TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Implementation of Tax Year 2020 Employer Tax Credits Enacted in Response to the COVID-19 Pandemic

July 9, 2021

Report Number: 2021-46-043

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Why TIGTA Did This Audit

In June 2020, TIGTA issued an interim report providing preliminary results of the IRS efforts to implement business tax provisions included in Coronavirus Disease 2019 (COVID-19) relief legislation. This report is a continuation of our review of the IRS's implementation of business tax provisions included in legislation passed in response to the pandemic. The overall objective of this review was to assess the IRS's actions to ensure the validity of employer tax credit claims as well as the accuracy of the employer reconciliations of advance payments.

Impact on Taxpayers

In response to the enactment of legislation, the IRS initiated an educational campaign to promote the availability of the various credits to employers; developed Form 7200, *Advance Payment of Employer Credits Due to COVID-19;* and developed processes and procedures to enable employers to request an advance payment of the employer tax credit even though the Tax Processing Centers were closed. The IRS started processing Forms 7200 on April 28, 2020. As of October 16, 2020, the IRS had processed 10,163 Forms 7200 and issued over $583 million in employer tax credits.

What TIGTA Found

Our review identified that the expediency required to implement this much-needed relief to employers did not allow for the development of the complex systemic verifications, including prerefund controls (*e.g.*, electronic business rules). As such, the IRS established procedures to manually review and process Forms 7200. Our review of 9,459 advance payment requests received as of June 4, 2020, determined that the IRS accurately processed most of these requests. TIGTA identified processing errors on 17 Forms 7200 with incorrect credits totaling $83,806. The errors included forms processed more than once; forms involving a government entity, which does not qualify; and forms that claimed an amount over the allowable threshold. The IRS was able to initiate actions to ensure that the taxpayers' accounts reflect the correct amount of employer tax credits.

In addition, TIGTA identified that manual verification processes established to review the advance payments claimed on Form 7200 [redacted] of the credit claims on Forms 941, *Employer's QUARTERLY Federal Tax Return*, during tax return processing. [redacted] our review of Tax Year 2020 Forms 941 processed with an employer tax credit as of October 1, 2020, identified a total of 317 potentially fraudulent employer tax credits for approximately $94.2 million that were not identified during processing.

Finally, TIGTA identified 113 government entities that filed a Tax Year 2020 Form 941 as of September 23, 2020, that were not eligible for the employer tax credits claimed totaling $2 million. As of December 17, 2020, the IRS identified an additional 420 government entities that received $7.2 million in erroneous employer tax credits and is working to reverse the credits. As a result, the IRS has implemented processes and procedures to continue to identify erroneous employer tax credit claims associated with government entities.

What TIGTA Recommended

TIGTA made no recommendations as the IRS addressed our concerns during the review.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

July 9, 2021

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

Michael E. McKenney

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Implementation of Tax Year 2020 Employer Tax Credits Enacted in Response to the COVID-19 Pandemic (Audit # 202040633)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) actions to ensure the validity of employer tax credit claims as well as the accuracy of the employer reconciliations of advance payments. This review is part of our Fiscal Year 2021 audit coverage of the IRS's response to the coronavirus pandemic and addresses the major management and performance challenges of *Responding to the COVID-19 Pandemic* and *Implementing Tax Law Changes*.

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

Copies of this report are also being sent to the IRS managers affected by the report information. 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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Appendices

Background

On March 18 and March 27, 2020, respectively, the President signed into law the *Families First Coronavirus Response Act* (FFCRA)[1] and *Coronavirus Aid, Relief, and Economic Security (CARES) Act*.[2] Provisions contained in the FFCRA and CARES Act provide businesses impacted by the Coronavirus Disease 2019 (COVID-19) pandemic with three new employer tax credits – the Sick Leave Credit, the Family Leave Credit, and the Employee Retention Credit. In addition, the CARES Act provides employers with the ability to defer payment of their portion of the Social Security tax. The employer tax credits apply to employee retention wages paid between March 13, 2020, and June 30, 2021, and wages paid for periods of leave between April 1, 2020, and March 31, 2021. Employers and self-employed individuals deferring the employer share of Social Security tax generally must repay half the deferral by December 31, 2021, and the other half by December 31, 2022.

Families First Coronavirus Response Act

The FFCRA provides refundable tax credits[3] to employers with fewer than 500 employees that reimburse them, dollar for dollar, for the cost of providing paid sick and family leave wages to their employees for leave related to COVID-19. Employees may receive up to 80 hours of paid sick leave to care for their own health needs or to care for other family members. Also, the employee may receive up to 10 weeks of paid family leave to care for a child whose school or place of care is closed or whose child care provider is unavailable due to COVID-19 precautions. Certain self-employed individuals in similar circumstances are entitled to similar credits.

To qualify for the credits, employers must be a nongovernmental entity and provide and pay qualified sick or family leave wages, defined in the FFCRA, for periods of leave between April 1, 2020, and March 31, 2021. Specifically, an eligible employer that pays qualified leave wages to its employees in a calendar quarter before it is required to deposit Federal employment taxes with the Internal Revenue Service (IRS) for that quarter may reduce the amount of Federal employment taxes that it deposits by the amount of the qualified leave wages paid. The eligible employer must account for the reduction in deposits on Form 941, *Employer's QUARTERLY Federal Tax Return*. However, if there are insufficient Federal employment taxes to cover the amount of the credits, an eligible employer may request an advance payment of the credits from the IRS. Figure 1 provides the requirements that need to be met to claim the Sick and Family Leave Credits.

