



*The Employer's ANNUAL Federal Tax
Return (Form 944) Program Was Effectively
Planned and Implemented, but Fewer
Returns Than Anticipated Were Filed*

September 17, 2007

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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.

Phone Number | 202-927-7037

Email Address | Bonnie.Heald@tigta.treas.gov

Web Site | <http://www.tigta.gov>



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 17, 2007

MEMORANDUM FOR DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT
DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT

Margaret E. Bezz

FROM: (for) Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Employer’s ANNUAL Federal Tax Return
(Form 944) Program Was Effectively Planned and Implemented, but
Fewer Returns Than Anticipated Were Filed (Audit # 200730017)

This report presents the results of our review of the development and implementation of the Employer’s ANNUAL Federal Tax Return (Form 944) Program. The overall objective of this review was to determine whether the Internal Revenue Service (IRS) adequately prepared to process Forms 944 during the 2007 Filing Season¹ and to evaluate the effectiveness of processing activities. This audit was part of our discretionary audit coverage of the Small Business/Self-Employed Division and was included in the Treasury Inspector General for Tax Administration Fiscal Year 2007 Annual Audit Plan.

Impact on the Taxpayer

In 2006, the IRS introduced Form 944 to allow certain employers to file their employment tax returns annually and pay the taxes due with their returns. The IRS’ goals for the new Form 944 Program are to reduce taxpayer burden for eligible employers that would normally file Employer’s QUARTERLY Federal Tax Return(s) (Form 941) with little or no employment taxes due and to maintain and possibly improve current filing and payment compliance levels. The IRS estimated about 1 million taxpayers would be eligible to file Forms 944, which could save approximately 46.2 million hours of burden for taxpayers and representatives and save more than \$4.1 million in IRS operating costs.

¹ The filing season is the period from January through mid-April when most individual income tax returns are filed.



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Synopsis

The IRS took appropriate actions to plan and implement new Form 944 for the 2007 Filing Season. It identified and notified the taxpayers eligible to file a Form 944 and mailed nearly 517,000 tax packages to them in December 2006. It also established procedures to inform new taxpayers of the filing requirements when applying for an Employer Identification Number.² The IRS computers were updated, programmed, and tested to process Forms 944. In addition, the IRS ensured tax examiners were adequately trained on the new filing requirements to address taxpayers' inquiries and questions.

While the Office of Taxpayer Burden Reduction (Project Office) effectively planned and implemented the Form 944 Program, the IRS did not receive the anticipated volume of returns. It had estimated about 1 million taxpayers would be eligible to file Forms 944, which would save the IRS more than \$4.1 million in operating costs. However, as of June 1, 2007, the IRS had received only about 326,000 Forms 944. Prior to implementing the Form 944 Program in 2006, the IRS had changed the Program requirements (in 2005) by reducing the employment tax liability amount from \$2,500 to \$1,000 and no longer requiring taxpayers to have filed 8 consecutive quarters of Forms 941. Adjusting the eligibility requirements increased the number of taxpayers eligible to file a Form 944 from 350,598 to 1,152,510. However, without using taxpayers' filing histories, it is difficult for the IRS to accurately estimate the number of taxpayers that will file a Form 944 each year, especially when these taxpayers may not have employment tax liabilities every year.

In addition, the Project Office is still analyzing filing data, tracking actual costs, and reviewing stakeholder input to evaluate benefits and to determine costs. By September 2007, the Project Office needs to determine whether the Form 944 Program should continue as developed, continue with modifications such as changing the eligibility limit, or be discontinued after Tax Year 2008. Although we made no recommendations, the IRS might consider the following in its evaluation effort:

- Obtain more information on the target population to assist in Program adjustments.
- Capture actual costs for evaluating Program results and future actions.
- Contact stakeholders to obtain other opinions on the success of the Form 944 Program.

² The Employer Identification Number is a nine-digit number assigned by the IRS to sole proprietors, corporations, partnerships, estates, trusts, and other nonindividual entities for tax-filing and reporting purposes.



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Recommendation

We made no recommendations in this report. However, key IRS management officials reviewed the report prior to issuance and agreed with the facts and conclusions.

Copies of this report are also being sent to the IRS managers affected by the report information. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-5894.



