



*Employers Who Do Not Comply
With Requests to Provide Complete
and Accurate Wage Documents
Are Not Always Assessed Penalties*

September 22, 2015

Reference Number: 2015-40-090

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

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HIGHLIGHTS

EMPLOYERS WHO DO NOT COMPLY WITH REQUESTS TO PROVIDE COMPLETE AND ACCURATE WAGE DOCUMENTS ARE NOT ALWAYS ASSESSED PENALTIES

Highlights

Final Report issued on
September 22, 2015

Highlights of Reference Number: 2015-40-090 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Each year, the Social Security Administration (SSA), in a process called Annual Wage Reporting, matches wage and withholding information sent by employers to tax returns filed by those employers with the IRS to identify discrepancies between the information submitted to each agency. The SSA's primary focus is to identify discrepancies in which earnings and tax withholdings reported to the IRS on filed tax returns differs from amounts reported on Forms W-2, *Wage and Tax Statement*, submitted to the SSA. A discrepancy can indicate that employees' earnings were not credited to their Social Security account.

WHY TIGTA DID THE AUDIT

The SSA refers unresolved discrepancy cases to the IRS because the IRS has the authority to penalize an employer if the employer fails to file complete and accurate Forms W-2 and W-3, *Transmittal of Wage and Tax Statements*. Discrepancies in crediting wages to an individual's Social Security account may affect the amount of Social Security benefits available to the employee upon retirement. The overall objective was to evaluate the IRS's processes and procedures for working SSA Combined Annual Wage Reporting discrepancy cases.

WHAT TIGTA FOUND

TIGTA found that the IRS did not always assess penalties against employers that did not reply to

the IRS's requests to resolve SSA-reported discrepancies as required. TIGTA's analysis of discrepancy cases referred to the IRS by the SSA for Tax Year 2011 found that the IRS did not correctly assess more than \$200 million in penalties on 32 employer discrepancy cases referred by the SSA. A comparison of wages and withholding reported by these 32 employers on their tax return to Forms W-2 submitted to the SSA identified underreported Forms W-2 wages totaling more than \$2 billion. The IRS had not established a process to identify these cases and, as a result, the penalties were not assessed as required.

In addition, TIGTA's analysis of discrepancy cases identified that the IRS excluded 22,814 of the 134,937 cases referred from the SSA. Of the 22,814 referred cases, 608 did not meet the IRS's case processing exclusion criteria and were erroneously excluded from being worked. As a result, the IRS did not assess more than \$22 million in penalties. A comparison of wages and withholding reported by these 608 employers on their tax return to Forms W-2 submitted to the SSA identified underreported Forms W-2 wages totaling more than \$225 million.

As part of a settlement agreement resulting from a lawsuit to force prompt resolution of the backlog of unreconciled cases (*i.e.*, wage information was not being timely recorded to earnings records), the IRS is required to work all cases referred by the SSA. IRS management indicated that the 608 cases were erroneously excluded because of computer programming errors.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division (1) develop a process to identify and ensure that penalties are assessed as required on those employers that do not reply to the IRS's requests for missing Forms W-2, and (2) correct computer programming errors to ensure that cases are accurately reflected in open inventory as needing to be worked and penalties assessed when appropriate. The IRS agreed with our recommendations and plans appropriate corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 22, 2015

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Employers Who Do Not Comply With Requests
to Provide Complete and Accurate Wage Documents Are Not Always
Assessed Penalties (Audit # 201440009)

This report presents the results of our review to evaluate the Internal Revenue Service's processes and procedures for working Social Security Administration Combined Annual Wage Reporting discrepancy cases. This audit is included in our Fiscal Year 2015 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included in Appendix V.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services).



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Abbreviations

BMF	Business Master File
CAWR	Combined Annual Wage Reporting
EIN	Employer Identification Number
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
SSA	Social Security Administration
TY	Tax Year



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Background

Employers are required to annually report to the Social Security Administration (SSA) wage and withholding for each employee on Form W-2, *Wage and Tax Statement*, through a process called Annual Wage Reporting. Employers are required to submit their Forms W-2 to the SSA by March 31¹ each year along with a Form W-3, *Transmittal of Wage and Tax Statements*. Form W-3 is a summary of the submitted Forms W-2. In addition, employers are also required to report and submit Federal taxes withheld from employees. Employers report to the IRS Federal taxes withheld from employees on Form 941, *Employer's QUARTERLY Federal Tax Return*; Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees*; or Form 944, *Employer's ANNUAL Federal Tax Return*.