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[1] Pub. L. No. 116-127, 134 Stat. 178, as amended by the *COVID-Related Tax Relief Act of 2020*, Pub. L. No. 116-260, div. N, 134 Stat. 1182, 1964, and the *Taxpayer Certainty and Disaster Tax Relief Act of 2020*, Pub. L. No. 116-260, div. EE, 134 Stat. 1182, 3051 (2020).

[2] Pub. L. No. 116-136, 134 Stat. 281, as amended by the *COVID-Related Tax Relief Act of 2020* and the *Taxpayer Certainty and Disaster Tax Relief Act of 2020* (2020).

[3] A refundable credit is a credit to reduce a tax liability. If the tax liability is reduced to zero and a credit remains, it is eligible to be refunded to the taxpayer.

Figure 1: Requirements for the Sick and Family Leave Credits

Sick Leave Credit	Family Leave Credit
Qualified wages are limited to 80 hours or 10 days paid to an employee at the employee's regular rate, or if higher, the Federal minimum wage or any applicable State or local minimum wages, up to $511 per day for the individual. An employee caring for someone is eligible at two-thirds of the employee's regular rate of pay, or applicable minimum wages, up to $200 per day.	Qualified wages are limited to two-thirds of the employee's regular rate of pay up to $200 per day per employee for up to 10 weeks or 50 days of qualified wages paid to an employee who is unable to work.
The IRS estimates the maximum credit allowed per employee is [redacted].[4]	The IRS estimates the maximum credit allowed per employee is approximately [redacted].[5]
Employee must be subjected to Federal, State, or local government isolation order, requested to self-quarantine, experiencing symptoms and seeking a diagnosis, caring for an individual in isolation or self-quarantine, or caring for a child if the school or place of care is closed or is unavailable.	Employee must be employed for a least 30 calendar days and unable to work/telework due to the need to care for a child because their school or place of care has been closed or is unavailable.

Source: Summary of requirements in the FFCRA.

As of February 25, 2021, the IRS processed 72,469 tax returns for Tax Year[6] 2020 claiming the Sick and Family Leave Credits totaling $2.8 billion.

Coronavirus Aid, Relief, and Economic Security Act

The CARES Act encourages eligible employers to keep employees on their payroll despite experiencing economic hardship related to COVID-19. As such, the CARES Act created the Employee Retention Credit, which is a refundable credit against employment taxes. The Employee Retention Credit is equal to 50 percent of qualified wages paid (including allocable qualified health plan expenses) between March 13, 2020, and December 31, 2020. Additional legislation passed in December 2020 and March 2021 that increased the credit to 70 percent of qualified wages paid between January 1, 2021, and December 31, 2021.[7] Certain government

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[4] The maximum amount claimed may not exceed the maximum allowable per employee: [redacted] maximum per employee (approximately). Note that Qualified Health Expenses is a conservative estimate, according to IRS management.

[5] The maximum amount claimed may not exceed the maximum allowable per employee: [redacted] maximum per employee (approximately). Note that Qualified Health Expenses is a conservative estimate, according to IRS management.

[6] The 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. The tax year on quarterly employment tax returns includes each of the four quarterly returns filed during the calendar year.

[7] The *Taxpayer Certainty and Disaster Tax Relief Act of 2020* and the *American Rescue Plan Act of 2021*.

entities are not eligible for this credit, and self-employed individuals are not eligible for this credit with respect to their own self-employment earnings.

To be eligible for the credit, employers must have a trade or business during Calendar Year 2020 or during the calendar quarter for which they are claiming the credit in Calendar Year 2021 and either fully or partially suspends operation due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19 or experiences a decline in gross receipts during the calendar quarter. For Tax Year 2020, the maximum amount of qualified wages taken into account with respect to each employee for all calendar quarters is $10,000, so that the maximum credit for an eligible employer for qualified wages paid to any employee is $5,000. For Tax Year 2021, the maximum amount of qualified wages taken into account with respect to each employee for all calendar quarters is $10,000 per quarter, so that the maximum credit for an eligible employer for qualified wages paid to any employee is $7,000 per quarter.[8] An eligible employer that pays qualified wages to its employees in a calendar quarter before it is required to deposit Federal employment taxes with the IRS may reduce the amount of Federal employment taxes by the amount of the Employee Retention Credit it plans to claim. However, if there are insufficient Federal employment taxes to cover the amount of the credit, an eligible employer may request an advance payment of the credit from the IRS.

As of February 25, 2021, the IRS processed 102,422 tax returns for Tax Year 2020 claiming Employee Retention Credits totaling $4.5 billion.

The CARES Act allows employers and self-employed individuals to defer the payment of their employer share of Social Security tax over the next two years.

Generally, half of the deferral is required to be repaid by December 31, 2021, and the other half is due by December 31, 2022. On August 8, 2020, the President issued a Presidential Memorandum[9] directing the Secretary of the Treasury to expand the deferral to also include the employee's portion of Social Security tax.[10] Pursuant to Notice 2020-65, *Relief With Respect to Employment Tax Deadlines Applicable to Employers Affected by the Ongoing Coronavirus (COVID-19) Disease 2019 Pandemic*, employers could elect to defer payment and withholding of the employee portion of Social Security tax between September 1 and December 31, 2020, for employees with biweekly pay that was less than $4,000. Under Notice 2020-65, the due date for withholding and paying the deferred tax was extended to April 30, 2021.[11] Therefore, as of September 1, 2020, many employers could defer 100 percent of Social Security tax.

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[8] The *American Rescue Plan Act of 2021* modifies the Employee Retention Credit for the third and fourth quarters of Tax Year 2021, which will impact the maximum credit amount for some taxpayers.