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Abbreviations

IRS

Internal Revenue Service



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Background

In 2006, the Internal Revenue Service (IRS) introduced a new employment tax¹ form to reduce the burden for small employers. By establishing new rules and processes, the IRS would allow certain employers to file their employment tax returns annually and pay the taxes due with their returns. The new Employer's ANNUAL Federal Tax Return (Form 944) Program allows certain taxpayers to file and pay employment taxes on

***The Employer's ANNUAL
Federal Tax Return (Form 944)
Program aims to reduce the
burden and cost for low-wage,
small-business employers filing
Employer's QUARTERLY
Federal Tax Returns (Form 941).***

January 31 following the end of the tax year rather than quarterly, as previously required. To be eligible, employers must have an estimated annual employment tax liability of \$1,000 or less. New employers who expect to owe \$1,000 or less (approximately \$4,000 or less in annual wages) also are eligible to file a Form 944. New businesses can self-identify themselves for the annual filing/payment Program when they request an Employer Identification Number.²

The Small Business/Self-Employed Division, Office of Taxpayer Burden Reduction, was responsible for implementing the Form 944 Program, which is operating under temporary regulations for 3 years to test the concept of annualizing the Employer's QUARTERLY Federal Tax Return (Form 941) quarterly filing requirement for certain taxpayers. The first Forms 944 were due January 31, 2007.

The IRS' goals for the new Form 944 Program are to reduce taxpayer burden for eligible employers that would normally file Form(s) 941 with little or no employment taxes due and to maintain and possibly improve current filing and payment compliance levels.

Figure 1 shows the results of the IRS' analysis of Form 941 return data using different dollar amounts of employment tax liabilities to identify potential cost savings and taxpayers eligible to participate in the Form 944 Program.

¹ Employment taxes include Federal income tax withholdings, Social Security taxes (both the employer's and employee's share), and Medicare payments, which employers reported on Employer's QUARTERLY Federal Tax Returns (Form 941).

² The Employer Identification Number is a nine-digit number assigned by the IRS to sole proprietors, corporations, partnerships, estates, trusts, and other nonindividual entities for tax-filing and reporting purposes.



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Figure 1: Summary of Savings

Tax Liability (less than)	Taxpayers	Savings
\$500	947,423	\$3,381,786
\$750	1,049,967	\$3,746,526
\$1,000	1,152,510	\$4,111,263
\$1,500	1,334,093	\$4,757,139
\$2,500 and Compliant With Filing Forms 941 for 8 Quarters	350,598	\$1,258,930

Source: IRS Annual File and Pay Costing (11/2004).

The IRS established a tax liability eligibility requirement at \$1,000 or less. Selecting the \$1,000 tax liability requirement was a conservative start; based on experience gained over 3 years, the IRS could raise or lower the amount or terminate the Program.

This review was performed at the Office of Taxpayer Burden Reduction in Downers Grove, Illinois, during the period January through September 2007. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

The Small Business/Self-Employed Division took appropriate actions to plan and implement the new employment tax return (Form 944) for the 2007 Filing Season.³ The IRS identified and notified the taxpayers eligible to file a Form 944 and mailed nearly 517,000 packages to them in December 2006. In addition, it established procedures to inform new taxpayers of the filing requirements when applying for an Employer Identification Number. The IRS computers were updated, programmed, and tested to process Forms 944. The IRS also ensured tax examiners were adequately trained on the new filing requirements to address taxpayers' inquiries and questions.

While the Office of Taxpayer Burden Reduction (Project Office) effectively planned and implemented the Form 944 Program, the IRS did not receive the anticipated volume of returns. It had estimated about 1 million taxpayers would be eligible to file Forms 944, which would save approximately 46.2 million hours of burden for taxpayers and representatives and save more than \$4.1 million in IRS operating costs. However, as of June 1, 2007, the IRS had received only about 326,000 Forms 944. It is difficult for the IRS to accurately estimate the number of returns that will be filed because these taxpayers may not have employment tax liabilities every year.

The Project Office used a Project Management Plan to guide the project team throughout the duration of the project. The Plan describes the approach to developing a successful system that meets users' expectations regarding timeliness, cost, quality, scope and function. The Plan also defines project management processes including risk management, configuration management, communication management, and quality management.

Implementation of the New Employment Tax Return Was Effectively Planned and Monitored

The Project Office initiated the Form 944 Program in November 2003, developed an action plan to track and monitor the Program's implementation, assigned tasks to employees from various business functions to ensure specific actions were completed correctly and timely, and used a Work Breakdown Structure⁴ to monitor the status of the tasks and biweekly meetings to check with employees responsible for completing the actions for the Program. It prepared biweekly status reports showing the progress of the tasks. These reports were rolled up into monthly

³ The filing season is the period from January through mid-April when most individual income tax returns are filed.

⁴ The Work Breakdown Structure is a Microsoft Office Project Professional 2003 system used to control and monitor the status of work assignments.



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summary reports and were available to management through the Risk Management Group⁵ process. As tasks were completed, the information gained was updated into the Work Breakdown Structure.