The SSA Combined Annual Wage Reporting Program

The Combined Annual Wage Reporting (CAWR) Program ensures that employers submit Forms W-2 and Forms W-3 to both the SSA and the IRS so that employees' Social Security accounts can be properly credited and the proper income and employment tax withholdings can be collected from employers. A comparison of SSA and IRS records is performed each year in a process known as the Annual Wage Reporting reconciliation. The SSA-CAWR Program includes a reconciliation to identify discrepancies in which earnings and tax withholdings reported to the IRS on filed tax returns differs from amounts reported on Forms W-2 submitted to the SSA.² A discrepancy can indicate that employees' earnings were not credited to their Social Security account. These discrepancies are called SSA-CAWR cases. Discrepancies in crediting wages to an individual's Social Security account may affect the amount of Social Security benefits available to the employee upon retirement.

Social Security Administration reconciliation process

When discrepancies involve more Social Security and Medicare wages reported to the IRS on an employer tax return than is reported to the SSA on Forms W-2, the SSA examines those cases. The SSA first attempts to resolve the difference without contacting the employer. If the discrepancy cannot be resolved, the SSA will send a notice and questionnaire to the employer requesting the earnings information needed to resolve the case. If the SSA does not receive a response after 45 days, it sends a second notice to the employer. The employer has an additional

¹ The annual due date for filing paper forms is the last day of February following the reporting year, or the following Monday if the last day in February falls on Saturday or Sunday.

² The IRS-CAWR Program includes a reconciliation to identify discrepancies in which an employer reports more earnings and tax withholdings on Forms W-2 submitted to the SSA when compared to the amounts reported on tax returns submitted to the IRS. We plan to perform a separate review of this program.



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45 days to respond to the second notice. If no response is received after the second notice, the case is referred to the IRS as a potential penalty case. The SSA does not have the legislative authority to assess penalties on employers for not complying with the requirement to report annually to the SSA the income and withholding for each employee.

The Internal Revenue Code (I.R.C.)³ gives the IRS the authority to penalize an employer if it fails to file complete and accurate Forms W-2 and W-3. An IRS tax examiner will attempt to resolve the discrepancies identified by the SSA. When IRS tax examiners are unable to resolve a discrepancy, the IRS sends the employer a Letter 0098C, *Wage Discrepancy per SSA; Information/Verification Requested*. This letter requests copies of Forms W-2 and notifies the employer of a potential penalty assessment if the forms are not submitted to the IRS. The IRS assesses civil penalties if the employer does not resolve the discrepancy by either:

- Filing missing Forms W-2,
- Amending its employment tax return, or
- Providing other information to resolve the discrepancy.

Once an employer has been assessed a penalty, the employer may provide missing Forms W-2 and request an abatement of the penalty assessed. Figure 1 provides the results of our analysis of assessments and abatements made on cases referred by the SSA to the IRS during Tax Year (TY)⁴ 2011.⁵

**Figure 1: Penalty Assessments and Abatements
on SSA-CAWR Cases – TY 2011**

	Cases	Penalty Amount
Cases Referred to and Worked by IRS	133,836	
Assessments	78,913	\$550,412,882
Abatement of Penalty ⁶	8,411	(\$94,213,958)
No Penalty Assessed	54,923	\$0

Source: Our analysis of the Business Master File⁷ (BMF), as of April 30, 2015.

³ I.R.C. § 6721.

⁴ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

⁵ SSA-CAWR cases are worked three years behind the current year to allow employers time to file Forms W-2 and/or Forms W-2c, *Corrected Wage and Tax Statement*, with the SSA and employment tax returns with the IRS. The IRS worked TY 2011 SSA-CAWR cases in Calendar Year 2014.

⁶ These are part of the 78,913 penalty assessments for which the penalty was subsequently abated.

⁷ The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.



