \$273 billion in revenue. Nearly 15 percent of businesses with between 10 and 99 employees' partner with a PEO.

PEOs are champions for their small business clients and their employees. Through a PEO, the employees of small businesses gain access to Fortune 500 employee benefits such as: health insurance, dental and vision care, life insurance, retirement saving plans, job counseling, adoption assistance, educational benefits, and other benefits they might not typically receive as employees of a small company. And, by

providing payroll, benefits, and HR services and assisting with compliance issues under state and federal law, PEOs allow small businesses to improve productivity and profitability, to focus on their core mission, and to grow. We appreciate this opportunity to share our views on how to ensure small businesses finally get the critical help Congress provided to keep employees on the job during unprecedented economic turmoil.

## **Executive Summary**

Congress enacted the ERTC in March 2020 as part of the CARES Act to encourage businesses to keep employees on the payroll during the COVID-19 pandemic. Despite lawmakers' intent that the ERTC provide immediate tax relief to employers experiencing financial harm during the pandemic, tens of thousands of employers are still waiting for the IRS to process their ERTC claims. As most of the country moves on from the pandemic, these employers—many of whom are small businesses—remain in an untenable position as they continue to wait for the IRS to deliver the assistance Congress authorized more than three years ago and to which they are entitled under the law. ***In fact, many of those small businesses are still waiting, in some cases two years or longer (and counting), for their ERTC claims.***

NAPEO's PEO members have seen first-hand the harm that the IRS's long ERTC processing times have wrought on the small businesses they serve, because ERTC funds are vital to keeping the small business afloat. Making things even worse, our members have also witnessed many of their small business clients being preyed upon repeatedly by the so-called ERTC mills whose high-priced business models depend on perpetuating highly questionable—if not fraudulent—ERTC claims. We ***share and fully support*** the IRS's and this committee's efforts to root out and prevent ERTC fraud. Every fraudulent claim filed by ERTC mills further delays the IRS's ability to review and approve the legitimate ERTC claims NAPEO members have filed for their small business clients. However, it is the very fact of the delay that has breathed life into these ERTC mills. Absent the backlog, they would not exist, preying on small businesses desperate for the funds they were promised.

NAPEO recognizes that the IRS is facing competing and very challenging demands. On the one hand, it is imperative that the IRS process the outstanding ERTC claims as quickly as possible so that businesses receive their much-needed tax refunds. On the other hand, we appreciate that the IRS has a responsibility to watch for potentially fraudulent ERTC claims, which slow processing times and could result in a small business being held liable for the ERTC mill's actions. NAPEO encourages the Oversight Subcommittee to work with the IRS to address both demands. Even more critical is holding the IRS accountable for continuing to ***dedicate additional resources to processing ERTC claims until all older claims filed from 2020-2022 are completely processed and resolved.*** While these fly-by-night mill operations continue to prey upon unsuspecting small businesses, PEOs rely on well-established business relationships their small business clients. In addition, the PEO industry has a strong relationship with the IRS, submitting billions of dollars of small business employee's payroll taxes in an accurate and efficient manner. Given these facts, plus the industry's working relationship with the IRS, the Service should prioritize the processing of amended PEO returns, knowing that the odds of fraud are very low, and that thousands of small businesses will be provided their ERTC. If the IRS wishes to help small businesses, they need look no further than processing PEO client ERTC claims.

Multi-year delays of this magnitude in the delivery of small business tax relief cannot be allowed to happen again. In addition to clearing the existing ERTC backlog, NAPEO urges Congress to secure a commitment from the IRS that it will implement the technology needed to prevent a repeat of what

occurred with the ERTC. This needs to include electronic filing and processing capabilities for all employment tax forms and related schedules, especially the amended employment tax returns that today are only available for filing with the IRS on paper.

