



*Further Actions Are Needed to Reduce
the Risk of Employment Tax Fraud to
Businesses That Use the Services of
Professional Employer Organizations*

September 13, 2017

Reference Number: 2017-40-085

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.

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HIGHLIGHTS

FURTHER ACTIONS ARE NEEDED TO REDUCE THE RISK OF EMPLOYMENT TAX FRAUD TO BUSINESSES THAT USE THE SERVICES OF PROFESSIONAL EMPLOYER ORGANIZATIONS

Highlights

Final Report issued on September 13, 2017

Highlights of Reference Number: 2017-40-085 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

Professional Employer Organizations (PEO) are referred to as a third-party payer because they generally pay wages and file employment tax returns on employees' wages that would otherwise be handled by their client companies. PEOs that are certified by the IRS are required to notify the IRS of those specific employers that use their services. However, employers that continue to use the services of a PEO that chooses not to participate in the certification program remain at risk.

WHY TIGTA DID THE AUDIT

This audit was initiated because legislation was enacted by Congress in Calendar Year 2014 in an effort to reduce the risk of employment tax fraud by third-party payers, in particular PEOs. This audit assesses the IRS's actions to establish processes for certifying PEOs authorized for the filing and paying of employment taxes. In addition, it evaluates the dual notice process for address changes associated with employers that have employment tax filing requirements.

WHAT TIGTA FOUND

In response to legislative provisions, the IRS has taken steps to implement processes and procedures to issue a notice as confirmation of any business address change when required and to establish a voluntary program for PEOs to become Federally certified. However, the

majority of PEOs do not participate in Federal certification, which results in the continued inability to link employers who use the services of these organizations. As of March 31, 2017, the IRS received applications for certification from 123 PEOs, whereas in September 2015, the National Association of PEOs estimated there were between 780 and 980 PEOs that represent 156,000 to 180,000 employers.

In addition, TIGTA found that processing time frames and procedures to periodically inform applicants as to the status of their application need to be developed. Finally, regarding the dual notice process, some notices were being issued erroneously and some notices were not being issued at all. For example, TIGTA identified 698,660 sets of notices that were unnecessarily issued to businesses whose address did not actually change. Using IRS cost data, TIGTA estimated that the issuance of these erroneous notices resulted in the IRS needlessly expending almost \$3 million. TIGTA also identified 256,826 sets of notices that should have been issued to businesses whose addresses were changed but did not receive a notice as required.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division, work with the Department of the Treasury to consider a legislative proposal requiring noncertified PEOs to register with the IRS and file Schedule R, *Allocation Schedule for Aggregate Form 941 Filers*, with their Form 941, *Employer's QUARTERLY Federal Tax Return*, and establish timeliness standards for reviewing applications. In addition, TIGTA made several recommendations to the Commissioner, Wage and Investment Division, to refine the programming criteria for the dual notice process.

The IRS agreed with all six of TIGTA's recommendations and has planned or taken corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 13, 2017

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION
COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Further Actions Are Needed to Reduce the Risk of Employment Tax Fraud to Businesses That Use the Services of Professional Employer Organizations (Audit # 201640019)

This report presents the results of our review to assess the Internal Revenue Service's actions to establish processes for certifying Professional Employer Organizations authorized for the filing and paying of employment taxes. In addition, we evaluated the dual notice process for address changes associated with employers that have employment tax filing requirements. This audit is included in our Fiscal Year 2017 Annual Audit Plan and addresses the major management challenge of Improving Tax Compliance.

Management's complete response to the draft report is included as Appendix VI.

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

CP	Computer Paragraph
EIN	Employer Identification Number
IRS	Internal Revenue Service
NAPEO	National Association of Professional Employer Organizations
PEO	Professional Employer Organization
RIPA	Responsible Individual Personal Attestation
TIGTA	Treasury Inspector General for Tax Administration



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Background

Employers are generally required by law to withhold employment taxes from wages paid to their employees and to report and submit the taxes withheld. Employment tax includes Federal income tax, Social Security and Medicare tax, and Federal unemployment taxes. An employer reports Federal taxes to the Internal Revenue Service (IRS) on Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*; Form 941, *Employer's QUARTERLY Federal Tax Return*; Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees*; Form 944, *Employer's ANNUAL Federal Tax Return*, or Form 945, *Annual Return of Withheld Federal Income Tax* (collectively referred to hereafter as employment tax returns). Employers can appoint or enter into an agreement with a third party to take over some or all of the employer's Federal employment tax withholding, tax return preparation, reporting, and tax payment responsibilities. One type of third-party payer arrangement is a Professional Employer Organization (PEO).

PEOs are sometimes referred to as an employee leasing organization as they assume some employment-related responsibilities for client companies, including hiring some or all of the client companies' employees whose services are then leased back to the client companies. The PEOs pay wages and file employment tax returns on employees' wages that would otherwise be handled by their client companies. The National Association of Professional Employer Organizations (NAPEO)¹ describes this relationship as "co-employment."²

Legislation was enacted to help reduce the risk to businesses from employment tax fraud by third-party payers

Congress enacted legislation in Calendar Year 2014 in an effort to reduce the risk of employment tax fraud by third-party payers, in particular PEOs. This included:

- **Consolidated Appropriations Act of 2014**³ – enacted January 17, 2014, requires the IRS to issue a notice as confirmation of any address change relating to an employer making employment tax payments. The IRS is required to send a notice to both the employer's former and new address. The requirement to send this notification was to protect employers, payers, and taxpayers from abusive third-party payroll providers. Although taxpayers are not required to respond to the notice, the intent of the notice is to have taxpayers let the IRS know when they did not authorize an address change.

¹ The NAPEO is the national trade association for the PEO industry. The NAPEO's members range in size from start-up PEOs to large publicly held companies.

² The IRS does not recognize the relationship between PEOs and their clients as "co-employment."

³ Pub. L. No. 113-76, 128 Stat. 5 (2014).



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- ***Achieving a Better Life Experience Act of 2014***⁴ – enacted December 19, 2014, as part of *The Tax Increase Prevention Act of 2014*, requires the IRS to establish a voluntary program for PEOs to become Federally certified. A Certified PEO shall be treated as the employer liable for employment taxes with respect to wages paid by the Certified PEO to a worksite employee performing services for any customer of the Certified PEO.

Federally Certified PEO application process

For a PEO to be eligible for Federal certification, among other things, they must:

- 1) Be a business entity.
- 2) Have at least one physical business location within the United States.
- 3) Have a history of Federal, State, and local tax compliance, financial responsibility, and organizational integrity.
- 4) Be managed by individuals (a majority of whom are U.S. citizens or residents) who have knowledge or experience regarding Federal and State employment tax compliance and business practices relating to those compliance requirements.

