

Employer Identification Numbers and Related Filing Requirements

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

Redaction Legend:

2b = Law Enforcement Guideline(s)

2e = Law Enforcement Procedure(s)

**Employer Identification Numbers and Related
Filing Requirements**

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Executive Summary

This review was conducted as part of Internal Audit's Fiscal Year 1997 Business Taxpayer Audit Strategy. Under the strategy, Internal Audit initiated a series of national reviews which were designed to identify opportunities to improve customer service and reduce burden for the business taxpayer. This review focused on the Service's processes designed to assign Employer Identification Numbers (EIN) and filing requirements. Specifically, the objective of this audit was to determine if procedures for establishing business entities and related filing requirements on the Business Master File (BMF) could be improved to reduce taxpayer burden, decrease costs and improve customer service.

Results

Overall the Service has efficient and effective processes for assigning EINs. Taxpayers have a variety of customer-friendly means to obtain EINs and the Service correctly processes Forms SS-4 (Application for Employer Identification Number) to establish accurate filing requirements for new business entities. An automated system for satisfying Form 941 filing requirements could be an additional means to improve customer service for business taxpayers. Such a system could reduce the burden of filing a tax return and decrease Service processing costs. In addition to those benefits, the Service could improve compliance efforts and focus Service resources on more productive cases by implementing corrective actions from a prior Internal Audit report.

Specifically we determined the following:

- The Service has efficient and effective processes for assigning EINs and establishing filing requirements.
- An automated system for satisfying filing requirements for \$0 Form 941 filers could benefit the Service and reduce taxpayer burden.
- Implementation of prior Internal Audit recommendations could improve compliance efforts.

The Service has efficient and effective processes for assigning EINs and establishing filing requirements. Taxpayers have a variety of customer-friendly means to obtain EINs. At least two of the available methods, Tele-TIN and the pilot Federal Employer Identification Number (FEIN) program, provide taxpayers with the requested EINs immediately. The Service also establishes accurate filing requirements when assigning EINs. Filing requirements are established based on information taxpayers provide, including a planned business start date and a date the business plans to start paying wages. Taxpayers are not bound to inform the

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Service of changes to these planned dates. However, the Service expects taxpayers to file tax returns based on the planned dates provided by them.

An automated system for satisfying filing requirements for \$0 Form 941 filers would benefit the Service and reduce taxpayer burden. In 1995 and 1996 the Service received and processed about 4.2 million Forms 941, Employer's Quarterly Federal Tax Return, without a tax liability. We estimate that Forms 941 filed without a tax liability in 1995 and 1996 may have cost the Service up to \$18 million to process. In addition, the Service spends thousands of hours resolving delinquency inquiries and satisfying filing requirements for taxpayers without tax liabilities. The Service could change this process by creating an interactive telephone system for use by BMF taxpayers who do not have a liability in a particular quarter.

Implementation of prior Internal Audit recommendations could improve compliance efforts. In a prior report, Internal Audit recommended that management modify computer programming to select more productive delinquency investigations and that the Service make better use of available information to establish filing requirements and ensure compliance. During this review we followed up on management's implementation of corrective actions arising from those recommendations. One recommendation was not correctly implemented and timely implementation of the other recommendations is at risk. When advised of the incorrect implementation, management took immediate corrective action. For the remaining recommendations, the Service needs to take measures to ensure that they are timely implemented.

Summary Recommendations

We recommend that the Service:

- Establish a system that allows taxpayers to telephonically satisfy their filing requirements, and revise EIN assignment and delinquency notices to reflect this procedural change.
- Include information in Form 941 instructions advising taxpayers to use the newly created telephone voice response system if they have a \$0 tax liability.
- 2b, 2e-----

- Establish a cross-reference between reporting agents and client accounts as recommended by the Andover Service Center Natural Work Group in order to timely implement previous Internal Audit recommendations.

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Preface

This review is one in a series of national audits designed to improve customer service and reduce burden for business taxpayers.

This review was discussed with all levels of the Service's management.

This review was conducted as part of Internal Audit's Fiscal Year 1997 Business Taxpayer Audit Strategy. Under the strategy, Internal Audit initiated a series of national reviews which were designed to identify opportunities to improve customer service and reduce burden for the business taxpayer. Collectively, this series of reviews addressed the major points of contact that a business taxpayer could have with the Service--from establishing a new business, through making tax deposits and filing returns, and responding to notices. We evaluated the Service's current processes from the perspective of how the business taxpayer might view them.