Other actions included developing the new Form 944 and providing instructions in both English and Spanish. The Project Office also developed taxpayer notification letters, electronic filing and payment stuffers, and a series of notices to remove taxpayers from the Form 944 Program when they exceeded the eligibility limit. In addition, it oversaw the updating of related IRS publications and revisions to more than 50 Internal Revenue Manual sections.

System and Processing Changes to Handle the New Employment Tax Return Were Successfully Implemented

The Project Office effectively managed and controlled the work needed to make systemic changes to process Forms 944. The IRS updated 40 computer programs and tested the ability of its computer systems to process Forms 944. After evaluation of the overall Program is completed, the functional business owners will become responsible for managing the Form 944 Program.

The Project Office also continued coordination activities with other Government agencies and professional organizations and held various briefings with IRS executives. It obtained approval of Temporary Regulations⁶ in December 2005 and initiated an evaluation study by IRS functions to determine the success of the new initiative in reducing taxpayer burden.

As a result of the implementation efforts, the IRS successfully processed the Forms 944 submitted by employers in both paper and electronic form.

⁵ The monthly Risk Management Group meeting allows project managers to report the status of their projects and to elevate risks/issues they are unable to resolve independently (or through their management chains). If risks or issues are not resolved during the Risk Management Group meeting, action items are assigned during the meeting to work toward resolving them.

⁶ The Temporary Regulations established the Form 944 Program and Internal Revenue Code Sections 6011 and 6302 (2006) concerning reporting and paying income taxes withheld from wages and reporting and paying taxes under the Federal Insurance Contributions Act (26 U.S.C. Section 3101 (1939)) (collectively, "employment taxes"). These Temporary Regulations provide the requirements for filing returns under this Act and returns with income tax withheld under Internal Revenue Code Section 6011 and Sections 31.6011(a)-1 and 31.6011(a)-4 of the Employment Tax Regulations (2006).



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The Volume of Forms 944 Received Fell Short of Expectations

While the Project Office effectively planned and implemented the Form 944 Program, the IRS did not receive the anticipated volume of returns. As of June 1, 2007, the IRS had received about 326,000 Forms 944, including 11,000 electronically filed returns, and had processed about 312,000 of the Forms. The original Program requirements were changed in 2005 to reduce the employment tax liability amount from \$2,500 to \$1,000 and to no longer require taxpayers to have filed 8 consecutive quarters of Forms 941. Adjusting the eligibility requirements increased the number of taxpayers eligible to file a Form 944 from 350,598 to 1,152,510. However, without using taxpayers' filing histories, it is difficult for the IRS to accurately estimate the number of taxpayers that will file a Form 944 each year.

The original Form 944 Program proposal was structured with the following criteria: each taxpayer had to have a total employment tax liability of less than \$2,500 and demonstrate at least 8 consistent quarters of filing employment tax returns and making payments. However, as the Project Office began to work on the initiative, it became apparent that this proposal was too complex for both the taxpayer and the IRS. On January 10, 2005, the Services Support and Modernization Committee⁷ approved a simpler Program that eliminated the compliance condition and changed the eligibility criterion to an annual employment tax liability threshold of \$1,000 or less. For future projections, the IRS may want to consider using taxpayers' previous filing histories.

The Project Office is preparing an evaluation of the Form 944 Program for a September 2007 presentation to IRS executives. It is identifying filing results from participating employers and is using the Program costs to match against its projected estimates and to provide cost information for evaluating the continuation of the Form 944 Program. In addition, the Project Office requested Taxpayer Delinquency Investigation⁸ information to determine whether the lack of filing compliance was attributable to status changes causing the employers to no longer need to file employment tax returns. Because this activity is ongoing, the IRS evaluation of the Form 944 Program filing results was not completed at the time of our review.

By September 2007, the Program Office needs to determine whether the Form 944 Program should continue as developed, continue with modifications such as changing the eligibility limit, or be discontinued after Tax Year 2008. Although we made no recommendations, the IRS might consider the following in its evaluation effort:

⁷ This Committee oversees the development and implementation of programs required to support IRS business needs.

⁸ A computer-generated printout indicating that a taxpayer is delinquent in filing a return.