Prior to the IRS allowing the online submission of a PEO certification application, the IRS verifies the applicant's identity. This includes verifying that an applicant is who they say they are by asking personal questions in conjunction with questions from the individual's most recently filed tax return. This is a mandatory process that applies to any individual submitting an application for certification. Once an applicant's identity is confirmed, an applicant then submits a Responsible Individual Personal Attestation (RIPA). The RIPA gathers information that will allow the IRS to perform a suitability check on each of the responsible individual(s)⁵ representing the PEO. This includes each responsible individual submitting fingerprint cards for a criminal background check to be conducted. It should be noted that all responsible individuals representing a PEO will need to first have their identity verified prior to submitting the required RIPA.

Once the required RIPA applications are submitted, the PEO will submit a Certified PEO application. Some of the information the applicant is asked to provide includes the PEO's experience in the industry, certain financial and tax compliance information, and any bankruptcy or court judgments against the PEO. The applicant is also required to upload the following documents:

⁴ Pub. L. No. 113–295, 128 Stat. 4010 (2014).

⁵ A responsible individual is defined in Treas. Reg. § 301.7705-1T(b)(13) and is generally an individual who: 1) owns at least 33 percent of the Certified PEO applicant; 2) is a director, officer, managing member, or sole proprietor of the Certified PEO applicant; or 3) controls, manages, or supervises the Certified PEO applicant's operations, finances, or Federal employment tax compliance.



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- Surety Letter stating the surety company will bond⁶ the PEO. A Form 14751, *Certified Professional Employer Organization Surety Bond*,⁷ is submitted after the PEO receives a notice of certification.
- Financial information, including annual audited financial statements prepared by a Certified Public Accountant.
- Assertion and Certified Public Accountant examination-level attestation regarding Federal employment tax compliance.
- Other miscellaneous company information such as Articles of Organization, Articles of Incorporation, Corporate Charter, and Partnership Agreements, if applicable.

The completed certified application and RIPAs are submitted via the IRS Online Registration System. All of the information gathered is signed under penalty of perjury. Upon completion of the application, a processing fee of \$1,000 is submitted by the applicant through Pay.gov.⁸ This fee is intended to cover some of the costs incurred by the IRS to process the application and to monitor ongoing compliance with certification requirements.

This review was performed with information obtained from the Small Business/Self-Employed Division office in Lanham, Maryland, and the Wage and Investment Division office in Atlanta, Georgia, during the period July 2016 through June 2017. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁶ An insurance agreement pledging that one will become legally liable for financial loss caused to another by the act or default of a third person or by some contingency over which the third person may have no control.

⁷ See Appendix V.

⁸ Pay.gov is the convenient and fast way to make secure electronic payments to Federal Government agencies. Many common forms of payment are accepted, including credit cards, debit cards, and direct debit.



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Results of Review

In response to legislative provisions, the IRS has taken steps to implement processes and procedures to issue a notice as confirmation of any address change relating to an employer making employment tax payments and to establish a voluntary program for PEOs to become Federally certified. The following actions were taken by the IRS to implement a process to send address change confirmation letters:

- Developed the Computer Paragraph (CP) 148 A/B notices, *We Changed Your Mailing Address*, to send to businesses that make employment tax payments and that the IRS identifies as having an address change.
- Implemented programming changes to identify business taxpayers meeting the criteria to receive the notices.
- Developed instructions for IRS employees explaining the new notices and how to address taxpayer correspondence and phone calls resulting from the issuance of these notices.

In addition to establishing the above processes and procedures, the IRS took the following actions to establish the voluntary PEO certification program:

- Created the Certified PEO project team, which included an IRS executive, a project manager, and other IRS personnel to review the applications. The team defined, designed, developed, and implemented certification application processes and procedures. This included developing a comprehensive desk guide for application reviewers that outlines the technology and procedures for reviewing applications.
- Met with representatives from various States, as well as the NAPEO, to gain insights into the industry and to help inform both policy and operational decisions regarding the Certified PEO program.
- Developed processes, computer systems, and applications to receive and process required applications and supporting documentation. For example, the IRS created a web portal (*i.e.*, an online application system) that allows PEOs to upload documentation necessary to complete the certification process.
- Administered outreach and educational initiatives to provide information to employers, tax preparation firms, and other stakeholders. For example, the IRS requested public comment on the various proposed rules and regulations for the certification process and created a web page to answer frequently asked questions.
- Developed compliance plans and the forms needed to ensure that, once certified, PEOs remain in compliance with the requirements outlined in the legislation.



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Legislation required the IRS to begin accepting applications on July 1, 2015. However, the online application process was not available until July 2016. Management explained that the delay resulted from significant policy, procedural, and system changes that were needed to successfully implement this new program. On June 26, 2015, the IRS alerted the Senate Finance and the House Ways and Means Committees about the delay. On August 5, 2015, the IRS also issued a notice through IRS.gov and various media outlets about the new date for the implementation of the PEO certification program.

It should be noted that the IRS was provided no additional funding to implement the processes and procedures required by legislation. The IRS was unable to provide us with the costs to establish the notice program. However, the IRS estimated that it cost nearly \$24 million to issue just over 5 million sets of notices in Fiscal Year⁹ 2016. The IRS estimates costs to establish the Certified PEO program totaled almost \$12 million.¹⁰ In addition, the IRS estimates that continued operational costs for this program will be nearly \$3.5 million each year.

Most Professional Employer Organizations Do Not Participate in Federal Certification, Which Results in the Continued Inability to Link Employers That Use the Services of These Organizations

Our review found that the IRS will continue to be unable to link employers with PEOs for the majority of employers that use these services. As of March 31, 2017, the IRS received applications for certification from 123 PEOs, whereas in September 2015, the NAPEO estimated there were between 780 and 980 PEOs that represent 156,000 to 180,000 employers. PEOs file an aggregate tax return and pay employment taxes owed under the Employer Identification Number (EIN) of the PEO for all employers using their services. As we previously reported, in these types of arrangements, the IRS has been unable to identify PEOs and the employers they represent. For example:

- In September 2011,¹¹ we reported that the IRS was unable to identify employers that use the services of a PEO or when employers terminate the use of those services. We recommended that the IRS track PEO relationships by inputting cross-referenced EINs on the employer business tax accounts.

⁹ Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

¹⁰ Cost incurred between Fiscal Years 2015 through 2017 (as of April 30, 2017).

¹¹ Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2011-40-103, *Affordable Care Act: Efforts to Implement the Small Business Health Care Tax Credit Were Mostly Successful, but Some Improvements Are Needed* (Sept. 2011).



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- In March 2015,¹² we reported that the IRS was still unable to link employers with PEOs. We made recommendations for the IRS to establish a program in which employers could inform the IRS as to the PEOs that they authorize/designate for filing and payment of employment taxes. We also recommended that the IRS require those PEOs with a service agreement¹³ to attach a Schedule R (Form 941), *Allocation Schedule for Aggregate Form 941 Filers*, to their Form 941 tax return listing the employers on whose behalf the PEOs are filing.