We discussed the reviews included in the strategy up-front with executive management and obtained their input on objectives and potential outcomes, as well as their commitment to take appropriate actions. We also worked closely with all levels of Service management to determine the significance and scope of the burden on the business taxpayer and the inefficiencies in existing practices for providing quality customer service. Through discussions with management, we jointly identified feasible alternatives to address these areas. We presented executive management with information to assist them in determining which alternatives to implement.

Objective and Scope

The objective of this audit was to determine if procedures for establishing business entities and related filing requirements on the Business Master File (BMF) could be improved to reduce taxpayer burden, decrease costs and improve customer service. Specifically, we:

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- Determined if the processes for assigning Employer Identification Numbers (EINs) and establishing filing requirements are efficient and effective.
- Determined if the process for satisfying Form 941 filing requirements could be improved.
- Determined if management had implemented several recommendations made previously in three Internal Audit reports.

To accomplish these objectives, we:

- Interviewed officials in various national office and local functions.
- Interviewed Telephone Routing Interactive System and BMF TeleFile analysts to obtain information about these two systems.
- Analyzed a Master File extract, traced a sample of Forms SS-4 (Application for Employer Identification Number) submitted by taxpayers, and reviewed various management reports.

We conducted our review from July 1997 through May 1998 in accordance with generally accepted government auditing standards. See Attachment I for more information on our specific objectives and scope of review.

Background

An Employer Identification Number is a nine digit number assigned by the Service to business entities for filing and reporting purposes.

Employer Identification Numbers (EINs) are nine digit numbers assigned to sole proprietors, corporations, partnerships, estates, trusts, and other entities for filing and reporting purposes. Every business entity required to file a Federal tax return must have, or be assigned, an EIN. Approximately two million EINs are assigned to the BMF annually.

There are two ways the Service assigns EINs. The most common method is via a Form SS-4. A taxpayer may mail

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or fax the form to the appropriate service center or may request an EIN by telephone through the Tele-TIN program, and subsequently submit the form.

Business entities are assigned an EIN when they file a Form SS-4 or from information available on a return they file.

The second method is the assignment of an EIN to a business tax return filed without one (using information available on the return). A notice is mailed to the taxpayer informing the taxpayer of the assigned number. A Form SS-4 is included with the notice and should be completed and returned to the assigning service center.

Form SS-4 is also used by the Social Security Administration (SSA) to collect and code employer information, including industrial activities. SSA provides this data to other agencies. The Census Bureau is the major user of SSA's industry coding.

In addition to the above methods for assigning EINs, the Pacific Northwest District piloted the Federal EIN (FEIN) program. This program is a FedState cooperative venture that enables taxpayers to obtain EINs from Washington State licensing bureaus at the same time they apply for state business licenses.

Assigning EINs includes establishing filing requirements. Filing requirements identify the types of returns taxpayers must file.

As part of issuing EINs, the Service establishes filing requirements. Filing requirements identify the types of returns taxpayers are required to file and the types of returns the Service mails to taxpayers. Filing requirements are also used to perform delinquency checks to determine if taxpayers have filed required tax returns.

Results

Overall the Service has efficient and effective processes for assigning EINs. However, the Service could decrease both taxpayer burden and processing costs by enhancing the means that Form 941 filers use to satisfy filing requirements when they have no employees. The Service could also

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enhance compliance efforts by ensuring implementation of recommendations from prior audit reports.

The Service Has Efficient And Effective Processes For Assigning EINs And Establishing Filing Requirements.

Taxpayers have a variety of ways to apply for EINs. Most taxpayers use Tele-TIN and receive their EINs immediately over the telephone.

Assigning EINs. The Service has efficient and effective processes for assigning EINs. Taxpayers have several methods to apply for EINs. At least two of the available methods, Tele-TIN and the pilot FEIN program, can provide taxpayers with the requested EINs immediately. In 1993 63% of EINs were assigned by Tele-TIN. Tele-TIN is one of the most popular and successful taxpayer service initiatives.

In addition to Tele-TIN and the FEIN program, the Service also has Fax-TIN and regular paper processing. Fax-TIN allows taxpayers to fax their applications for EINs directly to the Service. Fax-TIN applicants may receive EINs within three days. Taxpayers may also mail Forms SS-4 to the Service for processing. According to Form SS-4 instructions, taxpayers should allow about four weeks to receive EINs via the mail.

The Service has deemed the FEIN pilot program a success because of the high level of customer satisfaction and the high degree of accuracy.

Customer satisfaction with the FEIN program is universally positive. Because of its success the program is being expanded to two states per region. Expansion is supported by results from a 90-day test in the State of Washington in the Pacific Northwest District. During the 90-day test a total of 1,017 FEINs were issued. Only four of the 1,017 EINs had to be canceled either because the entity already had a number or a state employee pushed the wrong computer key and assigned the number in error.