[9] Federal Register, Vol. 85, No. 157, pp. 49587–49588, *Deferring Payroll Tax Obligations in Light of the Ongoing COVID-19 Disaster* (August 13, 2020).

[10] The IRS's authority was established in the issuance of Notice 2020-65, *Relief With Respect to Employment Tax Deadlines Applicable to Employers Affected by the Ongoing Coronavirus (COVID-19) Disease 2019 Pandemic* (August 2020).

[11] Notice 2021-11, *Additional Relief With Respect to Employment Tax Deadlines Applicable to Employers Affected by the Ongoing Coronavirus (COVID-19) Disease 2019 Pandemic* (January 2021), makes changes to Notice 2020-65 to extend the payment period to December 31, 2021.

As of February 25, 2021, we identified 152,739 employers that have deferred approximately $97.1 billion in Social Security tax. As previously mentioned, this amount will need to be fully repaid by December 31, 2022.[12]

Legislation passed in December 2020 and March 2021 modified provisions of the FFCRA and the CARES Act

On December 27, 2020, the President signed into law the *Taxpayer Certainty and Disaster Tax Relief Act of 2020* and the *COVID-Related Tax Relief Act of 2020*, which make changes to the new employer tax credits created in the FFCRA and CARES Act passed in March 2020. Employers are eligible to continue to claim the Sick and Family Leave Credits for periods of leave provided through March 31, 2021, and the Employee Retention Credit through June 30, 2021. The new legislation also retroactively clarifies language in the FFCRA and CARES Act. For example, the legislation clarifies the treatment of group health plan expenses for purposes of the Employee Retention Credit. Furthermore, the legislation retroactively modified the limitation that employers who received a Paycheck Protection Program[13] loan could not also receive the Employee Retention Credit, thus allowing employers to both receive the loan and claim the credit under certain conditions. Additionally, the new legislation extends the due date for employers to repay the employee share of the Social Security tax deferral from April 30, 2021, to December 31, 2021.

On March 11, 2021, the President signed into law the *American Rescue Plan Act*,[14] which also made changes to the employer tax credits in the FFCRA and CARES Act. Employers are now eligible to continue to claim the Sick and Family Leave Credits for periods of leave provided through September 30, 2021, and the Employee Retention Credit through December 31, 2021. However, the requirements we analyzed in this review were not impacted by the subsequently signed legislations (*e.g.*, government entity eligibility and credit thresholds).

An interim Treasury Inspector General for Tax Administration (TIGTA) report provides preliminary results on IRS efforts to implement business tax provisions

In June 2020, we issued an interim report providing preliminary results of the IRS efforts to implement business tax provisions included in relief legislation.[15] We reported that, in response to the enactment of this legislation, the IRS initiated an educational campaign to promote the availability of these credits. In addition, the IRS:

- Developed the new Form 7200, *Advance Payment of Employer Credits Due to COVID-19*,[16] to enable employers to request an advance payment of these credits. Along with the development of the form, the IRS also developed processes and procedures to enable employers to submit these requests even though the Tax Processing Centers

[12] This amount includes the employee portion of Social Security tax due by December 31, 2021.

[13] The CARES Act established the Payroll Protection Program to help businesses retain their employees by offering potentially forgivable loans from Small Business Administration lenders for use to meet payroll needs and other business expenses.

[14] Pub. L. No. 117-2 (2021).

[15] TIGTA, Report No. 2020-46-041, *Interim Results of the 2020 Filing Season: Effect of COVID-19 Shutdown on Tax Processing and Customer Service Operations and Assessment of Efforts to Implement Legislative Provisions* (June 2020).

[16] See Appendix III for Form 7200.

were closed. For example, the IRS implemented a process to enable employers to submit these requests via a dedicated E-fax line. Once a Form 7200 is received electronically, it is routed to a dedicated group of IRS employees who review and process these requests. Employers could begin to submit their Form 7200 starting April 1, 2020.

- Revised Form 941, adding lines to account for the various employer tax credits (*e.g.*, Sick and Family Leave Credits and Employee Retention Credit) and other tax relief (*e.g.*, deferral of payroll tax) due to COVID-19. Businesses will begin filing the revised Form 941 for their second quarter employment taxes due at the end of July 2020. In addition, businesses that requested and received an advance payment by filing Form 7200 will record that amount on the revised Form 941 to determine whether they owe additional employment taxes or are due a refund. See Figure 2 for excerpts from the revised Form 941 that employers will use to record the advance payment, employer tax credits, and Social Security tax deferral.

Figure 2: Form 941 Sections Used for Reporting Advance Payment, Employer Tax Credits, and Social Security Tax Deferral

Form **941 for 2020:** **Employer's QUARTERLY Federal Tax Return** 950120
(Rev. July 2020) Department of the Treasury — Internal Revenue Service OMB No. 1545-0029

		Column 1		Column 2
5a	Taxable social security wages . .	.	× 0.124 =	.
5a	(i) Qualified sick leave wages . .	.	× 0.062 =	.
5a	(ii) Qualified family leave wages .	.	× 0.062 =	.