It should be noted that for those PEOs that are certified by the IRS, they are required to notify the IRS of the specific employers that use their services. For example, once certified, a PEO is required to complete a Form 8973, *Certified Professional Employer Organization/Customer Reporting Agreement*, for each employer that it processes employment taxes for. In addition to Form 8973, these PEOs are required to include a Schedule R with their filed aggregate Form 941. Schedule R allows the IRS to identify which portion of the wages and employment taxes reported on the PEO's return are attributable to each individual employer and to identify potential filing and payment noncompliance. Figure 1 provides an example of the Schedule R and how it lists the specific employers associated with each PEO.

¹² TIGTA, Ref. No. 2015-40-023, *Processes Are Needed to Link Third-Party Payers and Employers to Reduce Risks Related to Employment Tax Fraud* (Mar. 2015).

¹³ The IRS defines a service agreement as a written or oral agreement between an employer and the PEO confirming a joint responsibility to collect, report, and pay any employment taxes with respect to the wages or compensation paid.



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**Figure 1: Schedule R (Form 941):
Allocation Schedule for Aggregate Form 941 Filers**

Schedule R (Form 941): Allocation Schedule for Aggregate Form 941 Filers
(Rev. January 2017)
Department of the Treasury – Internal Revenue Service

OMB No. 1545-0029

Employer identification number (EIN) -

Name as shown on Form 941

Type of filer (check one): Section 3504 Agent Certified Professional Employer Organization (CPEO)

Report for calendar year:

Check the quarter (same as Form 941):

1: January, February, March

2: April, May, June

3: July, August, September

4: October, November, December

950017

Read the instructions before you complete Schedule R. Type or print within the boxes. Complete a separate line for the amounts allocated to each of your clients. The term "client" as used on this form includes the term "customer." See the instructions.

(a) Client's Employer identification number (EIN)	(b) Type of wages, tips, and other compensation (CPEO Use Only)	(c) Wages, tips, and other compensation allocated to the listed client EIN from Form 941, line 2	(d) Federal income tax withheld from wages, tips, and other compensation allocated to the listed client EIN from Form 941, line 3	(e) Total social security and Medicare taxes allocated to the listed client EIN from Form 941, line 5e	(f) Section 3121(g) Notice and Demand-Tax due on unreported tips allocated to the listed client EIN from Form 941, line 5f	(g) Qualified small business payroll tax credit for increasing research activities allocated to the listed client EIN from Form 941, line 11	(h) Total taxes after adjustments and credits allocated to the listed client EIN from Form 941, line 12	(i) Total deposits from Form 941, line 13, plus any payments made with the return allocated to the listed client EIN
1		.	.	.	.	.	.	.
2		.	.	.	.	.	.	.
3		.	.	.	.	.	.	.
4		.	.	.	.	.	.	.
5		.	.	.	.	.	.	.
6		.	.	.	.	.	.	.
7		.	.	.	.	.	.	.
8		.	.	.	.	.	.	.
9		.	.	.	.	.	.	.
10		.	.	.	.	.	.	.
11	Subtotals for clients. Add all amounts on lines 1 through 10	.	.	.	.	.	.	.
12	Enter the combined subtotal from line 24 of all Continuation Sheets for Schedule R	.	.	.	.	.	.	.
13	Enter Form 941 amounts for your employees	.	.	.	.	.	.	.
14	Totals. Add lines 11, 12, and 13. The column totals must match the related lines on the aggregate Form 941.	.	.	.	.	.	.	.

For Paperwork Reduction Act Notice, see the instructions. IRS.gov/form941 Cat. No. 49301K Schedule R (Form 941) (Rev. 1-2017)

Source: IRS.gov.



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Since the certification program is voluntary, noncertified PEOs are neither required to submit a Form 9973 and Schedule R nor meet the bonding and suitability requirements. Because a PEO uses its own EIN when filing tax returns on behalf of the employers it represents and because the IRS has no way to identify that the PEO is filing and paying taxes on behalf of those employers, the IRS cannot monitor the PEO to ensure that the employment taxes are being properly filed and paid.¹⁴ In response to our raising this same concern in our March 2015 report, IRS management stated that in order for the IRS to require all PEOs to include Schedule R with their Form 941, legislation is needed.

The IRS has previously submitted requests for the necessary legislative changes to require PEOs to file Schedules R, but this legislation has still not been enacted. For example, the previous proposal would set forth to hold a PEO jointly liable with its clients for employment taxes and establish a reporting requirement (*i.e.*, Schedule R) to allocate wages and taxes among its clients. However, the legislation that was enacted only applies to those PEOs that become certified with the IRS. As such, clients that hire a noncertified PEO remain at risk.

Employment tax fraud committed by PEOs remains a significant risk to employers

Being certified by the IRS has certain Federal employment tax protections for both the Certified PEOs and the employers that use their services. For example, if a client company hires a Certified PEO, they can be assured that the PEO is bonded and there is not a material risk to the collection of employment taxes. As part of being certified, the Certified PEO's customers are not responsible for any unpaid employment taxes with respect to remuneration paid by the Certified PEO to worksite employees.¹⁵ As required by law, the IRS will publish lists detailing those PEOs that are Federally certified and those whose certification has been revoked or suspended. However, unlike those PEOs that are Federally certified, no such protection exists for those employers that continue to use the services of a PEO that chooses not to participate in the program. The following examples show the continued risk to employers resulting from unscrupulous PEOs that commit employment tax fraud. In each of these instances, employers, despite paying the employment tax to their PEO, remain liable to the IRS for the amount of employment taxes owed.

- On June 4, 2015, an individual was sentenced to 144 months in prison and three years of supervised release and ordered to forfeit \$10.8 million and to pay a total of more than \$108 million in restitution. According to court documents, this individual controlled a

¹⁴ If a PEO is serving as the employer's agent, the PEO must file a Form 2678, *Employer/Payer Appointment of Agent*, and Schedule R (Form 941).

¹⁵ A worksite employee is a covered employee who performs services for a customer at a worksite where, at any time during a calendar quarter, at least 85 percent of the individuals performing services for the customer are covered employees of the customer. To be a worksite employee, a covered employee regularly performing services for a customer at a worksite during a calendar quarter is not required to be performing services for the customer at the time the worksite coverage requirement is met at that worksite.



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PEO and instead of paying \$53 million in taxes that the PEO's clients owed the IRS, the individual stole the money that the client companies had paid to the PEO for those purposes.

