



Treasury Inspector General for Tax Administration Office of Audit

MILLIONS OF TAXPAYERS MAY BE NEGATIVELY AFFECTED BY THE REDUCED WITHHOLDING ASSOCIATED WITH THE MAKING WORK PAY CREDIT

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Highlights

Highlights of Report Number: 2010-41-002 to the Internal Revenue Service Commissioners for the Wage and Investment Division and Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

The Making Work Pay Credit is to be advanced to taxpayers through their wages by a decrease in Federal income tax withholding. This creates the vulnerability that some taxpayers may have their taxes underwithheld at the end of Tax Years 2009 and 2010. If taxpayers are advanced more of the Making Work Pay Credit than they are entitled to, they may ultimately owe taxes when filing their Tax Years 2009 and 2010 tax returns and may be assessed estimated tax penalties.

WHY TIGTA DID THE AUDIT

The Making Work Pay Credit, a provision of the American Recovery and Reinvestment Act of 2009, will apply to most taxpayers with earned income. The credit will be in effect for Tax Years 2009 and 2010. The Making Work Pay Credit was implemented using new income tax withholding tables issued by the Internal Revenue Service (IRS). Application of the tables could negatively affect a significant number of taxpayers. The overall objective of this review was to assess IRS efforts to implement the Making Work Pay Credit and to evaluate its impact on taxpayers.

WHAT TIGTA FOUND

Based on an analysis of Tax Year 2007 tax return data, TIGTA estimates that more than 15.4 million taxpayers could unexpectedly owe taxes for Tax Year 2009 as a result of the Making Work Pay Credit. TIGTA's analysis of the new withholding tables and the amount of the credit that taxpayers are to receive identified taxpayers who would be advanced more of the credit than they were entitled to receive. The changes to the withholding tables do not take the following situations into consideration:

- Dependents who receive wages.
- Single taxpayers with more than one job.

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- Joint filers where one or both spouses have more than one job or both spouses work.
- Individuals who file a return with an Individual Taxpayer Identification Number.
- Taxpayers who receive pension payments.
- Social Security recipients who receive wages.

More than 1.2 million taxpayers included in these groups may be subject to: 1) paying back some or all of the Making Work Pay Credit and 2) being assessed the estimated tax penalty or an increased estimated tax penalty as a direct result of the Making Work Pay Credit.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division: 1) increase media coverage and consider other forms of advertisement in addition to the mediums already being used and, to the extent possible, target these communications to taxpayers who may be adversely affected by underwithholding as a result of the Making Work Pay Credit, and 2) authorize the use of the withholding tables that were in effect prior to the enactment of the American Recovery and Reinvestment Act of 2009 for pension payments to help prevent a significant number of pensioners from being negatively affected by the Making Work Pay Credit.

In its response to the report, the IRS agreed with the first recommendation and the importance and value of exploring every avenue for communicating to the public about the Making Work Pay Credit. The IRS plans additional communication efforts. The IRS, however, did not agree with the second recommendation and stated that the procedure published in May 2009 that may be used by pension plan administrators to adjust the withholding on pension distributions to retirees who are not eligible for the Making Work Pay Credit approximated the withholding rate schedules used prior to the enactment of the Making Work Pay Credit. The IRS stated that providing additional sets of withholding tables would be burdensome, costly, and confusing for the IRS, taxpayers, and employers.

TIGTA disagrees with the IRS. The recommendation made by TIGTA to allow pension plan administrators to use the withholding tables which were in place prior to the implementation of the Recovery Act rather than two sets of tables would significantly reduce the burden the IRS is now placing on these taxpayers and would be consistent with the process being used by the Federal Government's Office of Personnel Management.

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/201041002fr.pdf>

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