11b	Nonrefundable portion of credit for qualified sick and family leave wages from Worksheet 1	11b	.
11c	Nonrefundable portion of employee retention credit from Worksheet 1	11c	.
11d	**Total nonrefundable credits.** Add lines 11a, 11b, and 11c	11d	.
12	**Total taxes after adjustments and nonrefundable credits.** Subtract line 11d from line 10 .	12	.
13a	Total deposits for this quarter, including overpayment applied from a prior quarter and overpayments applied from Form 941-X, 941-X (PR), 944-X, or 944-X (SP) filed in the current quarter	13a	.
13b	Deferred amount of social security tax	13b	.
13c	Refundable portion of credit for qualified sick and family leave wages from Worksheet 1	13c	.
13d	Refundable portion of employee retention credit from Worksheet 1	13d	.
13e	**Total deposits, deferrals, and refundable credits.** Add lines 13a, 13b, 13c, and 13d . . .	13e	.
13f	Total advances received from filing Form(s) 7200 for the quarter	13f	.
13g	**Total deposits, deferrals, and refundable credits less advances.** Subtract line 13f from line 13e .	13g	.
19	Qualified health plan expenses allocable to qualified sick leave wages	19	.
20	Qualified health plan expenses allocable to qualified family leave wages	20	.
21	Qualified wages for the employee retention credit	21	.
22	Qualified health plan expenses allocable to wages reported on line 21	22	.
23	Credit from Form 5884-C, line 11, for this quarter	23	.
24	Deferred amount of the employee share of social security tax included on line 13b . . .	24	.

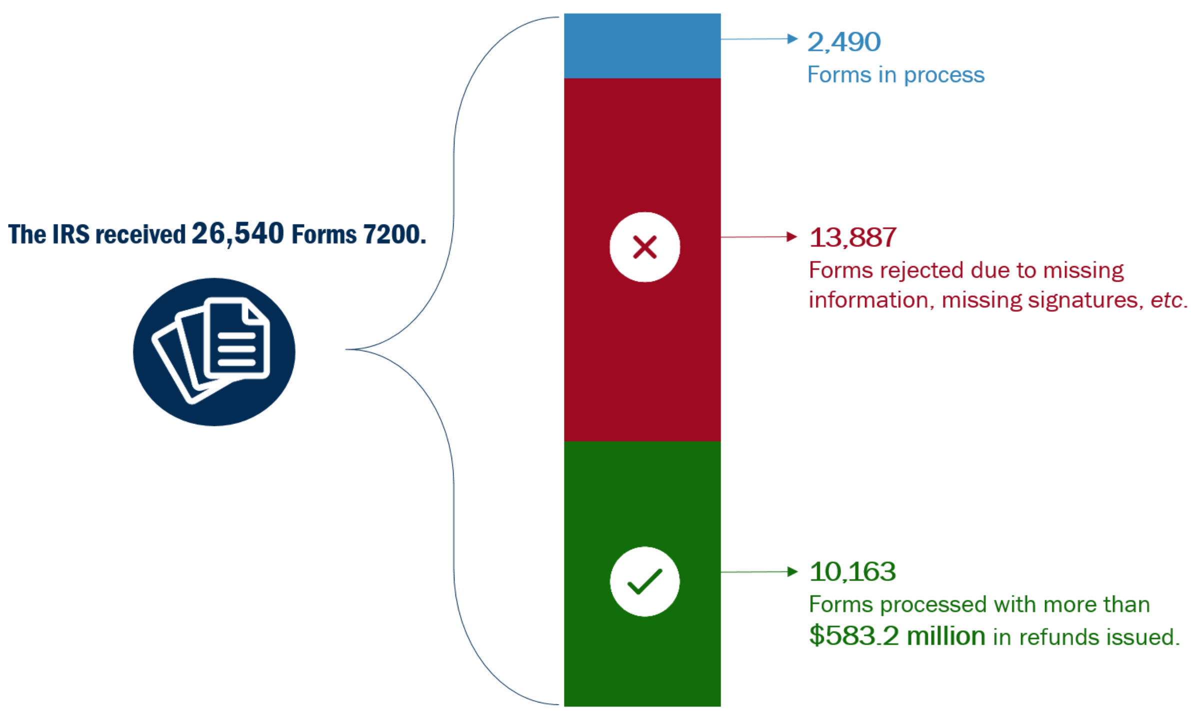
Source: Excerpts from the TY 2020 Form 941, revised as of July 2020.

This report is a continuation of our review of the IRS's implementation of business tax provisions included in laws passed in response to the pandemic. This review evaluates the IRS's efforts from when we last reported in June 2020 through January 2021 and includes evaluations of credit claims from April 2020 to October 2020. We have additional reviews to continue to evaluate the implementation of changes in eligibility requirements included in laws enacted subsequent to the FFCRA and CARES Act as well as assessing the IRS's efforts to track and monitor employer repayment of Social Security tax deferrals.

Results of Review

Our review identified that the expediency required to implement this much-needed relief to employers [redacted] the IRS established procedures to manually review and process Forms 7200, which it did beginning on April 28, 2020. As of October 16, 2020, the IRS has processed 10,163 Forms 7200 and issued over $583 million in advance employer tax credits. Figure 3 shows statistics on the Form 7200.

Figure 3: Form 7200 Statistics as of October 16, 2020



Source: IRS reports as of October 16, 2020.

Manual review of Forms 7200 ensured that they were valid claims. Our review of 9,459 Forms 7200 received as of June 4, 2020, determined that the IRS accurately processed the majority of these forms. We identified processing errors on 17 of the 9,459 Forms 7200, with incorrect credits totaling $83,806. When we brought our concerns to IRS management's attention, management agreed that tax examiners erroneously processed these claims. These included [redacted] Forms 7200 processed more than once; [redacted] Forms 7200 involving a government entity, which does not qualify; and [redacted] Forms 7200 that claimed an amount over the allowable threshold. Prior to our notifying IRS management, management had already developed processes to identify and adjust the Forms 7200 processed more than once. This allowed the IRS to initiate actions to ensure that the taxpayers' accounts reflect the correct amount of employer tax credits and plans to take actions to recover the funds erroneously paid.