## **Actions Needed Now to Prevent More Harm to Small Businesses**

While the pandemic is beginning to feel like a memory, the financial devastation experienced by many small businesses unfortunately continues. NAPEO respectfully asks the Oversight Subcommittee hold the IRS responsible for the following actions:

- **Maintain focus on clearing the existing ERTC backlog.** As the backlog numbers illustrated below indicate, the IRS made significant progress in reducing the ERTC backlog in recent months. But the recent uptick over the past few weeks is a cautionary tale that the backlog concerns are not over. We urge the IRS to continue dedicating additional resources to the backlog until all ERTC claims filed in 2020, 2021, and 2022 have been processed. Once that is accomplished, the IRS must continue to monitor the backlog to ensure that any ERTC claims filed in 2023 or later are being timely processed.
- **Prioritize and commit to fully resolving the oldest ERTC claims.** As discussed below, NAPEO members report that many ERTC claims filed in 2020, 2021, and 2022 remain unresolved, even as the IRS recently reduced the backlog by hundreds of thousands of applications. It is imperative that the IRS complete its review and processing of these older claims as soon as possible. ***The IRS's work to clear the backlog of unprocessed returns is not over until the processing is complete.***
- **Help prevent and address bad actors promoting improper ERTC claims.** In serving their small business clients, NAPEO's members have too often had front-row seats in witnessing the many ERTC mills try to take advantage of small businesses by hounding them with promises of tax credits that are too good to be true. PEOs, as well as the many accountants and other tax professionals that serve small businesses, have sounded the alarm on these mills and cautioned their clients to seek trusted advice regarding a potential ERTC claim. NAPEO urges both Congress and the IRS to hold the mills accountable for any actions that harm small businesses and to take steps to reduce the mills' ability to exploit the tax laws in the future.
- **Take steps now to ensure that small businesses never again experience a similar delay in obtaining critical tax relief.** The pandemic laid bare many of the problems with having an antiquated IRS, not least of which are the ERTC delays that are largely attributable to employers having to file their ERTC claims on the paper-only Form 941-X. It is essential that the IRS prioritize making Form 941-X available for electronic filing, and to ensure that robust programming is in place to electronically process all employment tax forms and related schedules, including Schedule R.

## **ERTC & PEOs: Helping Struggling Small Businesses**

### **What PEOs Do**

PEOs provide payroll, employee benefits, and human resource services to almost 200,000 small and mid-sized businesses (what are called "client employers") with four million employees nationwide. When a small business uses a PEO (including an IRS-certified PEO or "CPEO"), the small business no longer files

its own employment tax returns. Instead, the small business' employment taxes are reported together with those of the PEO's other client employers on an "aggregate" employment tax return (Form 941) that is filed by the PEO using the PEO's employer identification number (EIN).

## **ERTC and How PEOs Support Small Employers**

Congress enacted the ERTC as part of the CARES Act to encourage businesses to keep employees on the payroll during extreme economic disruption during the COVID-19 pandemic. The ERTC is a credit against payroll taxes that was initially made available with respect to wages paid by eligible employers after March 12, 2020, and before January 1, 2021. The Consolidated Appropriations Act of 2021 (CAA) retroactively made the ERTC available to many more small businesses by eliminating the prohibition on employers claiming the ERTC if they received a covered loan under the Paycheck Protection Program. Congress further expanded and extended the ERTC in the American Rescue Plan Act of 2021 so that it was generally available for wages paid through September 30, 2021.

In 2020, eligible employers could claim a maximum ERTC of \$5,000 per employee. In 2021, the potential credit amount was increased significantly so that eligible employers could generally claim up to \$7,000 per employee per quarter (for a per-employee maximum ERTC of \$21,000 over Q1-Q3 2021). Apart from those limits, there was generally no aggregate cap on the amount of ERTC an eligible employer could claim. (Different rules applied for employers that met the definition of a "recovery startup business.")

### *Claiming the ERTC*

Because the ERTC is a credit against payroll tax, it is claimed using the IRS's employment tax system. Instead of creating a separate tax form or process to help streamline ERTC claims, the IRS revised its existing employment tax returns (the quarterly-filed Form 941, for most employers), and required eligible employers to include any ERTC claims on their Form 941 for the applicable calendar quarter(s). Under this system, an employer that was eligible to claim the ERTC for each quarter would have generally needed to claim the credit on six separate Forms 941 (Q2 2020 through Q3 2021).