The Service also has a sufficient number of EINs available for future use. The current nine-digit EIN numbering system allows for one billion different combinations. As of 1994, an

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estimated 60 million EINs had been issued. Those EINs account for about 6% of the possible combinations, which means there is no shortage of available EINs.

Establishing Filing Requirements. The Service establishes accurate filing requirements based on information taxpayers provide on Form SS-4. We selected and reviewed a small judgmental sample of Forms SS-4 at the Andover Service Center to determine the accuracy of established filing requirements. Accurate filing requirements were established for 49 of 50 Forms SS-4 reviewed. The results of our test are supported by a more comprehensive survey conducted by the Service in 1992.

According to the results of the 1992 survey, 63% of taxpayers agreed with the filing requirements established by the Service. About 3% partially agreed with the filing requirements and 34% disagreed. Of the 34% who disagreed, 56% of the errors were made by taxpayers when completing Form SS-4. Two percent were the result of IRS errors and the source of the remaining 42% could not be determined because Forms SS-4 were not available for review. If the 2% error rate remains constant for the cases that could not be determined, the Service may well have correctly processed Forms SS-4 about 96% of the time.

2b, 2e-----
2b, 2e-----
2b, 2e-----
2b, 2e----- *Business
taxpayers are not required
to notify the Service when
planned dates change.*

Filing requirements are established based on information taxpayers provide on Form SS-4, including a planned business start date and the date the business plans to start paying wages. Although the Service establishes accurate filing requirements based on Form SS-4 information, some businesses may not start or hire employees when planned. However, taxpayers are not bound to inform the Service if the business does not start or hire employees when planned.

2b, 2e-----

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The Service Would Benefit From An Automated System For Satisfying Filing Requirements.

It may have cost the Service up to \$18 million in 1995 and 1996 to process Forms 941 filed by taxpayers without a liability.

During calendar years 1995 and 1996, the Service received and processed about 44.3 million Forms 941, Employer's Quarterly Federal Tax Return. Of these, approximately 10% (4.2 million) were filed by taxpayers without a liability, and processed at a cost to the Service of about four dollars per return. In addition to processing costs, the Service spends thousands of hours resolving delinquency inquiries and satisfying filing requirements for taxpayers without tax liabilities.

There are several reasons why business taxpayers without a liability file:

- The Service does not have an efficient method for taxpayers to close their filing requirements when they are no longer in business.
- Filing requirements, having been set up by the Service, must be satisfied whether or not a business has employees.
- Actions taken by the Service, such as sending delinquency notices, encourage taxpayers without a liability to file \$0 Forms 941.
- The Service informs taxpayers in their EIN receipt notice that they must file returns when they are without a liability.

The Service does not have an efficient method for taxpayers to close their filing requirements when they are no longer in business. Approximately 872,000 (21%) of the 4.2 million \$0 Forms 941 were filed as "Final" returns. These returns were filed by approximately 722,000 BMF taxpayers who wished to indicate to the Service that they would no longer need to file a return. Nineteen percent (about 137,000) of the businesses filed more than one final \$0 return, including 257 businesses that filed five or more.

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Newly established businesses filed 681,000 (16%) of the \$0 Forms 941 during 1995 and 1996.

The Service encourages taxpayers without liabilities to file by sending delinquency notices and by instructing tax examiners to inform taxpayers they must file.

Many taxpayers continually file Forms 941 for \$0, including about 106,000 businesses which filed six or more returns during 1995 and 1996 and 11,000 which filed in all eight quarters.

This appears to be an inefficient method for BMF taxpayers to satisfy their filing requirements.

Filing requirements must be satisfied whether or not a business has employees. During 1995 and 1996, approximately 16% (681,000) of the \$0 Forms 941 were filed in the same year the business was established. These businesses represent about 23% of all those that filed \$0 Forms 941 in 1995 and 1996. New businesses do not always have employees when they indicate they will on the Form SS-4.

Actions taken by the Service encourage taxpayers to file these returns. About 30% of the businesses in our review had received a delinquency notice at some point prior to filing a \$0 Form 941 return. In these cases taxpayers without a liability filed returns to satisfy the filing requirements established by the Service.

The Service informs taxpayers in their EIN receipt notices that they must file returns when they are without a liability. When taxpayers are assigned EINs, the Service establishes filing requirements based on information provided by taxpayers. The Service notifies taxpayers in writing of the assigned number and the related filing requirements. The notices instruct taxpayers to file required returns even if they were not in business or did not have employees for a specific period.

Additionally, procedures instruct Entity Unit tax examiners to inform taxpayers that if no business is conducted or no wages are paid, they are still required to file a tax return with no liability. However, there is no requirement for taxpayers to file such a return.