[redacted] Identify Potentially Erroneous or Fraudulent Employer Tax Credits Claimed on Employment Tax Returns

Our review identified that manual verification processes established to review the advance payments claimed on Form 7200 were [redacted]. For example, to ensure that Forms 7200 were valid claims, the IRS developed specific processes and procedures that included:

- Additional research on [redacted] to determine the eligibility of the advance payment. [redacted] the Form 7200 relates, reviewers conduct research [redacted].
- Ensuring that advance payments do not exceed the allowable amounts. For example, the Form 7200 reviewers verify that employers claiming the Sick and Family Leave Credits [redacted] and the Employee Retention Credit [redacted] listed on the Form 7200.[17]
- Ensuring that advance payments to entities not entitled to the credits are rejected. Government entities are not eligible for the Sick and Family Leave Credits or the Employee Retention Credit.

[redacted] our review of Tax Year 2020 Forms 941 processed with an employer tax credit as of October 1, 2020, identified a total of 317 tax returns with potentially fraudulent employer tax credits for approximately $94.2 million that were not identified during tax return processing. Each of the questionable Forms 941 we identified [redacted]. These 317 tax returns with potentially fraudulent claims include:

- [redacted],[18] [redacted]

[17] The maximum Employee Retention Credit for each quarter was increased to $7,000 per employee for Tax Year 2021 by the *Taxpayer Certainty and Disaster Tax Relief Act of 2020*.

[18] A unique nine-digit number used to identify a taxpayer's business account.

[redacted].

- [redacted] Forms 941 with potentially fraudulent employer tax credit claims totaling over $1 million. These tax returns were [redacted]. For example, claims were filed [redacted]. Management agreed with our concern and stated that they became aware of this scheme after reviewers of the Forms 7200 noted [redacted]. Management noted that they referred these tax returns to IRS Criminal Investigation for action.
- [redacted] Forms 941 with potentially fraudulent employer tax credit claims totaling over $1.2 million. These tax returns were [redacted]. There were [redacted] Employee Retention Credits of over $735,000 and [redacted] Sick and Family Leave Credits of over $484,000.[19] We shared these cases with IRS management, and they agreed that [redacted] Forms 941 warranted further review to determine if the employer fraudulently claimed Employee Retention or Sick and Family Leave Credits. For the remaining [redacted] Forms 941, the IRS determined that [redacted] Forms 941 were not questionable and has not yet made a determination on [redacted] Forms 941.

When we asked management why the verification/validation processes and procedures used for Forms 7200 [redacted], they stated that, unlike Form 7200, [redacted]. As such, [redacted]. Moreover, the IRS [redacted] tax return filing season was already underway and [redacted] when the legislation was enacted. In response to our bringing the above concerns to IRS management's attention, the IRS [redacted]. As of December 2020, the IRS has identified 41 additional tax returns [redacted], however, per IRS review, the tax returns did not have similar characteristics and are being processed through normal procedures.

The IRS created an identity theft filter to identify businesses that [redacted] and may be filing a potentially fraudulent tax return

In response to our bringing the above-mentioned erroneous claims to IRS management's attention, the IRS developed and implemented a new identity theft fraud filter in September 2020 to identify, [redacted]. As of October 22, 2020, this filter has identified 110 potentially fraudulent tax returns with refunds totaling $1.7 million. When a tax return is identified by the IRS, the refund will be stopped and a letter will be sent to the taxpayer requesting that they verify their identity. Once the taxpayer [redacted], the case may be sent to the Small Business/Self-Employed Division to [redacted]

[19] There are 22 tax returns that claimed both credits.

[redacted]. If the taxpayer [redacted], then the tax return is marked as confirmed identity theft. As of November 4, 2020, the IRS has confirmed that 32 tax returns were valid and the remaining 78 tax returns are awaiting a taxpayer response, with employer tax credits totaling $1.5 million. It should be noted that the Small Business/Self-Employed Division worked with various IRS functions to identify [redacted]. At the time of our analysis, the IRS had not yet conducted research and/or analysis [redacted].

Ineligible entities were allowed to claim the COVID-19 employer tax credits in error

Our review also identified 113 government entities that filed a Tax Year 2020 Form 941 as of September 23, 2020, that, per the FFCRA and CARES Act, are not eligible for the employer tax credits. These entities received erroneous employer tax credits totaling $2 million. When we brought these 113 entities to IRS management's attention, they indicated that they have sent 63 of the 113 entities to the Tax Exempt and Government Entities Division to determine eligibility and, as of December 17, 2020, began the process of reversing the erroneous credits. The remaining 50 entities were subsequently determined to have erroneous credits, and the IRS is working to reverse these credits. As of December 17, 2020, the IRS identified an additional 420 government entities that received $7.2 million in erroneous employer tax credits and are working to reverse the credits. As a result, the IRS has implemented processes and procedures to continue to identify erroneous employer tax credit claims associated with government entities.

Processes Are Being Implemented to Ensure That Employers Receiving Advance Employer Tax Credits File Their Required Employment Tax Return

Our analysis of 5,524 employers who received advance payments for the second quarter of Tax Year 2020 (ending June 30, 2020) identified 3,655 employers (66 percent) who did not report the correct advance payment amount or did not file the required Form 941. These include:

- 2,154 employers with advance payment discrepancies between what IRS tax accounts show were received as an advance payment and the amount reported on the corresponding employer's Form 941. Management noted that tax returns with discrepancies are systemically adjusted to reflect the amount of the advance payment listed on the filer's tax account when the Form 941 is processed. This will result in the IRS issuing a different refund than the amount reported on the Form 941 or the taxpayer needing to make a payment that is different than the amount reported on the Form 941.