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This review was performed at the Combined Annual Wage Reporting office in the Document Matching Office, Compliance Services, Small Business/Self-Employed Division in Philadelphia, Pennsylvania, during the period January through June 2015. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

Penalties Were Not Always Assessed When Employers Failed to Reply to Requests to Provide Missing Forms W-2

The IRS did not always assess penalties against employers that did not reply to the IRS's requests to resolve the SSA-CAWR discrepancy. Our analysis of SSA-CAWR cases referred to the IRS by the SSA for TY 2011 found that the IRS did not correctly assess penalties on 32 cases referred by the SSA. A comparison of wages and withholding reported by these 32 employers on their tax return to Forms W-2 submitted to the SSA identified underreported Forms W-2 wages totaling more than \$2 billion. Each of these cases involved an employer who failed to reply to the IRS's requests to provide Forms W-2 not submitted to the SSA.

According to the IRS, employers will submit their quarterly tax returns (*i.e.*, Form 94x series) to avoid having to pay penalties associated with failing to file and pay or for filing late. The IRS assesses a 5 percent penalty with a maximum penalty of 25 percent for each month or partial month a quarterly employment tax return is filed late. The penalty is a percentage of unpaid tax due with the return. The IRS also assesses 0.5 percent additional penalty for each month or partial month the tax is paid late. In contrast, the IRS assesses \$100 per Form W-2 up to a maximum of \$500,000 a year for small businesses and \$1,500,000 a year for large businesses for Forms W-2 the employer files late.

For the 32 employers we identified, the IRS could have assessed a 10 percent Intentional Disregard Failure to File penalty totaling more than \$200 million for the underreported Forms W-2 wages.⁸

The I.R.C.⁹ provides the IRS the authority to impose penalties for the failure to file correct information returns. The IRS may assess either the Late Filed Forms W-2 Penalty or the Intentional Disregard Failure to File Penalty, as follows.

- **The Late Filed Forms W-2 Penalty** – is assessed when original Forms W-2 are received in response to correspondence sent to the employer by the IRS. The I.R.C. states:

In the case of a failure by any person with respect to an information return, such person shall pay a penalty of \$100 for each return with respect to which such a

⁸ The amount of penalties actually collected would depend on whether an employer in response to IRS's request provided missing Forms W-2 and requested an abatement of the assessed penalty. For TY 2011, the IRS abated 15 percent of assessed penalties.

⁹ I.R.C. § 6721.



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failure occurs, but the total amount imposed on such person for all such failures during any calendar year shall not exceed \$1,500,000.

The failures described are:

- 1. Any failure to file an information return with the Secretary on or before the required filing date, and*
 - 2. Any failure to include all of the information required to be shown on the return or the inclusion of incorrect information.¹⁰*
- **The Intentional Disregard Failure to File Penalty** – is imposed on employers that do not comply with the IRS's requests to file Forms W-2. The I.R.C. states:

If 1 or more failures are due to intentional disregard of the filing requirement (or the correct information reporting requirement), then, with respect to each such failure the penalty imposed under subsection (a) shall be \$250, or, if greater, 10 percent of the aggregate amount of the items required to be reported correctly.¹¹

We provided IRS management with our exception cases to review. The IRS matched our exception cases to a file that it receives from the SSA to determine if the SSA resolved the cases subsequent to the referral to the IRS. IRS management explained that cases for which a penalty of \$25,000 or more will be assessed are held in suspense until after the end of the calendar year (for our cases, this means the file would have been held until after December 2014). After the suspense time frame, the IRS matches the cases to a SSA file to identify those not resolved by the SSA and that should have a penalty assessed.

The IRS's review of our exception cases confirmed that these 32 cases had not been resolved by the SSA and should have had a penalty assessed. IRS management indicated that no process was established to identify these cases and, as a result, the penalties were not assessed as required. For the 32 cases identified, the IRS is unable to assess penalties on ***1***¹² of the cases because the three-year statute of limitations for making the assessment has expired. IRS management stated that they plan to submit a programming request to establish a systemic process to identify cases not resolved by the SSA that require a penalty assessment. If the IRS does not timely establish an identification process, the proper amount of penalties will continue to go unassessed.