Once taxpayers start filing \$0 Forms 941 they continue this practice. About half of the businesses that filed \$0 Forms 941 in our review filed more than one, making up about 79% of the total \$0 returns filed. Of these businesses, about 106,000 filed six or more of these returns in the two-year period reviewed, including about 11,000 businesses that filed a \$0 Form 941 in all eight quarters.

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Filing tax returns without a liability creates unnecessary taxpayer burden. Business taxpayers must satisfy their filing requirements in one of three ways: 1) file a \$0 Form 941; 2) file a Form 9358, (stuffer accompanying the delinquency notice) indicating they are without a liability; or 3) call the Service and give an oral statement indicating they have no liability.

Many taxpayers (1.9 million) chose to file a \$0 Form 941 during 1995 and 1996 as one way to satisfy filing requirements. The Service has placed an undue burden on these taxpayers by encouraging them to file a Form 941 even when they do not have a liability. We worked with management to find a better method for satisfying filing requirements.

The Service could eliminate the cost and burden associated with filing Forms 941 for \$0 by implementing an interactive telephone system for use by BMF taxpayers.

Changes to the process for satisfying filing requirements could have eliminated those \$0 Forms 941 and associated processing costs, and reduced taxpayer burden. The Service could develop an interactive telephone system that would allow business taxpayers with no Form 941 liability in a particular quarter to telephonically satisfy the filing requirement. These taxpayers could inform the Service that they had no employees before they receive a delinquency notice for that quarter, or they could indicate a final or seasonal return. *This change could be implemented in one of two existing systems: the Telephone Routing Interactive System (TRIS) or BMF TeleFile.*

As of February 1998, TRIS had nine interactive applications. The Service could initiate another application that would allow Form 941 filers with no liability to satisfy their filing requirements by telephone. This would be a proactive step to reduce the number of \$0 Forms 941 filed.

TRIS analysts expressed concern about taxpayer authentication. Taxpayers who currently use TRIS applications access them through a Personal Identification Number (PIN). PINs are provided by notice to these taxpayers. This method of authentication may be impractical for \$0 Form 941 filers.

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The Telephone Routing Interactive System (TRIS) could be modified to allow BMF filers without a liability to satisfy their filing requirements.

However, taxpayers could be authenticated on TRIS as they are now when they call the Service. Under current guidelines, taxpayers can speak to tax examiners and indicate that they have no liability. Tax examiners authenticate taxpayers by inquiring about entity data on file. A new TRIS application could be created which would require taxpayers to input sufficient data for authentication. For example, the application might require taxpayers to enter their EINs, street numbers and the first five letters of their business addresses. This information could be input via a touch-tone telephone.

BMF TeleFile could also be expanded to allow business taxpayers that have a \$0 Form 941 liability to satisfy their filing requirements. BMF TeleFile for Forms 941 is scheduled for nationwide implementation in April 1998. Currently, only a select group of business taxpayers qualify to use this system.

BMF TeleFile analysts expressed concern that the Service could not monitor all of the taxpayers using the system if it was expanded. However, current procedures allow tax examiners to conduct business telephonically after authenticating taxpayers. Taxpayers with no liability could use an automated version of this authentication process, satisfy the filing requirement, and eliminate the need to file a Form 941 with \$0 liability.

BMF TeleFile could be expanded to accept Form 941 filers without tax liabilities.

In November 1997 we briefed the then Assistant Commissioner (Collection) and the Assistant Commissioner (Forms and Submission Processing) on the status of our review and presented our preliminary results and potential recommendations. The Assistant Commissioner (Collection) agreed that a telephone voice response system was a good issue and one that should be pursued by Internal Audit.

Recommendations

1. Establish a system that allows taxpayers to telephonically satisfy their filing requirements and revise EIN

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assignment and delinquency notices to reflect this procedural change.

Management's Response: Management agreed, with reservation, to develop a simplified system to eliminate taxpayer burden with regard to \$0 Forms 941. However, rather than modifying a current system management will include a tax compliance risk assessment as an early action item in their ETA Strategic Plan by January 1, 1999 and then proceed accordingly.

2. Include information in the Form 941 instructions advising taxpayers to use the newly created telephone voice response system if they have a \$0 tax liability.

Management's Response: Once a decision is made on the first recommendation, this action item will be included in the implementation plan.

Implementation of Prior Internal Audit Recommendations Would Improve Compliance Efforts.

A prior Internal Audit report recommended ways to select more productive delinquency investigations and make better use of available information to ensure compliance.

In a prior report, Internal Audit recommended that management:

- modify computer programming to select more productive delinquency investigations.
- make better use of available information to establish filing requirements and ensure compliance.