- 1,501 employers with advance payments totaling $73.9 million that did not file a Form 941 or were included on another payer's Form 941, Schedule R, *Allocation Schedule for Aggregate Form 941 Filers*.[20] It should be noted that the IRS estimates, as of March 2021, show that there are approximately 938,000 second quarter Tax Year 2020 Forms 941 that still need to be processed. As a result, the number of employers identified as not filing the required Forms 941 will likely change as the IRS

[20] At the time of our analysis, the IRS had not reconciled the Schedule R filers with advance payments; therefore, this population cannot be differentiated from the population of nonfilers.

processes these tax returns and completes the reconciliation of the advance employer tax credits.

Management noted they are implementing a compliance strategy [redacted] the IRS has not yet contacted these taxpayers.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the IRS's actions to ensure the validity of employer tax credit claims as well as the accuracy of the employer reconciliations of advance payments. To accomplish our objective, we:

- Evaluated the IRS's processes to ensure the validity and accuracy of advance payments paid to eligible employers, interviewed IRS management on the procedures to process Forms 7200, and analyzed Forms 7200 for validity and accuracy.
- Evaluated the controls to track E-fax submissions and determined if adequate controls over forms exist.
- Assessed the process to reconcile Forms 7200 with Forms 941 to ensure that advance payments are properly credited to the taxpayer's account. We compared the advance employer tax credit claims reported on Forms 941 with the amounts on Forms 7200.
- Reviewed the IRS's plans for implementing CARES Act § 2302, *Delay of payment of employer payroll taxes*.

Performance of This Review

This review was performed with information obtained from the Small Business/Self-Employed Division's Collection Policy office located in Atlanta, Georgia, during the period June 2020 through March 2021. 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.

Major contributors to the report were Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services); Diana M. Tengesdal, Director; Jonathan W. Lloyd, Audit Manager; Jaclynne O. Durrant, Lead Auditor; and Kenneth L. Carlson, Senior Auditor.

Validity and Reliability of Data From Computer-Based Systems

During this review, we obtained extracts from the Business Master File[1] for Tax Year 2020 for transaction codes, entity information, and credit information that were available on TIGTA's Data Center Warehouse.[2] We evaluated the data on the Data Center Warehouse by performing electronic testing of required data elements and reviewing existing information about the data and the system that produced them. This includes taking judgmental samples[3] of each dataset

[1] 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.

[2] TIGTA's centralized storage of IRS data files.

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

and validating against IRS source data, *i.e.*, IRS's Integrated Data Retrieval System.[4] We determined that the data used were sufficiently reliable for the purposes of this report.

Additionally, we obtained statistics on Forms 7200 from the IRS. We performed tests to assess the reliability of Form 7200 statistics. We evaluated the data by (1) performing electronic testing of required data elements, (2) reviewing existing information about the data and the system that produced them, and (3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for purposes of this report.

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: procedures to review and process Forms 7200. We evaluated these controls by reviewing the Internal Revenue Manual,[5] interviewing Form 7200 reviewers, and reviewing Form 7200 and Form 941 instructions.

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

[5] The primary, official source of IRS "instructions to staff" relating to the organization, administration, and operation of the IRS. It details the policies, delegations of authority, procedures, instructions, and guidelines for daily operations for all divisions and functions of the IRS.

Appendix II

Outcome Measures

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

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Actual; [redacted] (see page 7).

Methodology Used to Measure the Reported Benefit:

The IRS established procedures to manually review and process Forms 7200; however, these procedures were not used to ensure the validity of the employer tax credit claims on Forms 941 during tax return processing. Using the IRS's Business Master File data, our review of Tax Year 2020 Forms 941 processed with an employer tax credit as of October 1, 2020, identified [redacted].

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; $1,506,831 in potentially erroneous employer tax credits processed on potentially erroneous Forms 941 (see page 7).

Methodology Used to Measure the Reported Benefit:

The IRS established procedures to manually review and process Forms 7200; [redacted]. During Form 7200 processing, the IRS checks for entities not entitled to the employer tax credits, [redacted]. We identified 128 potentially fraudulent employer tax credits on 103 Forms 941 processed using [redacted]. We shared our cases with IRS management, and they agreed that 23 of 103 tax returns warranted further review to determine if the employer fraudulently claimed the employee tax credits.

As a result, the IRS created a new identity theft filter in September 2020 to [redacted]. The new filter has identified 110 potentially fraudulent tax returns. As of November 4, 2020, the IRS has confirmed that 32 tax returns were valid and the remaining 78 tax returns are awaiting a taxpayer response. These 78 tax returns still in process have potentially fraudulent employer tax credits totaling $1,506,831. The Small Business/Self-Employed Division worked with various IRS functions to [redacted]. At the time of our analysis, the IRS had not yet researched the pocket of [redacted].

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; $9,161,609 in potentially erroneous employer tax credits processed for government entities on the Form 941 (see page 7).[1]

Methodology Used to Measure the Reported Benefit:

The IRS established procedures to manually review and process Forms 7200; [redacted]. The FFCRA and CARES Act state that government entities are not eligible for the employer tax credits. During Form 7200 processing, the IRS checks for entities not entitled to the employer tax credits, *e.g.*, government entities. [redacted]. As a result, our review of Tax Year 2020 Forms 941 processed with an employer tax credit as of September 23, 2020, identified 113 government entities that filed Forms 941. These entities claimed employer tax credits totaling $1,966,542. We notified management of the 113 government entities, and management stated that, as of December 17, 2020, the IRS began the process to reverse the erroneous credits on 63 entities and agreed to take action on the remaining 50 entities. Additionally, the IRS identified 420 additional government entities that received $7,195,067 in erroneous credits and is working to reverse these credits.

