IRS May Offset PEO Employment Tax Credits

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The IRS is authorized to offset certain COVID-19 employment tax credits to any existing tax liabilities of a Professional Employer Organization (PEO) that pays wages to individuals as part of the services provided to a client employer pursuant to a service agreement, although the credits being claimed on the Form 941 Schedule R are attributable to wages paid to a client employer's employees.

The IRS has discretion to credit any overpayment against "any liability in respect of an internal revenue tax on the part of the person who made the overpayment." With respect to the COVID-19 employment tax credits, the IRS can offset excess refundable COVID-19 employment tax credits to any existing tax liabilities on the employer's account.

For taxpayers who use a PEO that pays wages to individuals as part of the services provided to a client pursuant to a service agreement, although the credits being claimed on the Form 941 Schedule R are attributable to wages paid to a client's employees, the 3504 agent or PEO is the taxpayer who is actually claiming the employment tax in an aggregate amount on a Form 941 filed under its own EIN. If a refund is ultimately issued to the PEO, it is then between the PEO and the client to ensure the PEO remits any portion of the refund it received to the client in the appropriate amount.

The IRS is not a party to those agreements and has no obligation to refund any portion of the PEO's refund to a client identified on Schedule R. The IRS does not issue refunds to the client entities themselves, but rather any refunds are paid to the PEO. Since the Schedule R information is not determinative of the PEO's ultimate tax liability, the IRS would not be able to determine the appropriate refund to issue to the PEO based solely on the Schedule R information on a client-by-client basis for any particular employment tax credit. Rather, until the IRS determines entitlement to the entire line item amount claimed on the Form 941, no refunds or credits are paid out to the PEO.

Although employers who utilize PEO's may encounter difficulties receiving payment of the refundable tax credits they may be entitled to if the PEO they have chosen has outstanding federal tax liabilities, this is a civil matter strictly between the PEO and the client employer, not the IRS.

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