- On July 9, 2015, a Chief Executive Officer of a PEO was sentenced to 70 months in prison and three years of supervised release and ordered to pay \$29,174,931 in restitution to the IRS. The PEO collected Federal payroll taxes from employers and was required to turn over those funds to the IRS in a timely manner. However, instead of doing so, the Chief Executive Officer used the funds for other company expenses and personal expenditures.
- On December 15, 2015, the president of a PEO was sentenced to 135 months in prison and two years of supervised release and ordered to pay over \$17 million in restitution. From 2008 to March 2014, the president defrauded at least 113 clients of almost \$17 million intended for payroll and employment tax payments and used it to support his personal lifestyle.
- On March 28, 2016, the owner of a PEO was sentenced to 60 months of supervised probation and 12 months of home confinement and ordered to pay restitution of \$377,163. The owner was convicted of willfully causing the failure to pay over employment taxes to the IRS.¹⁶

Legislative Recommendation

Recommendation 1: The Commissioner, Small Business/Self-Employed Division, should work with the Department of the Treasury, Office of Tax Policy, to consider a legislative proposal to require noncertified PEOs to register with the IRS, similar to requiring tax return preparers to obtain a Preparer Tax Identification Number,¹⁷ and require the noncertified PEOs to file a Schedule R with their Form 941.

Management's Response: The IRS agreed with this recommendation and has developed a suggestion for a legislative proposal. IRS management plans to work with the Office of Chief Counsel to share the proposal with the Department of the Treasury.

¹⁶ These case examples were located on the IRS's website and were from public record documents on file in the courts within the judicial district where the cases were prosecuted.

¹⁷ A Preparer Tax Identification Number is a number issued by the IRS to paid tax return preparers. It is used as the tax return preparer's identification number and, when applicable, must be placed in the Paid Preparer section of a tax return that the tax return preparer prepared for compensation.



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**Processing Time Frames and Procedures to Periodically Inform
Applicants of the Status of Their Application Need to Be Developed**

The IRS has not established time frames for reviewing applications. The IRS publicized the expectation that if a PEO submitted its application by September 30, 2016, the PEO would be eligible for retroactive certification as of January 1, 2017, even if the date of its notice of certification was after January 1, 2017. However, the IRS did not certify any of the applications received as of September 30, 2016, until June 1, 2017, which is nearly one year after the IRS implemented the program. When we brought our concerns about the untimely processing of the applications to IRS management's attention, management stated that they received more applications than they originally expected. In addition, the applications were more complex and took longer to process. For example, many of the applications were from very large PEO companies that were associated with a significant number of related companies and responsible individuals. This created more work for the limited number of staff to properly and timely complete their review of the applications. Management did indicate that it plans on establishing timeliness standards after it has obtained and reviewed sufficient information from the PEO applications it has processed thus far.

Processes to notify applicants of the status of their application have not been developed

The IRS has not developed processes and procedures to periodically notify applicants of the status of the IRS's processing of their applications. Our discussions with a sample of PEOs that submitted their application by September 2016 raised concerns regarding not being notified as to the status of the IRS processing their applications. For example, between March 16 and March 24, 2017, we surveyed 21 (17 percent) of the 122 PEOs¹⁸ that submitted applications as of January 6, 2017. Of the 21 applicants we interviewed, 15 (71 percent) responded that, in their opinion, the IRS has not timely processed their application. Further, 12 applicants expressed concern that they have not been notified by the IRS regarding the status of their application.

When we discussed this concern with IRS management, they noted that notices to provide the status of applicant submission and processing have been developed but were not being used unless an applicant contacted the IRS about the status of the application. Also, subsequent to feedback from stakeholders regarding the lack of IRS application status notifications, IRS management updated IRS.gov to include the ability for applicants to check the status of their application by logging in to their online account.

¹⁸ We selected a judgmental sample of 21 of the 122 applicants that submitted an application as of January 6, 2017. A judgmental sample is a nonprobability sample, the results of which cannot be used to project the population.



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Processes to monitor and ensure Certified PEO compliance with program requirements have not been completed

During our review, we found that the development of processes needed to ensure that, once certified, PEOs remain compliant with program requirements is still in the planning phase. For example, the systemic process needed to link Certified PEOs to their clients using information from the Forms 8973 and Schedule R has not been implemented. When we brought these concerns to the IRS's attention, management stated that programming requests have been submitted, but the programming needed may not be completed until sometime in Calendar Year 2018 or later because these requests are prioritized with other IRS programming needs and funding. We plan on performing an additional review of the PEO certification program, which will include an assessment of the IRS's monitoring and compliance processes as well as its processes regarding the annual Certified PEO verification process.

Recommendation

Recommendation 2: The Commissioner, Small Business/Self-Employed Division, should establish timeliness standards for reviewing applications.

Management's Response: The IRS agreed with this recommendation. The IRS plans to collect data related to application processing time and develop a study to identify areas for improving processing time once it has processed a sufficient number of Certified PEO applications.

Programming Errors Resulted in the Erroneous Issuance of Notices and Some Employers Not Being Notified of Address Changes As Required

Our review of approximately 5.3 million sets of notices (*i.e.*, notices sent to both the old address and new address) issued between September 2015 and September 2016 identified:

- 698,660 sets of notices that were unnecessarily issued to businesses when the businesses' address did not actually change. These included 407,319 sets of notices that were issued to the same address because the address information contained minor formatting changes such as abbreviations (*e.g.*, "Street" to "St") or other minor punctuation or spacing differences. For another 291,341 sets of notices, two programming errors and a missing business requirement caused an address change when in fact the address did not change. For example, a missing business requirement associated with the "Care of Name" caused an address change even though the business's physical address did not change.

When we shared our exception cases with the IRS, the IRS agreed that the notices we identified were being incorrectly issued because of minor formatting changes, system programming errors, and incomplete business requirements. Although the IRS uses a



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standardized software (also used by the U.S. Postal Service) to ensure that the IRS's outgoing mail, notices, tax packages, *etc.*, comply with the Postal Service's address standards, this software does not alleviate the address changes resulting from the minor formatting issues. IRS management advised us that they do not have a way to identify these minor types of address changes. We disagree. At a minimum, the IRS could systemically identify minor address changes and establish a process to confirm whether a notice should in fact be sent to these businesses.

Management did agree to fix the programming issues and incomplete business requirements not associated with the minor formatting type changes. IRS management indicated that a programming change request was submitted. Using IRS cost data, we estimate that the issuance of these erroneous notices resulted in the IRS needlessly expending almost \$3 million.¹⁹

- 256,826 sets of notices to businesses whose address was changed but to which notices were not issued as required. This resulted because the Form 940 was not documented as a business requirement. When we brought this issue to IRS management's attention, they advised us that the Form 940 criteria was overlooked when requirements were being developed for the necessary programming changes. IRS management subsequently advised us that the necessary programming change request was submitted and is scheduled to be implemented in January 2018.