Management's Response: IRS management disagreed with the outcome measure, stating that the outcome incorrectly assumes that 100 percent of the entities cited are ineligible to claim employer credits. Management also stated that the systemic programming to reject credits claimed by these taxpayers without a manual review may reject a valid, otherwise qualifying, entity entitled to the credits. Systemically rejecting returns may unintentionally harm taxpayers by erroneously requiring them to contact the IRS to rectify the issue, delaying a refund or credit to which they are entitled and increasing burden. Instead, the IRS has a process to identify taxpayers who have claimed a credit and appear to be ineligible entities and proposes disallowance of the credit in question. This post-processing approach more appropriately balances compliance with the need to assist taxpayers during a pandemic. Finally, management believed the outcome measure does not accurately reflect the potential impact of the TIGTA audit since it also includes returns identified by the IRS.

Office of Audit Comment: There is no incorrect assumption in our calculation of the outcome measure. Each of the entities used to calculate the outcome measure was a government entity, and the IRS determined they were ineligible to claim the credit. In addition, we disagree that a systemic process to reject these

[1] The outcome is based upon nearly $2 million TIGTA identified and $7.2 million the IRS identified after we brought the original cases to their attention.

tax returns may unintentionally harm government entities identified as attempting to erroneously claim a credit. In fact, the IRS's post-processing approach significantly increases its cost to address these erroneous claims. Finally, the outcome measure includes those ineligible government entities that the IRS identified due to processes that were put in place in response to our identification of erroneous credits issued to ineligible government entities. The IRS was in the process of developing a compliance strategy, which may have included identifying these tax returns, at the time of our notifying management of this issue.

Appendix III

Form 7200, *Advance Payment of Employer Credits Due to COVID-19*

Form **7200**
(March 2020)
Department of the Treasury
Internal Revenue Service

Advance Payment of Employer Credits Due to COVID-19

▶ Go to *www.irs.gov/Form7200* for instructions and the latest information.

OMB No. 1545-0029

Name (not your trade name)	**Employer identification number (EIN)**
Trade name (if any)	Applicable calendar quarter (check one) (2) ☐ April, May, June (3) ☐ July, August, September (4) ☐ October, November, December
Number, street, and apt. or suite no. If a P.O. box, see instructions.	
City or town, state, and ZIP code. If a foreign address, also complete spaces below. (See instructions.)	

Foreign country name	Foreign province/county	Foreign postal code
Does a third-party payer file your employment tax return? (See instructions.) If "Yes," enter its name.		Third-party payer's EIN (if applicable)

Tip: File Form 7200 if you can't reduce your employment tax deposits to fully account for these credits that you expect to claim on your employment tax return for the applicable quarter. Don't reduce your employment tax deposits and request advanced credits for the same expected credits. You will need to reconcile your advanced credits and reduced deposits on your employment tax return. You can't request an advance payment of the credit for sick and family leave for self-employed individuals.

Part I Tell Us About Your Employment Tax Return

A Check the box to indicate which employment tax return form you file (or will file for 2020):
(1) ☐ 941, 941-PR, or 941-SS **(2)** ☐ 943 or 943-PR **(3)** ☐ 944 or 944(SP) **(4)** ☐ CT-1

B Is this a new business started on or after January 1, 2020? . . . . ▶ ☐ **Yes** ☐ **No**
If "Yes," skip line C unless you've already filed Form 941, Form 941-PR, or Form 941-SS for at least one quarter of 2020.

C Amount reported on line 2 of your most recently filed Form 941 (or wages reported on Schedule R (Form 941), column (c), by your third-party payer (see instructions)). If you file a different employment tax return, see instructions . . . . ▶

D Enter the total number of employees you have. See instructions . . . . . . ▶

Part II Enter Your Credits and Advance Requested

1	Total employee retention credit for the quarter. See instructions			1	
2	Total qualified sick leave wages eligible for the credit and paid this quarter. See instructions . . .			2	
3	Total qualified family leave wages eligible for the credit and paid this quarter. See instructions . . .			3	
4	Add lines 1, 2, and 3			4	
5	Total amount by which you have already reduced your federal employment tax deposits for these credits for this quarter	5			
6	Total advanced credits requested on previous filings of this form for this quarter	6			
7	Add lines 5 and 6			7	
8	**Advance requested.** Subtract line 7 from line 4. If zero or less, don't file this form			8	

Third-Party Designee
Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? See the instructions for details. ☐ **Yes.** Complete below. ☐ **No**
Designee's name ▶ ______ and phone number ▶ ______
Select a 5-digit personal identification number (PIN) to use when talking to the IRS ▶

Sign Here
Under penalties of perjury, I declare that I have examined this form, including any accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Printed title
Printed name		Best daytime phone

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	PTIN	Check ☐ if self-employed
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

How To File
Fax your completed form to 855-248-0552.

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 56392D Form **7200** (3-2020)

Appendix IV

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

May 27, 2021

MEMORANDUM FOR MICHAEL E. McKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: De Lon Harris
Commissioner, Small Business/Self-Employed Division
Examination

SUBJECT: Draft Audit Report – Implementation of Tax Year 2020 Employer Tax Credits Enacted in Response to the COVID-19 Pandemic (Audit # 202040633)

Thank you for the opportunity to review and comment on the subject draft audit report. We are proud of the significant actions we executed in a short time to effectively implement multiple and broad legislative tax changes. We maintained a dual focus on customer service and compliance, while simultaneously dealing with the pandemic's impacts on our own workforce. This audit has been particularly challenging since TIGTA audited our decisions in real-time, reviewing our compliance efforts while we were still developing our compliance plans.