The SSA maintains a record of the earnings of every worker whose employment is covered by the Social Security program. Each worker has a separate SSA earnings record, accessed by name and Social Security Number, which documents that individual's covered earnings over the

¹⁰ I.R.C. § 6721(a).

¹¹ I.R.C. § 6721(e).

¹² *****1*****.



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course of an entire working life. The SSA obtains wage data from reports submitted by employers and then posts the reported wages to individual SSA records. A worker's covered earnings, as documented in the SSA's records, determine both eligibility for Social Security benefits and the proper amount of such benefits. Therefore, it is important that SSA's earnings records accurately reflect the full amount of wages paid.

In addition, when employers do not send all Forms W-2 to the SSA, the IRS in turn will not receive this information. The IRS considers Forms W-2 received from the SSA as legitimate third-party documents submitted by the employer. The IRS uses this information when processing tax returns to confirm income and withholding reported on the tax return as being valid. Those individuals who file a tax return reporting correct income and withholding may be incorrectly identified by the IRS as filing a potentially fraudulent tax return if Forms W-2 were not sent by their employers to the SSA as required.

Recommendation

Recommendation 1: The Commissioner, Small Business/Self-Employed Division, should develop a process to identify and ensure that penalties are assessed, as required, on those employers that do not reply to the IRS's requests for missing Forms W-2.

Management's Response: The IRS agreed with this recommendation. To augment the existing "no reply process," the IRS will review the identified case-specific discrepancy issues at the Master File level to determine what information technology issues should be resolved within available information technology resources constraints and will submit Unified Work Requests, if appropriate.

Management, however, did not agree with our outcome measure. The IRS stated that although we applied an abatement rate to our cases, the outcome measure assumes that all non-abated penalty cases receive the higher 10 percent penalty for intentional disregard. The IRS also stated that some cases would likely qualify for the lower \$100 per return late-filed penalty. Finally, the IRS stated that penalties are not appropriately measured as revenue but should be measured by their influence on voluntary compliance using a multiplier effect.

Office of Audit Comment: The abatement rate that we computed did not assume that all non-abated penalty cases receive the higher 10 percent penalty. In addition, the abatement rate did in fact take into consideration those cases in which the 10 percent penalty was abated and the lower \$100 dollar per return late-filed penalty was subsequently applied. Moreover, while we agree that the most important outcome of penalties is to improve future compliance, the penalties are additional revenue.



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Discrepancy Cases Referred by the Social Security Administration Were Not Always Worked

Our analysis of SSA-CAWR cases referred to the IRS by the SSA for TY 2011 identified that the IRS excluded 22,814 of the 134,937 cases from the SSA referred inventory, including 608 that did not meet the IRS's case processing exclusion criteria and were erroneously excluded from being worked. Specifically, our analysis identified:

- **22,206 cases met the IRS's SSA-CAWR case exclusion criteria** – The IRS's SSA-CAWR procedures exclude cases from being assessed civil penalties if the employer is in bankruptcy, no longer in business, or is a Federal agency. In addition, the case will not be worked as part of the SSA-CAWR Program if the employer is involved in a tax issue worked by another IRS function or the employer submitted amended or corrected Forms W-2 that resolved the discrepancy. Our review of these 22,206 cases found that each case met the IRS's exclusion criteria.
- **608 cases were erroneously excluded from inventory** – These cases were erroneously excluded because of computer programming errors. A comparison of wages and withholding reported by employers on their tax return to Forms W-2 submitted to the SSA identified underreported Forms W-2 wages totaling more than \$225 million. For these 608 cases the IRS could have assessed a 10 percent Intentional Disregard Failure to File penalty totaling more than \$22 million for the underreported Forms W-2 wages.¹³ IRS management indicated that the errors caused SSA-CAWR discrepancy cases to not be listed in open inventory as needing to be worked. In addition, some cases had an indicator that showed they were closed when they were still unresolved and in an open status. Although the IRS is unable to assess penalties on cases in which the three-year statute of limitations for making the assessment has expired, IRS management stated that they plan to submit a computer programming request to ensure that cases are not being erroneously excluded from the inventory. If the IRS does not timely address computer programming errors, cases will not be worked and penalties will not be assessed as required.