During this review, we followed up on management's implementation of corrective actions to the above recommendations. We determined programming was not correctly modified to select more productive cases, and the Service is not on track to implement a reporting agent/client cross-reference. As a result, the Service continues to generate less productive nonfiler cases and may not

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effectively implement two previous Internal Audit recommendations to improve compliance.

A 2b, 2e-----Feature Will Improve The Productivity Of Delinquency Investigations

*In a previous report,
Internal Audit estimated that
the Service closes out about
2b, 2e-----
2b, 2e-----

2b, 2e-----*

In an August 1996 report, Internal Audit determined that
2b, 2e-----
2b, 2e-----In that
report Internal Audit estimated that each year the IRS closes
about 2b, 2e-----
2b, 2e-----

To improve the productivity of employment tax delinquency investigations, management agreed to modify the delinquency
2b, 2e-----

2b, 2e----- Management agreed to implement the check
2b, 2e-----

*During our review we found
that changes to the
delinquency check program
to reduce unproductive TDIs
were not properly
implemented.*

During this review we followed up on management's implementation of the check and determined that it was not implemented. 2b, 2e-----
2b, 2e-----
2b, 2e-----When advised of the programming problem, management took immediate action to implement the check.

We also suggest a modification to the original recommended
2b, 2e----feature. We recommend that the 2b, 2e----
feature 2b, 2e-----
2b, 2e-----

Management agrees with our suggestion and has included this modification in a Request for Information Services.

Management should properly implement corrective actions to audit findings. Correct implementation of the check should result in a reduction in unproductive nonfiler cases.

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In an August 1996 report, Internal Audit made two recommendations to implement crosschecks that would establish filing requirements.

In order for the recommended crosschecks to be implemented appropriately, the Service should establish a Reporting Agent indicator as recommended by an Andover Service Center Natural Work Group.

A Reporting Agent Indicator Will Allow More Effective Implementation Of Recommendations To Improve Employment Tax Compliance

In an August 1996 report, Internal Audit recommended that the Service:

1. Match EINs on Forms W-3 (Transmittal of Income and Tax Statements) received from the Social Security Administration (SSA) against the BMF. If the entity is present on the BMF and there are no filing requirements and no subsidiary indicator, the Service should establish an employment tax filing requirement.
2. Establish a Form W-2/BMF crosscheck of EINs that appear on Forms W-2 transmitted with electronically filed Forms 1040. For those EINs that match an existing BMF account, the Service should establish employment tax filing requirements if the account does not have a filing requirement and does not contain a subsidiary indicator.

Both of the above recommendations were contingent on the Service establishing a Reporting Agent indicator recommended by an Andover Service Center Natural Work Group. This reporting agent indicator was also referred to as a subsidiary indicator in the previous Internal Audit report.

Current procedures allow parent corporations and certain agents to file consolidated employment tax returns for their subsidiaries and clients. These consolidated returns are filed under the EIN of the parent or agent. However, Forms W-2 and W-3 must be filed with SSA under the subsidiary's or client's EIN.

State reporting requirements mandate that each individual subsidiary or client file its own unemployment tax return (Form 940). Master File programming, with some exceptions, will generate a filing requirement for Form 941 if the Form 940 has been filed by the client. However, there is no cross-reference on the client's master file account to

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show that a consolidated Form 941 has been filed by a reporting agent. This inconsistency creates unnecessary Master File and Combined Annual Wage Reporting (CAWR) nonfiler cases on the clients.

An Andover Service Center quality initiative made recommendations to implement an indicator to link client accounts to their reporting agents. The National Director of Quality recommended the proposed system changes be tested and appropriate changes made. Our prior audit did not recommend establishing this reporting agent indicator because the Andover Service Center was taking steps to implement the indicator.

This reporting agent indicator needs to be implemented before a Forms W-3/W-2 employment tax filing requirement crosscheck can be fully effective. Internal Audit promised to follow up with the National Director of Quality and other National Office functions as appropriate concerning the creation of this reporting agent indicator.

We assessed management's progress on establishing a reporting agent indicator. Implementation of the two recommendations from the Review of the Employment Tax Nonfiler Program Internal Audit report is contingent on this indicator. In our opinion, management has not made sufficient progress on establishing this indicator to ensure that the two recommendations will be timely implemented. Management needs to timely establish this indicator to allow sufficient time for implementing the two recommendations by February 1, 1999.

Management has not made sufficient progress on establishing a reporting agent indicator recommended by an Andover Service Center Natural Work Group.