Enacted in March 2020, the Families First Coronavirus Response Act (FFCRA) and Coronavirus Aid, Relief, and Economic Security (CARES) Act provided businesses impacted by the coronavirus pandemic with new employer tax credits – the Sick and Family Leave Credit and the Employee Retention Credit. In addition, the CARES Act provided employers with the ability to defer payment of their portion of the Social Security tax. Subsequent legislation in December 2020 and March 2021 extended and modified limitations and qualifications for these credits.

Within one month of enactment, the IRS initiated an educational campaign to promote the availability of these credits; designed the new Form 7200, *Advance Payment of Employer Credits due to COVID-19*; developed processes and procedures to enable employers to submit these advance payment requests; and revised affected employment tax forms. We also established procedures to manually review and process Forms 7200, which included referring suspicious requests to Criminal Investigation. After the initial implementation, we created a tool that assists the review process and includes automated error indicators for items such as duplicate requests.

In addition to developing the Form 7200 review process, the IRS also designed many systemic processes to limit errors and duplicate refunds. Specifically, we implemented programming that systemically reconciles the return filed with the dollar amount of advances paid, which ensures that duplicate payments are not made. Additional risk mitigations include a systemic refund hold filter that automatically applies when a significant discrepancy exists between the amount of advance credit reported by a taxpayer and the amount that was paid to the taxpayer. We also implemented processes to quickly review and release refund freezes after review completion.

During filing, our programming systemically reverses any advances to liabilities that have been paid and offsets those liabilities against the credit reported on the taxpayer's return. This systemic process recoups improper payments during filing and, if a balance is owed, generates the required notice. Additionally, in response to the legislation, we were evaluating incoming returns to identify filter updates to address fraudulent filings as TIGTA began its audit. Because TIGTA conducted this audit in real-time, we had not yet completed our analysis or the revision of our filters. We are confident that our recurring review efforts did and will continue to identify improvements during the development and completion of the implementation and compliance plans.

We developed and implemented a process to reconcile third-party payers and the advance credits paid to their clients and other compliance actions. Development began in June 2020 and the first cases were identified and made available for reconciliation in August 2020. We also developed procedures to address advance credit recipients who did not file tax returns. Since August 2020 we have continually monitored advance recipients' filing status and will place returns in the examination workstream when return processing for the period has completed.

In addition to the extensive efforts noted above, the IRS developed post-processing compliance plans, which include the development and delivery of necessary training for our employees and revising employment tax examination report forms and associated tools to allow examiners to make appropriate adjustments to the credits claimed on the returns.

Our Form 7200 advance process was a success, ensuring that taxpayers received critical funds they needed in these unprecedented times. We committed extensive resources to this important process, and we worked to ensure that these tax provisions were not abused by unscrupulous taxpayers by quickly analyzing incoming data as returns were filed. However, we disagree with TIGTA's position that the IRS should have [redacted]. The volume of employment tax returns is significantly higher than the volume of Forms 7200 which [redacted]. This proposal would result in the improper rejection of many legitimate claims.

Attached are our responses to your outcome measures. If you have any questions, please contact me, or Scott Irick, Director, Examination, Small Business/Self-Employed Division.

Attachment

Attachment

Outcome Measure #1: Cost Savings (Funds Put to Better Use) – Actual; [redacted] from processing of [redacted] (see page 7).

Comments:
We agree with the methodology for this outcome measure.

Responsible Official:
Director, Return Integrity Verification Program Management (RIVPM).

Outcome Measure #2: Cost Savings (Funds Put to Better Use) – Potential; $1,506,831 in potentially erroneous employer tax credits processed on potentially erroneous Forms 941 (see page 8).

Comments:
We agree with the methodology for this outcome measure.

Responsible Official:
Director, Return Integrity Verification Program Management (RIVPM).

Outcome Measure #3:
Cost Savings (Funds Put to Better Use) – Potential; $9,161,609 potentially erroneous employer tax credits processed for government entities on the Form 941 (see page 9).

Comments:
We disagree. This outcome measure incorrectly assumes that 100% of the entities cited are ineligible to claim employer credits.

In addition to the issues discussed above, the systemic programming to reject credits claimed by these taxpayers without a manual review may reject a valid, otherwise qualifying, entity entitled to the credits. Systemically rejecting returns may unintentionally harm taxpayers by erroneously requiring them to contact the IRS rectify the issue, delaying a refund or credit to which they are entitled and increasing burden. Instead, the IRS has a process to identify taxpayers who have claimed a credit and appear to be ineligible entities and proposes disallowance of the credit in question. Our post-processing approach more appropriately balances compliance with the need to assist taxpayers during a pandemic.

Finally, the Outcome Measure does not accurately reflect the potential impact of the TIGTA audit since it also includes returns identified by the IRS.

2

Responsible Official:
N/A

Appendix V

Abbreviations

CARES	Coronavirus, Aid, Relief, and Economic Security Act
COVID-19	Coronavirus Disease 2019
EIN	Employer Identification Number
FFCRA	Families First Coronavirus Response Act
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration

To report fraud, waste, or abuse,
call our toll-free hotline at:

(800) 366-4484

By Web:

www.treasury.gov/tigta/

Or Write:

Treasury Inspector General for Tax Administration

P.O. Box 589

Ben Franklin Station

Washington, D.C. 20044-0589

Information you provide is confidential, and you may remain anonymous.