In April 1988, the National Committee to Preserve Social Security¹⁴ filed a lawsuit to force prompt resolution of the backlog of unreconciled cases (*i.e.*, wage information was not being

¹³ The amount of penalties actually collected would depend on whether an employer in response to the IRS's request provided missing Forms W-2 and requested an abatement of the assessed penalty. For TY 2011, the IRS abated 15 percent of assessed penalties.

¹⁴ The organization subsequently changed its name to the National Committee to Preserve Social Security and Medicare.



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timely recorded to earnings records) that resulted from a legislative change¹⁵ in the wage recording system. In addition, the lawsuit sought the adoption of measures to ensure that the problem does not recur in the future. As part of a settlement agreement resulting from the lawsuit,¹⁶ the IRS is required to work all SSA-CAWR cases. The current agreement with the SSA states that:

IRS will reconcile discrepancies between employer W-2/W-3 wage reports provided SSA and tax returns provided IRS on Form 94X in which more Social Security/Medicare wages/tips were reported by employers to the IRS than to the SSA. Such reconciliation activity will include contacting employers when SSA is unable to resolve discrepancies based upon its own records. For these non-tax-related cases, IRS's reconciliation will be subsequent to SSA's initiating contact with employers. IRS will also assess penalties in cases where non-filing employers fail to respond to SSA and IRS contacts.¹⁷

Recommendation

Recommendation 2: The Commissioner, Small Business/Self-Employed Division, should correct computer programming errors to ensure that cases are accurately reflected in open inventory as needing to be worked and penalties are assessed when appropriate.

Management's Response: The IRS agreed with this recommendation. The IRS will review the case-specific discrepancy issues at the CAWR Automated Penalty level to determine what information technology issues should be resolved within available information technology resources constraints and will submit Unified Work Requests, if appropriate. Management did not agree with our related outcome measure, citing the same reasons as those noted in the previous section. TIGTA's response is also the same as noted in the previous section.

¹⁵ Pub. L. No. 94-202, 42 U.S.C. § 432. Specifically, Pub. L. No. 94-202 § 8 changed the requirement of detailed wage reports to an annual basis. It also added § 432 to 42 U.S.C., which authorized the Secretaries of Health and Human Services and Treasury to enter into an agreement for the processing of tax return information.

¹⁶ *National Committee to Preserve Social Security v. Bowen*, 735 F. Supp. 1069 (D.D.C. 1990).

¹⁷ This agreement can be terminated only if the Secretary of the Treasury and the Commissioner of Social Security agree in writing to do so.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the IRS's processes and procedures for working SSA-CAWR discrepancy cases. To achieve this objective, we:

- I. Determined whether the IRS correctly worked SSA-CAWR cases referred to it by the SSA.
 1. Researched legislative requirements to determine the IRS's responsibility to obtain missing income documents and assess penalties on behalf of the SSA.
 2. Researched legislative requirements to determine if the SSA has the authority to assess penalties related to the SSA-CAWR Program.
 3. Performed computer analysis on BMF CAWR tax modules data to select SSA-CAWR TY 2011 discrepancy cases for which the status indicated the case was closed. We computed the amount of assessments and abatement of tax, penalty, and interest for the SSA-CAWR cases.
 4. Performed computer analysis on BMF CAWR tax module 88 data to select SSA-CAWR discrepancy cases for which the status indicated that a notice was not generated and computed the total amount of tax discrepancy for the SSA-CAWR cases that were not worked.
 5. Performed computer analysis on BMF CAWR tax module 88 data to select SSA-CAWR discrepancy cases for which the status indicated that a notice was generated but a reply was not received from the employer, computed the total amount of tax discrepancy for the SSA-CAWR cases that were not assessed a penalty, and computed the amount of penalty that should have been assessed.

Data validation methodology

During this review, we relied on data from the IRS's BMF database for TY 2011 provided by the Treasury Inspector General for Tax Administration's Office of Investigations' Strategic Data Services.¹ We performed additional extracts from the BMF located on the Treasury Inspector General for Tax Administration's Data Center Warehouse.² Before relying on our data, we ensured that each file contained the specific data elements we requested. In addition, we selected random samples of each extract and verified that the data in the extracts were the same as the

¹ Strategic Data Service is responsible for managing and retrieving IRS data.