Processes have not been established to identify and protect businesses alerting the IRS of unauthorized address changes

We were unable to evaluate the extent to which businesses addresses are being changed without authorization. The IRS does not track or maintain calls/correspondence from employers with concerns about their address being changed. However, with the increase in business identity theft, for those employers that do respond and indicate that there was an unauthorized address change, it would be prudent for the IRS to track these employer contacts and develop a process to add some type of indicator to the business tax account to evaluate filings for potential fraud. We also found that the IRS does not track or keep statistics regarding specific contacts or correspondence received from taxpayers reporting that an unauthorized change to their address was made.

The IRS instructs taxpayers to call or write if the mailing address shown on the notice is incorrect or if there should not be a change to the taxpayer's address. Figure 2 provides an example of the notice and instructions to taxpayers.

¹⁹ The IRS estimates the final cost per set of notices to be approximately \$3.91.



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Figure 2: CP 148B Notice

 Department of the Treasury Internal Revenue Service Cincinnati OH 45999	Notice	CP148B
	Notice date	February 2, 2018
s018999546711s ABC CORPORATION 22 BOULDER STREET HANSON CT 00000-7253	Employer ID number	NN-NNNNNNN
	To contact us	1-800-829-0115
Page 1 of 1		

We changed your mailing address

We updated our records for your mailing address.

We update our records anytime the address entered on a tax return is different from what we have in our records, or a Form 8822-B is received.

The address shown above is where we previously sent IRS notices and letters about your tax account. We will no longer mail notices and letters to that address. We also sent a confirmation notice to your new mailing address.

Caution for employers regarding third-party payroll providers

Additional information

What you need to do
Our update to your address may be for minor changes in words and abbreviations, such as using "Street" rather than "St." in your address. To avoid confusion, you or your tax preparer should always enter your correct mailing address in exactly the same way every time you file tax returns.

If the mailing address for IRS notices and letters shown above is correct, you do not need to do anything.

If there should not be a change to your address, call or write to us using the contact information at the top of this page. If you call, please review the most recent tax returns you filed for differences in addresses entered. For written correspondence, include a copy of this notice. We can address concerns more quickly via telephone.

If we find any issues with an account, we send a letter or notice to your address of record. We strongly caution any employer against changing the address of record to that of a payroll service provider or other third party as it may significantly limit our ability to inform the employer of tax matters involving the business. The employer is ultimately responsible for depositing and paying all federal employment tax liabilities.

For more information, visit www.irs.gov and search keywords, "Change of Address" or "Outsourcing Payroll Duties."

- Visit www.irs.gov/cp148b
- For tax forms, instructions, and publications, visit www.irs.gov or call 1-800-TAX-FORM (1-800-829-3878).
- Keep this notice for your records.
- Please be sure you (or your tax preparer) always enter your correct mailing address on tax returns in exactly the same way every time you file unless you change your mailing address after you filed your last return.

If you need assistance, please don't hesitate to contact us.

Source: IRS Notice Gatekeeper (i.e., the IRS notice repository).



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Internal IRS guidelines require tax assistors who receive calls from employers in response to receiving a notification letter who state the address should not have been changed to research the reason for the address change. If the employer still has concerns after receiving the information provided by the assistor, the employer is asked to follow up their call with written correspondence. The employer's concerns will then be addressed by an IRS function with additional expertise to address the concerns.

Redaction of the EIN from both notices will help further protect against business identity theft

Our review found that the address change notices used to inform business taxpayers that their address has been changed include the full EIN of the employer. As previously mentioned, the address change notice is issued to both the old and new address of the business. As such, the notice going to the old address could be delivered to someone other than the true taxpayer. IRS management had previously advised us that it had plans to truncate the EIN on the CP 148B notices (*i.e.*, the notice sent to the old address) starting January 2018. On January 26, 2017, we notified IRS management that we were concerned that they were not taking more immediate action to begin truncating the EINs because approximately 5.3 million CP 148B notices had been issued from September 2015 to September 2016. The IRS agreed to truncate the EIN on both notices; however, it is still planning on implementing this change in January 2018.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 3: Establish processes and procedures to reduce unnecessary resources expended notifying employers of an address change when programming incorrectly identifies an address change resulting from minor formatting revisions.

Management's Response: The IRS agreed with this recommendation and has requested a revision to Revenue Procedure 2010-16, which establishes how a taxpayer's address of record is updated. Upon revision of this procedure, affected business taxpayers will be required to affirmatively request a change of address by completing Form 8822-B, *Change of Address or Responsible Party – Business*.

Recommendation 4: Ensure that programming is updated to include Form 940 in the criteria to generate CP 148 notices when an address is changed.

Management's Response: The IRS agreed with this recommendation and has submitted a Unified Work Request on January 19, 2017, to request programming changes that will add Form 940 to the list of forms requiring the issuance of CP 148 notices. IRS management expects the programming change to be effective by January 2018; however, programming changes are subject to limited resources, budgetary constraints, and competing priorities.



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Recommendation 5: Develop processes and procedures to track employer contacts with the IRS alerting them of an unauthorized address change and refer these unauthorized address changes to the appropriate IRS function to determine why the change occurred and if the employer's account should be marked to proactively protect the business against possible identity theft.

Management's Response: The IRS agreed with this recommendation and has updated its procedures on July 13, 2017, to instruct employees to route cases for review when responses to CP 148 notices allege the address change was triggered by fraud or identity theft or was otherwise unauthorized. Upon review, the case will be forwarded to the appropriate area for resolution.

Recommendation 6: Ensure that EINs are truncated on all CP 148 notices.

Management's Response: The IRS agreed with this recommendation and has submitted a Unified Work Request on January 19, 2017, to request redaction of the EINs on CP 148 notices. IRS management expects the programming change to be effective by January 2018; however, programming changes are subject to limited resources, budgetary constraints, and competing priorities.



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Appendix I

Detailed Objectives, Scope, and Methodology

Our overall objective was to assess the IRS's actions to establish processes for certifying PEOs authorized for the filing and paying of employment taxes. In addition, we evaluated the dual notice process for address changes associated with employers that have employment tax filing requirements. To accomplish these objectives, we:

- I. Determined if the PEO certification program would adequately address concerns raised in prior TIGTA reports.
 - A. Reviewed prior TIGTA reports and summarized recommendations and the IRS's planned corrective actions relating to concerns with PEOs.
 - B. Interviewed IRS management to confirm the current status of the IRS's planned corrective actions.
 - C. Reviewed the current PEO certification processes and determine if these processes would address TIGTA's prior findings/concerns.
- II. Ensured that the IRS completed the PEO certification requirements as outlined in the regulations.
 - A. Reviewed Certified PEO legislation and determined what forms and instructions were required by the regulations.
 - B. Reviewed IRS plans to develop certification management processes (annual verification, decertification, and suspension/revocation).
- III. Determined whether the IRS had sufficient procedures, processes, and systems in place to process Certified PEO applications.
 - A. Ensured that processes were established by the IRS to review and process RIPA applications.
 - B. Ensured that processes were established by the IRS to review and process Certified PEO applications.
 - C. Identified the IRS functions that were assigned to process the Certified PEO forms and determined whether processes were in place to process the new forms.