Unfortunately, many eligible employers were unable to determine their eligibility for the ERTC until after the deadline to file the Form 941. This meant the only option to claim the ERTC was to file an amended employment tax return (Form 941-X) for each quarter in 2020 and 2021 during which they were entitled to the ERTC. Unlike Form 941, which may be filed electronically with the IRS, **employers must file Form 941-X on paper.**

### *Claiming the ERTC on Aggregate Returns*

As described above, many small businesses do not file their own employment tax returns and instead have their employment taxes reported on an aggregate Form 941, including when a small business hires a PEO. When a PEO claims a payroll tax credit on behalf of a client employer, IRS procedures generally require the PEO to file Schedule R (Form 941) to provide client-level information regarding the client employer's tax credit claim.

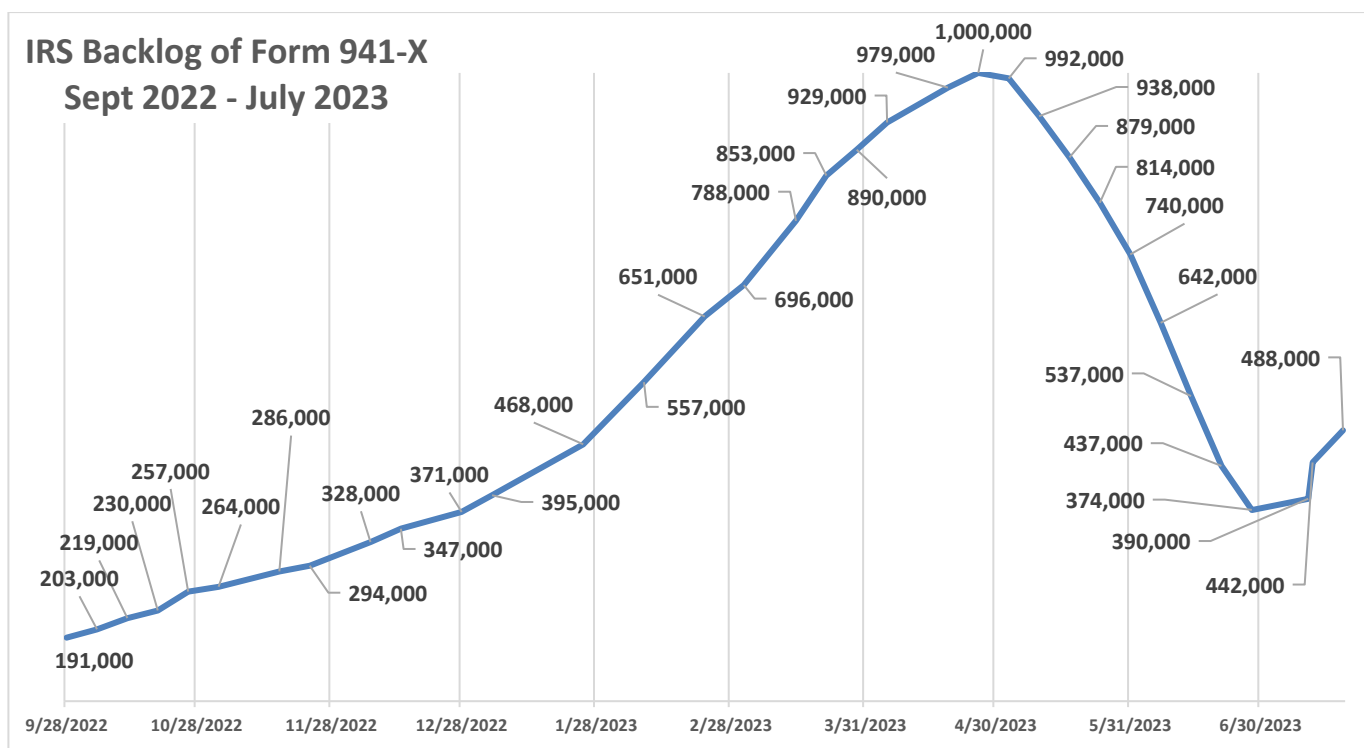
Because the IRS chose to incorporate the ERTC claims process into existing employment tax reporting procedures, small employers who use PEOs and other aggregate filers were required to claim the ERTC through the aggregate filer's Form 941/941-X. Similar to employers that file their own employment tax

returns, small businesses that use PEOs were often unable to determine their ERTC eligibility in time for the PEO to make a claim on the aggregate Form 941. This resulted in PEOs needing to file numerous aggregate Forms 941-X—sometimes even with respect to the same quarter—to assist their small business clients in claiming a refund for the ERTC.