Implementation of these two recommendations should identify some nonfilers approximately 14 to 18 months earlier than current processes, and help to ensure that the Service is receiving employment tax returns from all employers who issued Forms W-2. In November 1997 we briefed the then Assistant Commissioner (Collection) and the Assistant Commissioner (Forms and Submission Processing) on the status of our review and shared our preliminary results.

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Recommendations

3. 2b, 2e-----

Management's Response: Management submitted a Request for Information Services to change the program as stated in the recommendation.

- 4. Establish a cross-reference between reporting agents and client accounts as recommended by the Andover Service Center Natural Work Group. After establishing the cross-reference:
 - a) Match EINs on Forms W-3 received from SSA with the BMF. If the entity is present on the BMF and there are no filing requirement and no reporting agent indicator, the Service should establish an employment tax filing requirement.
 - b) Establish a Form W-2/BMF crosscheck of EINs that appear on Forms W-2 transmitted with electronically filed Forms 1040. For those EINs that match an existing BMF account, the Service should establish employment tax filing requirements if the account does not have a filing requirement code and does not contain a reporting agent indicator.

Management's Response: Management agreed with the recommendation to cross-reference the Business Master File with Employer Identification Numbers on Forms W-3 received from the Social Security Administration and on Forms W-2 associated with electronically filed Forms 1040. Management will also provide the necessary support to implement the reporting agent indicator. Requests for Information Services will be submitted to request the necessary programming and recommended actions will be implemented once supporting

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programming and tape matches are available for the cross referencing.

Conclusion

Our review showed that overall the process to assign EINs is efficient and effective. Taxpayers can apply for EINs through several methods, including two that provide EINs immediately. When EINs are established the Service assigns appropriate filing requirements based on the information provided by taxpayers.

Existing systems could be enhanced to reduce processing costs and taxpayer burden. The Service could change the process by which Form 941 filers without a liability satisfy their filing requirements. This change would eliminate the need for BMF taxpayers to file a \$0 Form 941 when they are without a liability resulting in reduced taxpayer burden and Service processing costs. Either TRIS or BMF TeleFile could be expanded to accommodate these taxpayers. The Service currently receives and processes about 2.1 million \$0 Forms 941 each year, filed solely to satisfy filing requirements.

Recommendations from a previous audit report were not properly implemented or are at risk for untimely implementation. When notified, management took immediate action to correctly implement a 2b, 2e---- feature. However, management has not made sufficient progress on establishing a reporting agent indicator. As a result, two other Internal Audit recommendations are at risk for untimely corrective actions.



Preston B. Benoit
Audit Manager

EINs and Related Filing Requirements

Attachment I

Detailed Objectives and Scope

The overall objective of our review was to determine whether procedures for establishing entities and filing requirements on the Business Master File (BMF) were efficient and effective, and whether they could be improved to reduce taxpayer burden, reduce costs and improve customer service. To achieve this objective we:

- I. Determined the necessity, purpose and use of EINs, and whether the Service efficiently and effectively assigns EINs by:
 - A. interviewing national and local officials from various functional areas concerning the assignment of EINs.
 - B. reviewing EIN assignment procedures.
- II. Determined whether the Service establishes appropriate entities and filing requirements for business taxpayers by:
 - A. tracing a sample of Forms SS-4 to the BMF to determine if the Service established correct filing requirements.
 - B. reviewing results of a prior filing requirements study.
 - C. reviewing results from taxpayer focus groups to determine if they provide information the Service can use to improve the EIN assignment process.
 - D. determining why the Service assigns and controls EINs for non-tax purposes.
- III. Determined if the process for establishing entities and filing requirements leads to unproductive Tax Delinquency Investigation and nonfiler cases, and the unnecessary preparation, filing and processing of tax returns with \$0 tax liability by:
 - A. analyzing a BMF extract of eight quarters of Forms 941 (1995 and 1996) to determine the volumes of Forms 941 filed with \$0 tax liability.
 - B. profiling business entities in the BMF extract of Forms 941 (See A above) to identify indicators (final returns, seasonal filers, etc.) concerning the reasons business taxpayers may have filed Forms 941 with \$0 tax liability.
 - C. determining why taxpayers filed Forms 941 for \$0 based on the results of the profiled data in Step IIIB.

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- D. researching several internal systems to determine if there is an automated method for Form 941 filers to satisfy their filing requirements when they are without a liability. To accomplish this we:
 - 1. interviewed personnel associated with the Telephone Routing Interactive System (TRIS) and BMF TeleFile.
 - 2. obtained background information on TRIS and BMF TeleFile.

- IV. Determined whether the Service effectively implemented recommendations from three Internal Audit reports by:
 - A. interviewing National Office officials to determine the status of establishing a Reporting Agent indicator on the BMF for entities whose payroll tax returns are filed by a reporting entity.
 - B. following up on selected recommendations to determine if management had taken corrective action.