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- D. The IRS provided TIGTA with a listing of 122 Certified PEO applications as of January 6, 2017. We accessed the Versa¹ system by the application number to identify the applicant submitter for the Certified PEO applications. We judgmentally selected the application submitters for 48 (39 percent) of 122 CPEO applications. We selected a judgmental sample² because we wanted to ensure that processes were established, but we did not intend to project the results to the overall population. We made telephone calls from March 16, 2017, to March 24, 2017, and were successful in contacting 21 of 48 application submitters. We obtained responses from the 21 application submitters to TIGTA's survey of eight questions concerning their experiences with obtaining certification from the IRS.
- IV. Determined if the IRS had adequate plans to ensure that PEOs are meeting their certification, tax filing, and payment requirements.
- A. Reviewed Certified PEO legislation and corresponding Internal Revenue Code sections and Treasury regulations to identify Certified PEO compliance requirements.
- B. Determined the data sources that the IRS will use to verify that Certified PEOs are complying with their requirements.
- C. Reviewed the IRS's compliance plans and procedures for notifying Certified PEOs when they are identified as not complying with the program requirements.
- V. Reviewed the IRS's address change notification program to ensure that notices were being issued as required.
- A. Reviewed the IRS's processes and procedures for issuing CP 148 A/B, *We Changed Your Mailing Address*, notices.
- B. Performed tests to ensure that CP 148 notices were being properly issued by the IRS.
- C. Identified businesses that should have been issued notices but were not.
- D. Determined if the IRS received any correspondence from taxpayers indicating that they were unaware of an address change on their account and determined how the IRS resolves the issues.
- E. Evaluated what information the IRS tracks and summarizes to show the overall effectiveness of the address change notification program.

¹ MicroPact's Versa is a commercial off-the-shelf solution that can be deployed on multiple platforms and can be installed at the IRS data center or hosted by MicroPact.

² A judgmental sample is a nonprobability sample, the results of which cannot be used to project the population.



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Data validation methodology

During this review, we relied on data stored at TIGTA's Data Center Warehouse³ and performed analysis of data extracted from the IRS Business Master File⁴ Notices Mainframe. To assess the reliability of computer-processed data, programmers within TIGTA's Data Center Warehouse validated the data files we extracted, and we ensured that each data extract contained the specific data elements we requested and that the data elements were accurate. For example, we reviewed judgmental samples of the data extracts and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System⁵ or other systems, if possible. As a result of our testing, we determined 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: processes and procedures to 1) certify PEOs and ensure that the Certified PEOs remain compliant; 2) link PEOs with the clients they represent; and 3) ensure that CP 148 notices are properly issued to businesses that have an address change. We evaluated these controls by reviewing applicable Internal Revenue Code sections, Treasury Regulations, and Internal Revenue Manual sections; interviewing IRS management; and reviewing relevant IRS forms and publications.

³ A collection of IRS databases containing various types of taxpayer account information that is maintained by TIGTA for the purpose of analyzing data for ongoing audits.

⁴ 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.

⁵ 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

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)

Diana M. Tengesdal, Director

Larry Madsen, Audit Manager

Jeremy Berry, Lead Auditor

Gwendolyn Gilboy, Senior Auditor



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Appendix III

Report Distribution List

Commissioner
Assistant Secretary of the Treasury for Tax Policy
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Services and Enforcement
Deputy Commissioner, Small Business/Self-Employed Division
Deputy Commissioner, Wage and Investment Division
Director, Legislative Program Coordination Office, Small Business/Self-Employed Division
Director, Enterprise Case Management Program Management Office, Small Business/
Self-Employed Division
Director, Customer Account Services, Wage and Investment Division
Director, Submission Processing, Wage and Investment Division
Director, Office of Audit Coordination



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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:

- Taxpayer Burden – Potential; 698,660 sets of notices that were unnecessarily issued to businesses whose address did not actually change (see page 11).

Methodology Used to Measure the Reported Benefit:

We received a CP 148 A/B, *We Changed Your Mailing Address*, extract from September 2015 to September 2016 that contained 10,593,816 notices. We then identified CP 148 A/B notices that were unnecessarily issued to businesses whose address did not actually change.

Our review of CP 148 A/B notices issued between September 2015 to September 2016 found that 698,660 sets of notices were unnecessarily issued to businesses whose address did not actually change. These included 407,319 sets of notices that were issued to the same address because the address information contained minor formatting changes such as abbreviations (*e.g.*, “Street” to “St”) or other minor punctuation or spacing differences. For another 291,341 sets of notices, two programming errors and a missing business requirement caused an address change when in fact the address did not change. For example, a missing business requirement associated with the “Care of Name” caused an address change, even though the business’s physical address did not change.

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Potential; the IRS needlessly expended almost \$3 million in erroneously issued notices (698,660 sets of notices) because of minor formatting changes, system programming errors, or a missing business requirement (see page 11).

Methodology Used to Measure the Reported Benefit:

Our review of 10,593,816 CP 148 A/B notices issued between September 2015 and September 2016 found that 698,660 sets of notices that were unnecessarily issued to businesses whose address did not actually change. Based upon cost estimates provided by the IRS of approximately \$3.91 per set of notices, the issuance of these erroneous notices because of minor



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formatting changes or system programming errors or a missing business requirement resulted in the IRS needlessly expending \$2,735,114 ($\$3.9148 \times 698,660$).

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 256,826 sets of notices to businesses whose address was changed, but notices were not issued as required. This occurred because the Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, was not documented as a business requirement (see page 11).

Methodology Used to Measure the Reported Benefit:

We received a CP 148 A/B extract from September 2015 to September 2016 that contained 10,593,816 notices. Additionally, we used multiple data extracts stored at TIGTA's Data Center Warehouse. Using both of these data sources, we determined that the IRS was not sending out CP 148 A/B notices when it should have been.

Our review found that 256,826 sets of notices to businesses whose address was changed were not issued as required. This resulted because the Form 940 was not documented as a business requirement.

Type and Value of Outcome Measure:

- Taxpayer Privacy and Security – Potential; 5,296,908 address change notices were sent to taxpayers' old address and contained nontruncated EIN (see page 11).

Methodology Used to Measure the Reported Benefit:

Our review found that the address change notices used to inform business taxpayers that their address has been changed contains the employers' EIN. As previously mentioned, the address change notice is issued to both the old and new address of the business. As such, the notice going to the old address could be delivered to someone other than the true taxpayer. Approximately 5.3 million CP 148 B notices have been sent from September 2015 to September 2016 that contained a nontruncated EIN.