² A Treasury Inspector General for Tax Administration repository of IRS data.



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data captured in the IRS's Integrated Data Retrieval System.³ Based on the results of our testing, we believe that the data used in our review were reliable.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: controls over IRS processing of cases referred by the SSA and controls over the assessment of civil penalties. We evaluated these controls by interviewing IRS management and performing analysis of the Forms W-2, *Wage and Tax Statement*; Forms W-3, *Transmittal of Wage and Tax Statements*; and employment tax return data from the CAWR Automated Program system and the BMF information relating to Forms W-2, Forms W-3, employment tax returns, and civil penalties.

³ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Examination, Small Business/Self-Employed Division SE:S:E
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Director, Office of Audit Coordination OS:PPAC:AC
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Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S



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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; approximately \$171.6 million from 32 CAWR cases referred to the IRS by the SSA that were not correctly assessed penalties for not filing Forms W-2, *Wage and Tax Statement*, when the employer failed to reply to the IRS's requests to provide the Forms W-2 that were not submitted to the SSA (see page 4).

Methodology Used to Measure the Reported Benefit:

We conducted an analysis of all TY 2011 business employment tax returns reporting wages and withholding paid to/for employees. We compared the employee wage and withholding information on the employment tax returns to the wage and withholding information provided to the SSA by employers.

- We eliminated Employer Identification Numbers (EIN) for which the wage and withholding amounts reported on the employment tax returns matched the wage and withholding amounts provided to the SSA.
- We eliminated all EINs that had civil penalties assessed.
- We eliminated EINs that were worked by other IRS functions, were located in disaster areas, or were out of business or bankrupt because these are not worked by the SSA-CAWR Program.

Failure to Reply Cases

1. We matched the remaining EINs to the EINs referred by the SSA that were closed with a No Reply closing code on the BMF. This identified 68 employers.
2. Eliminated all EINs for which the computed civil penalty was below the IRS's penalty tolerance. This resulted in 32 employers. We then calculated the difference between the wages and withholding reported on the employment tax returns to what was reported on Forms W-2 submitted to the SSA for these 32 employers. This amount totaled \$2,019,006,077.



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3. We then calculated the amount of the 10 percent intentional disregard failure to file penalty for the underreported Forms W-2 wages. The penalty assessments totaled \$201,900,607.
4. We then applied a 15 percent abatement rate. The abatement rate was computed by analyzing Tax Year 2011 SSA-CAWR cases where a penalty assessment was made and then abated. Applying the 15 percent abatement rate to the \$201,900,067 resulted in \$171,615,517 in unassessed civil penalties.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; approximately \$19.2 million from 608 CAWR cases referred to the IRS by the SSA were erroneously excluded from inventory and were not correctly assessed penalties for not filing Forms W-2 (see page 7).

Methodology Used to Measure the Reported Benefit:

We conducted an analysis of all TY 2011 business employment tax returns reporting wages and withholding paid to/for employees. We compared the employee wage and withholding information on the employment tax returns to the wage and withholding information provided to the SSA by employers.

- We eliminated EINs for which wage and withholding amounts reported on employment tax returns matched the wage and withholding amounts provided to the SSA.
- We eliminated all EINs that had civil penalties assessed.
- We eliminated EINs that were worked by other IRS functions, were located in disaster areas, or were out of business or bankrupt because these are not worked by the SSA-CAWR Program.

SSA Referrals Not Worked

1. We matched the remaining EINs to the EINs referred by the SSA that contained no closing codes on the BMF. This identified 608 employers.
2. We calculated the difference between the wages and withholding reported on the employment tax returns to that reported on Forms W-2 submitted to the SSA for the 608 employers. This amount totaled \$225,361,212.
3. We then calculated the amount of the 10 percent intentional disregard failure to file penalty for underreported Forms W-2 wages. Penalty assessments totaled \$22,536,121.
4. We then applied a 15 percent abatement rate. The abatement rate was computed by analyzing Tax Year 2011 SSA-CAWR cases where a penalty assessment was made and then abated. Applying the 15 percent abatement rate to the \$22,536,121 resulted in 19,155,703 in unassessed civil penalties.