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- Obtain more information on the target population to assist in Program adjustments.
- Capture actual costs for evaluating Program results and future actions.
- Contact stakeholders to obtain other opinions on the success of the Form 944 Program.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the IRS adequately prepared to process Employer's ANNUAL Federal Tax Returns (Form 944) during the 2007 Filing Season¹ and to evaluate the effectiveness of processing activities.² To accomplish the objective, we visited the Form 944 Program Project Office in Downers Grove, Illinois, and contacted other IRS personnel to evaluate the effectiveness of Program implementation activities. Specifically, we:

- I. Evaluated the actions taken by the IRS to identify and notify the taxpayers eligible to file a Form 944.
 - A. Discussed with Office of Taxpayer Burden Reduction personnel and reviewed project records as to whether the IRS had reviewed the low-dollar employment tax population to identify a group that could benefit from the new filing requirements.
 - B. Reviewed cost savings (identified by the IRS) associated with taxpayers selected to file a Form 944.
 - C. Identified actions taken to notify eligible taxpayers that they were selected to file a Form 944.
- II. Determined whether the appropriate forms and instructions were sent to the taxpayers eligible to file a Form 944.
 - A. Contacted Media and Publications office personnel and reviewed available records regarding whether the IRS had provided Form 944 packages to the eligible taxpayers.
 - B. Analyzed the IRS Business Master File³ for Processing Year 2006 and identified eligible taxpayers that did not file a Form 944. The data were extracted and validated by programmers in our Office of Information Technology using run-to-run balancing.
 - C. Analyzed the Integrated Data Retrieval System⁴ and determined whether employers were required to file or failed to file the proper form.

¹ The filing season is the period from January through mid-April when most individual income tax returns are filed.

² In 2006, the IRS introduced a new employment tax return (Form 944) to allow certain employers to file their employment tax returns annually and pay the taxes due with their returns.

³ 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.

⁴ The IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



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- III. Identified actions taken by the IRS to educate new taxpayers applying for an Employer Identification Number⁵ about the filing requirements of Form 944.
 - A. Determined whether the IRS had advertised Form 944 to eligible taxpayers.
 - B. Analyzed the Business Master File for Processing Year 2006 and identified new taxpayers that filed a Form 944. The data were extracted and validated by programmers in our Office of Information Technology using run-to-run balancing.
- IV. Determined whether the IRS took adequate actions to ensure tax examiners were adequately trained to address taxpayers' questions.
 - A. Communicated with Customer Account Services function managers and reviewed training material concerning whether the IRS had trained personnel on the Form 944 filing requirements.
 - B. Identified training instructions and reference material covering Form 944.
 - C. Verified whether managers and quality review personnel had monitored call activity.
- V. Determined whether appropriate IRS systems were updated, programmed, and tested to include Form 944.
 - A. Evaluated whether the IRS implemented and tested program changes to allow the processing of Forms 944.
 - B. Reviewed available information on whether the IRS processed Forms 944 submitted by eligible taxpayers.
 - C. Analyzed the Business Master File for Processing Year 2006 to evaluate the account statuses of eligible taxpayers that filed a Form 944. The data were extracted and validated by programmers in our Office of Information Technology using run-to-run balancing.
 - D. Discussed with Office of Taxpayer Burden Reduction staff and reviewed evaluation plans as to whether the IRS determined that the processing of Forms 944 had been successful and should be continued.
- VI. Determined whether the IRS established controls and procedures to identify taxpayers exceeding the tax liability threshold during the tax year.
 - A. Assessed whether the IRS established a mechanism to identify eligible taxpayers exceeding the limit.

⁵ The Employer Identification Number is a nine-digit number assigned by the IRS to sole proprietors, corporations, partnerships, estates, trusts, and other nonindividual entities for tax-filing and reporting purposes.



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- B. Evaluated the actions taken to resolve the unpostable Forms 944 filed by taxpayers that incorrectly filed Forms 941 and did not opt out of the Form 944 Program.
- C. Analyzed the Business Master File data and verified whether the IRS changed the filing requirements of taxpayers that had more than a \$1,000 employment tax liability.



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Appendix II

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs)
Parker Pearson, Director
Edward Gorman, Audit Manager
Lawrence Smith, Senior Auditor
Lynn Rudolph, Senior Auditor
Judy Harrauld, Information Technology Specialist



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Appendix III

Report Distribution List

Acting Commissioner C
Office of the Commissioner – Attn: Acting Chief of Staff C
Assistant Deputy Commissioner for Operations Support OS
Assistant Deputy Commissioner for Services and Enforcement SE
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Wage and Investment Division SE:W
Chief Information Officer OS:CIO
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Wage and Investment Division SE:W
Associate Chief Information Officer, Applications Development OS:CIO:AD
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division
SE:W:CAR
Director, Examination, Small Business/Self-Employed Division SE:S:E
Director, Research, Small Business/Self-Employed Division SE:S:R
Director, Specialty Programs, Small Business/Self-Employed Division SE:S:SP
Director, Taxpayer Burden Reduction, Small Business/Self-Employed Division SE:S:TBR
Director, Media and Publications, Wage and Investment Division SE:W:CAR:MP
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