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Appendix V

**Form 14751, Certified Professional
Employer Organization Surety Bond**

Form 14751 (May 2017)	Department of the Treasury - Internal Revenue Service Certified Professional Employer Organization Surety Bond Required by Section 7705(c) as a Term of Certification	OMB Number 1545-2266
---------------------------------	--	-------------------------

Part I - Identify Type of Bond or Rider

This is a (check the one that applies)	Bond number
<input type="checkbox"/> New bond <input type="checkbox"/> Strengthening bond <input type="checkbox"/> Superseding bond <input type="checkbox"/> Rider	

Part II - Bonding

We, the Principal(s) named in Part IV and Surety named in Part V, are obligated to the United States of America as Oblige in the Penal Sum of:

_____ dollars (\$ _____).

Principal(s) and Surety are liable in an amount equal to the sum of any tax liabilities accrued by Principal(s) under subtitle C of the Internal Revenue Code (Code) during the term of this bond to the extent unpaid, up to the penal sum of this bond. Surety shall remain liable under this bond for the assessment and collection periods applicable to the Principal(s) under sections 6501 and 6502 of the Code, respectively, with respect to any taxable period that occurs during the term of the bond unless and until the bond is superseded. Principal(s) and Surety also jointly and severally obligate their heirs, executors, successors, and assigns for the payment of this amount. Surety agrees to pay a claim under this bond within thirty (30) calendar days of receiving written demand for payment of the claim from Oblige. The written demand for payment will provide the amount of tax liability that has not been paid by one or more Principal(s) and the date by which the Principal(s) should have paid this amount. Nothing in this bond or any amendments thereto shall affect the liability of Principal(s) for any unpaid employment taxes accrued by Principal(s) under subtitle C of the Code.

For purposes of certified professional employer organizations (CPEOs) that are members of a controlled group within the meaning of section 414(b) and (c) with other CPEOs, each CPEO member of such controlled group is a Principal of this bond.

If this is a new bond posted within 30 days of the CPEO's notice of certification, it shall be effective on the effective date of certification specified by the IRS Approving Official in the notice of certification issued to Principal (if there is more than one Principal, it shall be effective on the effective date specified in the notice of certification issued to the first Principal to receive notice of certification). If it is a new bond posted immediately following cancellation of an existing bond, the effective date shall be the date this bond is executed by Surety below (which shall be no later than the effective date of the cancellation of the existing bond). If this is a rider amending an existing bond to increase the penal sum, it shall apply to liabilities that arise on or after the effective date of the existing bond that the rider amends. If this is a strengthening or superseding bond to increase the penal sum, it shall apply to liabilities that arise on or after the effective date of the existing bond it strengthens or supersedes, as applicable.

This bond may be cancelled by Surety only after Surety gives written notice, sent by certified mail, to Principal(s) and Oblige of Surety's intent to cancel the bond at least 90 days in advance of the effective date of cancellation. Similarly, this bond may be cancelled by Principal(s) only after written notice is given by Principal(s), sent by certified mail, to Oblige of Principal(s)' intent to cancel the bond at least 90 days in advance of the effective date of cancellation. In either case, the written notice of cancellation must state the effective date of cancellation.

Notwithstanding the cancellation of this bond, unless a superseding bond is issued, Surety remains liable for any unpaid taxes of Principal(s) under subtitle C for which liability accrued on or after the effective date of this bond and prior to the effective date of cancellation.

Surety agrees to provide written notice, sent by certified mail, to Principal(s) and Oblige if Surety ceases to meet any requirements described under "Qualifying Surety" in the instructions to this Form immediately upon learning of such failure.

Part III - Rider

To be attached to and for a part of Bond Number _____ dated _____ given by the Principal(s) named in Part IV and Surety named in Part V, in favor of the United States of America as Oblige, in the original penal sum of:

_____ dollars (\$ _____).

Principal(s) and Surety agree to amend the attached bond as follows (check all that apply)

Change in penal sum

The penal sum of the attached bond or any modification of said penal sum is changed from

_____ dollars (\$ _____) to

_____ dollars (\$ _____) for

any tax liabilities accrued by Principal(s) under subtitle C of the Internal Revenue Code (Code) on or after the effective date of the attached bond identified above, to the extent unpaid.



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Change in Contact Information of Principal(s)

Number of Principals _____

The address, and/or telephone number of Principal(s), as given on the attached bond, or any previously executed rider are changed

From

Name		Telephone number	
Address (street address)	City	State	Zip code

To

Name		Telephone number	
Address (street address)	City	State	Zip code

From

Name		Telephone number	
Address (street address)	City	State	Zip code

To

Name		Telephone number	
Address (street address)	City	State	Zip code

Addition or Removal of Principal(s) (To be used by CPEOs that are members of a controlled group within the meaning of section 414(b) and (c) with other CPEOs)

Number of Principals _____

The organization below is added/removed as a Principal to the bond

Added Removed

Principal (name of CPEO)		Federal EIN	
Address (street address)	City	State	Zip code
Telephone number			

(This organization must be added to or removed from Part IV)

Change in Contact Information of Surety

The address, and/or telephone number of Surety, as given on the attached bond, or any previously executed rider are changed

From

Name		Telephone number	
Address (street address)	City	State	Zip code



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To			
Name		Telephone number	
Address (street address)		City	State Zip code

Provided, however, that the attached bond shall be subject to all its agreements, limitations, and conditions except as herein expressly modified, and further that the aggregate liability under the attached bond, all riders attached thereto, including this rider, and all strengthening bonds shall in no event exceed the largest penal sum in force when a claim under this bond is made.

Part IV – Principal(s)

Under penalties of perjury, I declare that I have examined this form and any accompanying statements, and to the best of my knowledge and belief, they are true, correct, and complete. The Principal(s) will file all returns and statements as required by law or regulations; and the Principal(s) will pay all taxes including any penalty and interest charges.

Number of Principals _____

Principal (name of CPEO)		Federal EIN	
Address (street address)		City	State Zip code
Telephone number	Signature of Principal	Title (if applicable)	Date

Certificate of Corporate Principal (corporations only): I certify that the person above, who signed on behalf of the Principal, is an authorized representative of the corporation.

Signature of Secretary of the Corporation	Name (print or type)	Date
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Part V - Surety

Under penalties of perjury, I declare that I have examined this form and any accompanying statements, and to the best of my knowledge and belief, they are true, correct, and complete.