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Appendix V

Management's Response to the Draft Report

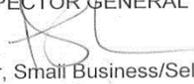


COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

SEP 03 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Karen Schiller 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Employers Who Do Not Comply With Requests to Provide
Complete and Accurate Wage Documents Are Not Always
Assessed Penalties Draft Audit Report (Audit # 201440009)

Thank you for the opportunity to review your draft report titled: "Employers Who Do Not Comply with Requests to Provide Complete and Accurate Wage Documents Are Not Always Assessed Penalties." We appreciate that you observed that we properly worked 99.55% of cases according to our processing criteria.

The Combined Annual Wage Reporting (CAWR) Program ensures that employers submit Forms W-2 and Forms W-3 to the Social Security Administration (SSA) and a federal tax withholding form to the IRS so that employees' Social Security accounts can be properly credited and the proper income and employment tax withholdings can be collected from employers. A comparison of SSA and IRS records is performed each year in a process known as the Annual Wage Reporting reconciliation (SSA-CAWR). The SSA-CAWR Program includes a reconciliation to identify discrepancies in which earnings and tax withholdings reported to the IRS on filed tax returns is greater than amounts reported on Forms W-2 submitted to the SSA.

As was noted in your report, we processed 134,937 cases received from SSA under our established reconciliation program procedures. These procedures include evaluating each case under our exclusion criteria. Our exclusion criteria properly eliminated 22,206 from further review thereby focusing our personnel and other resources on cases that required additional scrutiny. However, 608 additional cases were excluded incorrectly because of two computer programming errors that prevented certain cases from appearing as open inventory. As you recommended, we will review the computer programming errors to determine how to correct the problems to ensure that cases are accurately reflected in open inventory as needing to be worked.

We agree that we should identify and ensure penalties are assessed, as required, on those employers that do not reply to the IRS's requests for missing Forms W-2. Our



*Employers Who Do Not Comply
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"no reply process" systemically assesses penalties on accounts when a response to the notice of proposed penalties is not received timely. As we are reviewing the computer programming to ensure proper exclusion criteria are being used, we will also review the programming to ensure penalties are assessed when appropriate.

We disagree with the outcome measures as presented. Although you applied an abatement rate to the cases, the outcome measures assume that all non-abated penalty cases receive the higher 10% penalty for intentional disregard. However, some cases would likely qualify for the lower \$100 per return "late filed" (i.e., non-intentional) penalty. In addition, we continue to assert that penalties are not appropriately measured as "revenue" but should be measured by their influence on voluntary compliance using a multiplier effect.

Attached is a detailed response outlining planned corrective actions to address your recommendations. If you have any questions, please contact me, or a member of your staff may contact Shenita Hicks, Director, Examination, Small Business/Self-Employed Division at 859-669-5526.

Attachment



*Employers Who Do Not Comply
With Requests to Provide Complete and Accurate
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Attachment

Recommendation 1:

The Commissioner, Small Business/Self-Employed Division, should develop a process to identify and ensure penalties are assessed, as required, on those employers that do not reply to the IRS's requests for missing Forms W-2.

Corrective Action:

To augment our existing "no reply process," we will review the identified case-specific discrepancy issues at the Masterfile level to determine what information technology issues should be resolved within available information technology resources constraints and will submit Unified Work Requests (UWRs), if appropriate.

Implementation Date:

September 15, 2017

Responsible Official:

Director, Examination/AUR Policy, Small-Business/Self Employed

Corrective Action Monitoring Plan:

IRS will monitor this corrective action as part of our internal management system of controls.

Recommendation 2:

The Commissioner, Small Business/Self-Employed Division, should correct computer programming errors to ensure that cases are accurately reflected in open inventory as needing to be worked and penalties assessed when appropriate.

Corrective Action:

We will review the case-specific discrepancy issues at the CAWR Automated Penalty (CAP) level to determine what information technology issues should be resolved within available information technology resources constraints and will submit Unified Work Requests (UWRs), if appropriate.

Responsible Official:

Director, Examination/AUR Policy, Small Business/Self-Employed

Implementation Date:

September 15, 2017

Corrective Action Monitoring Plan:

IRS will monitor this corrective action as part of our internal management system of controls.