- V. Determined, in conjunction with management, cost-effective, reasonable alternatives to any identified systemic or procedural weaknesses from sub-objectives I through IV.

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Requirements

Attachment II

Management Response



ASSISTANT COMMISSIONER
(FORMS AND SUBMISSION
PROCESSING)

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

SEP 10 1998

RECEIVED

SEP 17 1998
9808520
Chief Inspector

MEMORANDUM FOR CHIEF INSPECTOR

THRU: Bob Wenzel
Chief Operations Officer

FROM: Brien T. Downing
Assistant Commissioner
(Forms and Submission Processing) OP:FS

SUBJECT: Review of the Draft Internal Audit (IA) Report - Employer
Identification Number (EIN) and Related Filing Requirements

Thank you for the opportunity to respond to the recommendations in the subject draft IA report. We appreciate your understanding of our need for extending the response date to accommodate the coordination effort, and apologize for the delay. As you know, it was necessary to solicit input from the Assistant Commissioners Collection, Customer Service and Electronic Tax Administration (ETA). We have responded to the four recommendations and also included, as an attachment, concerns expressed by the Office of the Assistant Commissioner (Collection) related to the telephonic acceptance of zero liability Forms 941. If your staff has any questions or needs additional information, they may contact my Internal Audit Liaison, Cris Balzereit, at (202) 622-7055.

Recommendation 1: Establish a system that allows taxpayers to telephonically satisfy their filing requirements and revise EIN assignment and delinquency notices to reflect this procedural change.

Assessment of Cause: Internal Audit concludes that the Service could eliminate the cost and burden associated with filing Forms 941 for zero tax liability by implementing an interactive telephone system for use by BMF filers of Forms 941.

Corrective Action(s): We agree, with reservation, that the Service should develop a simplified system to eliminate the burden on taxpayers filing Forms 941 when there is no tax liability. As concerns have been expressed by the Assistant Commissioner (Collection) related to potential misuse, rather than move quickly to modify a current system to accommodate this need, we should include a tax compliance risk assessment as an early action item in our implementation plans and proceed accordingly.

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The report recommends using our current interactive telephone systems, either TRIS or Telefile, as the vehicle for the taxpayer to telephonically make their return when there is a zero tax liability.

a) TELEFILE - Adding this market segment to the existing Telefile System poses operational problems in regard to authentication, signature/alternative signature, and systems performance. However, ETA will enlist the aid of Internal Audit, Criminal Investigation and Information Systems to explore all potential areas for 941 Telefile expansion, including all no-remit Form 941 returns. This task will be incorporated into the ETA Strategic Plan.

b) TRIS - TRIS is a legacy system that is in a maintenance mode and additional applications cannot be considered. However, the Modernization Blueprint calls for the introduction of automated self-service applications as part of Phase I, Sub-release 1.2, scheduled for Years 2000/2001. If this still remains an unresolved issue, we will include it for consideration for Phase 1, Sub-release 1.2.

Implementation Date: a) January 1, 1999
b) NA

Responsible Official(s): a) Assistant Commissioner (Electronic Tax Administration)
b) Assistant Commissioner (Customer Service)

Recommendation 2: Include information in the Form 941 instructions, advising taxpayers to use the newly created telephone voice response system if they have a \$0 tax liability.

Assessment of Cause: Internal Audit concludes that the Service could eliminate the cost and burden associated with filing Forms 941 for zero tax liability by implementing an interactive telephone system for use by BMF filers of Forms 941.

Corrective Action(s): Once a decision is made on Recommendation 1, this action item will be included in the implementation plan.

Implementation Date: N/A

Responsible Official(s): Assistant Commissioner (Electronic Tax Administration)
Assistant Commissioner (Customer Service)
Assistant Commissioner (Forms and Submission Processing)

EINs and Related Filing Requirements

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Recommendation 3: 2b, 2e

2b, 2e

Assessment of Cause: Internal Audit concludes that the filing of zero tax liability returns could be significantly reduced by the suppression of tax return delinquency notices unless a prior tax return has posted or payment is present on the current tax period. This proposal would reduce the expense of processing Forms 941 with zero tax liabilities, reduce taxpayer burden, and eliminate staff time expended in resolving zero tax delinquency cases.

Corrective Action(s): A Request for Information Services has been submitted to change the program as stated in the recommendation. The Chief Information Officer has responded that the change will be completed by January 15, 1999.