Name of Surety		Telephone number	
Address (street address)		City	State Zip code
Signature of Surety	Title	NAIC identifying number	Date

Part VI - Approval by IRS

Bond approved

Date bond approved	Internal Revenue Service Approving Official	Name (print or type)
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Paperwork Reduction Act Notice

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax. You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103. The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

- Recordkeeping 55 min
- Learning about the law or the form 20 min
- Preparing, copying, assembling, and sending the form to the IRS 45 min



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Appendix VI

Management's Response to the Draft Report



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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

AUG 28 2017

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mary Beth Murphy 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Further Actions Are Needed to Reduce the
Risk of Employment Tax Fraud to Businesses That Use the
Services of Professional Employer Organizations
(TIGTA #201640019)

Thank you for the opportunity to review and comment on the subject draft audit report. Congress enacted the Achieving a Better Life Experience (ABLE) Act on December 19, 2014, which changed the landscape of the IRS' authority with respect to Professional Employer Organizations (PEOs). Specifically, the new law requires the IRS to establish a voluntary certification program, whereby a PEO can apply to the IRS for certification. A Certified PEO (CPEO) shall be treated as the employer liable for employment taxes with respect to wages paid by the CPEO to a work site employee performing services for any customer of the CPEO.

We appreciate your acknowledgement of the numerous steps the IRS has taken to implement and establish a voluntary program for PEOs to become Federally certified, such as: creating an executive led project team to implement the legislation, meeting with external stakeholders to gain insights into the industry and help inform policy and operational decisions, developing processes, systems, and procedures to receive and process applications, and developing compliance plans to ensure the CPEOs remain in compliance with the requirements outlined in the legislation.

As your report notes, the certification program is voluntary. IRS remains unable to link non-certified PEOs to employers who utilize their services. The legislation only requires tracking of these relationships for CPEOs. Once certified, a CPEO is required to complete a Form 8973, *Certified Professional Employer Organization/Customer Reporting Agreement*, for each of its customers. Additionally, these CPEOs are required to include a Schedule R, *Allocation Schedule for Aggregate Form Filers*, with their aggregate employment tax returns. Schedule R allows the IRS to identify which portion of the wages and employment taxes reported on the CPEO's return are attributable to each individual employer and to identify potential filing and payment noncompliance.

The initial application review was complex and required a lengthier evaluation process than anticipated, due in part to the numerous steps required for application completion,



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which resulted in a longer than expected application processing time. After processing a sufficient number of applications, we will gain additional insight and knowledge to allow for application reviews to be handled more expeditiously.

We appreciate your acknowledgement of the steps we have taken to implement processes and procedures to comply with the Consolidated Appropriations Act of 2014 that required the IRS to issue a notice as confirmation of any address change relating to an employer making employment tax payments. As noted in your report, the IRS received no additional funding to implement the PEO-related processes and procedures required by the ALE Act and the Consolidated Appropriations Act of 2014 - the implementation of which is estimated to cost roughly \$40 million dollars.

Attached is a detailed response outlining our corrective actions to address your recommendations. If you have any questions, please contact me, or a member of your staff may contact Brenda Dial, Director, Examination, SB/SE Division at (240) 613-2849.

Attachment



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Attachment

RECOMMENDATION 1:

The Commissioner, Small Business/Self-Employed Division, should work with the Department of the Treasury, Office of Tax Policy, to consider legislation requiring non-Certified PEOs to register with the IRS, similar to requiring tax return preparers to obtain a Preparer Tax Identification Number,¹ and require the non-Certified PEOs to file a Schedule R with their Form 941.

CORRECTIVE ACTION:

We agree with this recommendation, and while the IRS does not propose legislation, we have developed a suggestion for a legislative proposal, and will work with the Office of Chief Counsel for sharing with the Department of Treasury.

IMPLEMENTATION DATE:

January 15, 2018

RESPONSIBLE OFFICIAL:

Director, Exam Operations, Small Business/Self-Employed Division (SB/SE)

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 establish timeliness standards for reviewing applications.

CORRECTIVE ACTION:

We agree with this recommendation. Once we have processed a sufficient number of CPEO applications, we will collect data related to application processing time and develop a study to identify areas for improving processing time.

IMPLEMENTATION DATE:

December 15, 2018

RESPONSIBLE OFFICIAL:

Director, Exam Operations, Small Business/Self-Employed Division (SB/SE)

¹ A Preparer Tax Identification Number is a number issued by the IRS to paid tax return preparers. It is used as the tax return preparer's identification number and, when applicable, must be placed in the Paid Preparer section of a tax return that the tax return preparer prepared for compensation.



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CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 3:

The Commissioner, Wage and Investment Division, should establish processes and procedures to reduce unnecessary resources expended notifying employers of an address change when programming incorrectly identifies an address change resulting from minor formatting revisions.

CORRECTIVE ACTION:

We agree with this recommendation and have requested a revision to Revenue Procedure 2010-16, which establishes how a taxpayer's address of record is updated. Upon revision of the procedure, affected business taxpayers will be required to affirmatively request a change of address by filing Form 8822-B, *Change of Address or Responsible Party – Business*. The approval and publication of the revised Revenue Procedure is outside the IRS' span of control; consequently, we cannot provide an implementation date at this time.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL(S):

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 4:

The Commissioner, Wage and Investment Division, should ensure that programming is updated to include Form 940 in the criteria to generate CP 148 notices when an address is changed.

CORRECTIVE ACTION:

We agree with this recommendation and have submitted a Unified Work Request (UWR) on January 19, 2017, to request programming changes that will add Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, to the list of forms requiring the issuance of Computer Paragraph (CP) Notices 148A, *BMF Change of Address Notification sent to new address* and 148B, *BMF Change of Address*



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Notification sent to old address. We expect the programming change to be effective by January 2018; however, programming changes are subject to limited resources, budgetary constraints and competing priorities. Consequently, we cannot provide an implementation date at this time.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 5:

The Commissioner, Wage and Investment Division, should develop processes and procedures to track employer contacts with the IRS alerting them of an unauthorized address change and refer these unauthorized address changes to the appropriate IRS function to determine why the change occurred and if the employer's account should be marked to proactively protect the business against possible identity theft.

CORRECTIVE ACTION:

We agree with this recommendation. Internal Revenue Manual Procedural Update was issued on July 13, 2017, which instructs employees responsible for address changes received in response to CP Notices 148A and/or 148B, alleging the address change was triggered by fraud, ID Theft, or was otherwise unauthorized, to route the case for review. Upon review, the case will be forwarded to the appropriate area for resolution.

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL(S):

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN:

N/A



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RECOMMENDATION 6:

The Commissioner, Wage and Investment Division, should ensure that EINs are truncated on all CP 148 notices.

CORRECTIVE ACTION:

We agree with this recommendation. On January 19, 2017, a UWR was submitted, requesting redaction of the Employer Identification Numbers on CP Notices 148A and 148B. We expect the programming change to be effective by January 2018; however, programming changes are subject to limited resources, budgetary constraints and competing priorities. Consequently, we cannot provide an implementation date at this time.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN:

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