

IRS Finalizes Rules to Collect Taxes on Erroneously Claimed Employee Retention Credits and Other COVID-19 Tax Credits

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The U.S. Department of the Treasury and the Internal Revenue Service (IRS) have finalized rules for the recapture of erroneously claimed Employee Retention Credits (ERC) and other tax credits provided to employers for COVID-19 paid sick and family leave, treating them as an underpayment of taxes that may be assessed and collected. The new final rules were published on July 26, 2023, and remove and replace the temporary and proposed regulations released in 2020 and 2021.

Quick Hits

- The Treasury Department and the IRS finalized rules for the recapture of erroneously distributed ERC and paid sick and family leave tax credits.
- The final rules, effective July 24, 2023, treat erroneous tax credits as underpayments of taxes that may be assessed and collected.

COVID-19 Tax Credits

The [Coronavirus Aid, Relief, and Economic Security \(CARES\) Act](#), enacted in March 2020 just after the onset of the pandemic, provided the employee retention credit (ERC), a fully refundable tax credit against the employer component of employment tax (Social Security and Railroad Retirement) equal to 50 percent of qualified wages paid. The credit was later expanded to 70 percent of qualified wages by the American Rescue Plan Act (ARPA).

The [Families First Coronavirus Response Act \(FFCRA\)](#), enacted in March 2020, provided relief from economic hardships due to the COVID-19 pandemic. This relief included offering payroll tax credits for wages paid for mandatory leave under the Emergency Paid Sick Leave Act (EPSLA) and the Emergency Family and Medical Leave Expansion Act (EFMLEA). Those laws generally required certain employers with fewer than 500 employees to provide up to eighty hours of paid sick leave to employees to care for themselves or for others suffering from COVID-19 or related reasons. The laws called for specified daily and aggregate rates of pay for up to ten weeks of paid family and medical

leave at two-thirds of employees' regular rates of pay, up to \$200 per day or \$10,000 in the aggregate if employees were forced to care for a child whose school or place of care was closed or childcare provider was unavailable due to COVID-19–related reasons.

Subsequent amendments extended both of these tax credits to cover wages paid from April 1, 2020, through September 30, 2021.

Erroneous Credit Recapture

Internal Revenue Code Section 6201 authorizes the secretary of the Treasury to assess tax liabilities, including interest and penalties. Specifically, the FFCRA and CARES Act allow for the secretary of the Treasury to issue regulations to assess and recapture ERC and paid sick and family leave credits erroneously distributed.

Under the final rules published by the IRS, any amount of ERC or paid sick or family leave wage credits that were erroneously refunded to employers will “be treated as an underpayment” of taxes and “may be assessed and collected by the Secretary in the same manner as the taxes.” Any amount of credits erroneously refunded will include “any amount of credits advanced to an employer” in accordance with the CARES Act and the FFCRA.

The rules clarify that in situations where third-party payors claim tax credits on behalf of an employer both the third-party payor and the employer may be liable for any underpayment of taxes assessed due to the erroneous refund of credits.

Next Steps

The final rules are effective as of July 24, 2023. Employers may want to review their COVID-19 payroll tax credits in accordance with the new final rules that may require them to pay back any excess tax credits they received.

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