



## Treasury Inspector General for Tax Administration Office of Audit

### **WITHHOLDING COMPLIANCE PROGRAM RESULTS ARE TRENDING FAVORABLY, BUT PROGRAM ENHANCEMENTS ARE NEEDED**

Issued on March 23, 2010

## Highlights

Highlights of Report Number: 2010-40-030 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

### **IMPACT ON TAXPAYERS**

The Withholding Compliance Program (Program) is based on the premise that by addressing underwithholding at its source, noncompliance problems can be resolved early in the process and, thereby, prevent future delinquencies that can be costly to both the Internal Revenue Service (IRS) and taxpayers. While the Program is helping ensure individuals are meeting their obligations to pay taxes, steps are needed to ensure opportunities are not being missed to address underwithholding problems among high wage earners and Program actions are not unnecessarily burdening taxpayers and employers.

### **WHY TIGTA DID THE AUDIT**

This audit was initiated to evaluate the effectiveness of case selection and processing in the Withholding Compliance Program. The audit was conducted as part of our Fiscal Year 2009 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

### **WHAT TIGTA FOUND**

Compliance and collection data are trending favorably under the Withholding Compliance Program. However, there are two steps that could be taken to enhance its operational effectiveness. First, a statistically valid risk-based approach needs to be explored to select problem withholding cases.

While the current approach has successfully identified a number of problem withholding cases, it does have some limitations. The most significant limitation, perhaps, is that certain risk factors are not progressive since the withholding rate remains constant as the amount of wages increase. Consequently, opportunities may be missed to detect and address withholding problems among higher wage earners. Moreover, some in the taxpaying public might perceive that an approach using a

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constant withholding factor is not as impartial as it could be because individuals at higher wage levels can have withholding problems and avoid being selected for possible Program action.

The second step that could be taken to enhance the Program is ensuring lock-in letter issuance is not unnecessarily burdening employers and taxpayers. Lock-in letters direct employers to withhold taxes for a specific employee at a specified rate.

### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the Director, Compliance, Wage and Investment Division, develop and implement a statistically valid study to assess the underwithholding compliance risk throughout all segments of the taxpayer population and use the results to adjust, as appropriate, the case selection methods. TIGTA also recommended that the Director ensure actions are taken to correct computer programs that initiate lock-in letters and research the employers TIGTA identified that may have been incorrectly issued lock-in letters to determine if they are overwithholding any employees and, if necessary, correct the withholding.

IRS management agreed, in general, with our recommendations and has or plans to take actions in response to our recommendations. The IRS plans to perform a statistically valid study to formulate a risk-based decision for case creation and, if necessary, use the results to adjust the case selection methods. In addition, the IRS plans to continue pursuing programming changes to correct computer programs that initiate lock-in letters. The IRS also plans to research employers identified in our audit to determine if corrections are needed. However, this research will not be expanded as it would be cost prohibitive from a resource allocation standpoint.

Management also concurred that their corrective actions in response to our recommendations, along with other planned Program improvements, will result in significant revenue from additional withholding. However, the full realization of the projected revenue is dependent upon resources and may be negatively impacted by the recent economic downturn.

### **READ THE FULL REPORT**

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2010reports/201040030fr.pdf>.

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