Implementation Date: January 15, 1999

Responsible Officials: Assistant Commissioner (Customer Service)

Recommendation 4: Establish a cross-reference between reporting agent and client accounts as recommended by the Andover Service Center Natural Work Group in order to timely implement previous IA recommendations. After establishing the cross-reference:

- a) Match EINs on Forms W-3 received from Social Security Administration (SSA) with the Business Master File (BMF). If the entity is present on the BMF and there are no filing requirements and no reporting agent indicator, the Service should establish an Employment Tax filing requirement.
- b) Establish a Form W-2/BMF cross check of EINs that appear on Forms W-2 transmitted with electronically filed Forms 1040. For those EINs that match an existing BMF account, the Service should establish Employment Tax filing requirements if the account does not have a filing requirement code and does not contain a reporting agent indicator.

Assessment of Cause: To improve employment tax compliance, Internal Audit previously recommended implementation of cross checks between the Business Master File and Forms W-2 and W-3 that would result in the establishment of employment tax filing requirements. A reporting agent indicator, as previously recommended by the Andover Service Center Natural Work Group, would need to be implemented.

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Corrective Action(s): We agree with the recommendation to cross-reference the BMF with EINs on Forms W-3 received from the SSA and on Forms W-2 associated with electronically filed Forms 1040. RIS(s) will be submitted to request the necessary programming and recommended actions will be implemented once supporting programming and tape matches are available for the cross-referencing. Submission Processing will provide the necessary support to implement the reporting agent indicator once Customer Service has defined the requirements.

Implementation Date: 2b, 2e

Responsible Official(s): Assistant Commissioner (Customer Service)
Assistant Commissioner (Forms and Submission Processing)

Attachment

cc: Assistant Commissioner (Customer Service)
Assistant Commissioner (Collection)
Assistant Commissioner (Electronic Tax Administration)
National Director, Submission Processing Division
National Director, Tax Forms and Publications Division

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EINs and Related Filing Requirements



ASSISTANT COMMISSIONER
COLLECTION

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

June 24, 1998

1998 JUN 26 PM 12:45

A/C FORMS AND
SUBMISSION PROCESSING

MEMORANDUM FOR ASSISTANT CHIEF INSPECTOR (INTERNAL AUDIT)
ASSISTANT COMMISSIONER
(FORMS AND SUBMISSION PROCESSING)

FROM: Deborah S. Reilly
Assistant Commissioner (Collection) OP:CO

SUBJECT: Review of Draft Internal Audit (IA) Report - *Employer
Identification Numbers (EINs) and Related Filing
Requirements* (MIS#970043)

We have reviewed the subject draft report. While we are in general agreement with IA's findings, we take exception to recommendations 1 and 2 (page 10), as well as to the last sentence of the narrative at the bottom of page 9, immediately preceding the recommendations. The narrative and recommendations relate to the establishment of "a system that allows taxpayers to telephonically satisfy their filing requirements." Although we are not responsible for implementing the recommendations, as the process owner for Nonfiling, we have a strong interest in them because the Nonfiler Program will be impacted if they are implemented. We ask, therefore, that you take our position into consideration.

We are concerned that the establishment of allowing taxpayers to satisfy their filing requirements via TRIS, TeleFile, or a similar system could potentially open the floodgates for abuse. Currently, when there is no liability for a tax period, the taxpayer is required to notify the IRS of this fact in writing (on the tax return or in a letter) or by speaking with an IRS employee. Use of a voice response mechanism would make it extremely easy for a taxpayer to be taken off the liability list simply by using a touch-tone phone, or for someone other than the taxpayer to do so, with impunity. Before such a system is implemented, we insist that it be tested for its level of risk to tax compliance. Furthermore, validation processes to verify the claim of no liability must be built into the system, perhaps with the use of state data. (Of course, there is always the danger that the taxpayer could be giving false information to the state, too.)

At the meeting in November 1997 (referenced at the bottom of page 9 of the draft report), the then Assistant Commissioner (Collection) "agreed that a telephone voice response system was a good issue," but that Internal Audit and others needed to study in depth, the risks inherent in such a system. At no time did he endorse the implementation of such a system without further investigation into the problems it might

EINs and Related Filing Requirements

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inadvertently cause. In addition, at a subsequent meeting with IA and impacted officials on April 16, 1998, the National Director, Collection Field Operations, also cautioned that there is a big difference between a taxpayer's oral testimony to an IRS employee regarding a no liability period and allowing a taxpayer to simply push some buttons on their telephone to claim no tax liability

We will not require a closing conference with IA unless our position is not reflected in the response to the draft report. If you have any questions regarding this response, please let me know, or a member of your staff may call Elaine Munroe, my Internal Audit liaison, at 622-4943.

cc Chief Operations Officer
Regional Inspector, Northeast Region
Assistant Commissioner (Customer Service)
Assistant Commissioner (Electronic Tax Administration)