### ERTC Backlog: Recent Numbers Don't Tell the Whole Story

Employers' ERTC claims have led to the filing of unprecedented numbers of Forms 941-X with the IRS. The IRS's employment tax systems and procedures were simply not equipped to handle this influx, and it led to an immense backlog of unprocessed Forms 941-X that topped out at a staggering 1,000,000 in April 2023. The chart below illustrates the number of unprocessed Forms 941-X the IRS reported on IRS.gov from September 2022 through July 19, 2023.

*NAPEO-prepared chart based on data provided on [IRS.gov](https://www.irs.gov) (Sept. 28, 2022 – July 19, 2023)*



NAPEO appreciates that, in response to the alarming increase in the Form 941-X backlog throughout the early months of 2023, multiple members of Congress raised this concern with Commissioner Werfel and obtained a commitment from him that the IRS would make substantial progress on reducing the backlog in the coming weeks and months. As the chart above shows, the IRS initially made good on that commitment, reducing the backlog from a high of 1,000,000 down to 374,000 as of June 28, 2023. Since that time, however, the backlog has increased again by 114,000 to 488,000 as of July 19, 2023.

In addition to being concerned over the recent uptick in the backlog numbers, **NAPEO cautions that the significant reduction in the backlog that took place throughout May and June 2023 does not necessarily mean that the small businesses that have been waiting the longest on their ERTC claims have by now received a refund as a result of this effort.** In fact, NAPEO recently surveyed 43 PEOs and found that nearly 18,000 small business PEO clients are still waiting for the IRS to approve thousands of

claims for ERTC credits from filed in 2020, 2021, and 2022. **That includes almost 4,000 claims from 2020 awaiting processing.** Despite the IRS's commitment to processing the Form 941-X backlog on a first-in, first-out basis, this has not resulted in all the earlier-made ERTC claims being resolved first.

### **NAPEO's Efforts to Help Small Businesses**

As early as May 2020, NAPEO reached out to the IRS and Treasury Department to sound the alarm on the filing complexity involved with the ERTC and other pandemic tax relief. By March 2021—before many employers had even filed a single ERTC claim—NAPEO was already urging the IRS to dedicate more resources to processing ERTC claims. The many employment tax experts at NAPEO's PEO members recognized at that point that normal IRS procedures on filing and processing employment tax would be insufficient to handle the anticipated ERTC claims.

### *Congress Focused on Reducing ERTC Backlog*

NAPEO, its PEO members, and hundreds of small business clients of PEOs have been calling attention to the ERTC backlog, seeking assistance from the IRS, IRS Taxpayer Advocate Service, and members of Congress. Individual NAPEO members have been working with members of Congress to determine the status of ERTC claims. NAPEO members have written Congress and encouraged their clients to do the same – and more than 1,300 small businesses have written to express their frustrations with the delay in processing the ERTC. More than 70 NAPEO members took time from their jobs to visit their representative and senators to urge action on the backlog. Small businesses call NAPEO every day asking for assistance to get their ERTC claim processed. These small business owners are incredibly frustrated and angry. A process that was supposed to quickly get them much needed assistance has turned into a two-to-three-year wait with no way of finding out what happened to their claim.

Congress is likely to continue to use payroll tax credits to assist small businesses. While we are grateful that the IRS has put the necessary resources into clearing the backlog of 941-X filings, it should not have taken three years and a million unprocessed tax forms to get the IRS to act. The inability of the IRS to act quickly, to shift resources to processing these claims, to simplify their processing of these forms, and their allowing claims to go upwards of three years without action are inexcusable. The IRS needs to immediately clear out all the old ERTC claims, put into place safeguards against fraudulent claims, and put into place technology that quickly processes legitimate payroll tax credits in a timely manner.

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Once again, NAPEO thanks the Oversight Subcommittee for holding this hearing. We ask for your continued attention to the ERTC backlog until every small business, including those that use a PEO, has received the ERTC funds for which it filed a claim and to which it is entitled.

We hope the information provided in our written statement is helpful to the Oversight Subcommittee. Should you have any questions, please contact [Thom Stohler](#), NAPEO's Vice President of Federal Government Affairs.

Sincerely,

Pat Cleary  
President and CEO  
NAPEO