TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

RECOVERY ACT

Millions of Taxpayers May Be Negatively Affected by the Reduced Withholding Associated With the Making Work Pay Credit

November 4, 2009

Reference Number: 2010-41-002

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:
1 = Tax Return/Return Information

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HIGHLIGHTS

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.

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.

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.
- 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.

RECOMMENDATIONS AND IRS RESPONSE

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. The IRS agreed with Recommendation 1 and disagreed with Recommendation 2.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

November 4, 2009

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION
COMMISSIONER, WAGE AND INVESTMENT DIVISION

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Interim Audit Report – Millions of Taxpayers May Be Negatively Affected by the Reduced Withholding Associated With the Making Work Pay Credit (Audit # 200940139)

This report presents the interim results of our review to assess the Internal Revenue Service (IRS) efforts to implement the Making Work Pay Credit and to evaluate its impact on taxpayers. Our final report on this subject will be issued in the first quarter of Fiscal Year 2010 and will include updated results. The audit addresses the major management challenge of Processing Returns and Implementing Tax Law Changes.

The American Recovery and Reinvestment Act of 2009 (Recovery Act)[1] provides separate funding to the Treasury Inspector General for Tax Administration through September 30, 2013, to be used in oversight activities of IRS programs. This audit was conducted using Recovery Act funds.

The IRS questioned the context of the issues presented in this report stating that, for most households, the negative effect will mean only a reduced refund and not an out-of-pocket tax liability on April 15. This is definitely not the case for the more than 15 million taxpayers discussed in this report. If these taxpayers' situations in Tax Year 2009 remain the same as they were in Tax Year 2007, they will face out-of-pocket tax liabilities and may even face estimated tax penalties. We acknowledge that some of the taxpayers included in our estimates may have had multiple sequential jobs rather than multiple concurrent jobs and, therefore, would not be negatively affected by the new Making Work Pay Credit withholding tables. However, this was pointed out in the report, and there was no way for either the Treasury Inspector General for Tax

[1] Pub. L. No. 111-5, 123 Stat. 115.

Administration or the IRS to estimate those numbers. To downplay the potential effect on taxpayers with multiple jobs is not consistent with good tax administration.

The IRS also indicates in its response that we did not account for taxpayers who may have fallen into more than one of our categories of taxpayers who were negatively affected by the new withholding tables. We would like to make clear that we identified 2,681 taxpayers who are in more than one of the categories. The number did not affect our overall estimate of 15.4 million taxpayers that may be affected by the Making Work Pay Credit.

Finally, the IRS stated that we made no attempt to quantify the number of taxpayers who have already adjusted their withholding based on the changes to the withholding tables. This is not the case. Although there is no way to systemically identify taxpayers making changes to their withholding, the report specifically discusses our telephone contacts with taxpayers to determine whether they were aware of the changes to the tables and whether they had adjusted or would adjust their withholding. We provide additional comments related to specific recommendations in the body of this report. 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 recommendations. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.

Table of Contents

Abbreviations

ES	Estimated Tax
IRS	Internal Revenue Service
ITIN	Individual Taxpayer Identification Number
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year

Background

The American Recovery and Reinvestment Act of 2009 (Recovery Act)[1] contains many economic stimulus provisions, one of which is the Making Work Pay Credit found in Section 1001 of the Act. The Making Work Pay Credit is the main focus of this report; however, we reference two other provisions of the Recovery Act that affect the Making Work Pay Credit, namely Section 2201 "Economic Recovery Payment to Recipients of Social Security, Supplemental Security Income, Railroad Retirement Benefits, and Veterans Disability Compensation or Pension Benefits" and Section 2202 "Special Credit for Certain Government Retirees."

The Making Work Pay Credit is a refundable tax credit allowed against the lesser of 6.2 percent of earned income or $400 ($800 in the case of a joint return). The credit will be reduced as taxpayers' modified Adjusted Gross Income exceeds $75,000 ($150,000 for joint filers) and will be completely phased out as taxpayers' modified Adjusted Gross Income reaches $95,000 ($190,000 for joint filers).[2] In order to qualify for the Making Work Pay Credit, individuals must have both earned income and a valid Social Security Number. In the case of a joint return, only one valid Social Security Number is required. Earned income is defined in Section 32 of the Internal Revenue Code as "wages, salaries, tips, and other employment compensation…plus the amount of the taxpayer's net earnings from self-employment…no amount received as a pension or annuity shall be taken into account."

Single filers are eligible for a Making Work Pay Credit of up to $400 while joint filers are eligible for up to $800 per household.

Implementing the Making Work Pay Credit is a challenge for the Internal Revenue Service (IRS) because of the requirement for it to be advanced to taxpayers throughout the year and later claimed on their individual income tax returns. The credit is to be advanced to taxpayers by their employers through withholding reductions that result in an increase in take home pay, which is intended to help increase spending and stimulate the economy. Nonetheless, advancing the Making Work Pay Credit to taxpayers through reduced income tax withholding creates the potential for some taxpayers to have their taxes underwithheld at the end of the year if the adjustment in their withholding is significantly different than the amount of the Making Work Pay Credit to which they will be entitled. Adding to the difficulty of administering the Making

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[1] Pub. L. No. 111-5, 123 Stat. 115.

[2] The phase-out limits in the law are different than those limits contained in the new withholding tables (this was intentionally done to minimize the negative impact on two earner families). The new tables begin phasing out at about $66,530 ($118,130 for joint filers) and phase out completely at about $84,300 ($144,800 for joint filers). In determining the number of taxpayers negatively affected, we used the phase-out amounts found in the new tables.

Work Pay Credit are Sections 2201 and 2202 of the Recovery Act which address other economic recovery benefits to be received by certain taxpayers. These benefits affect the amount of Making Work Pay Credit these taxpayers are eligible to receive. The Making Work Pay Credit will be reduced by any payment received as a result of Section 2201 and by any credit allowed by Section 2202 of the Recovery Act. These situations will be discussed in greater detail later in this report.

The Department of the Treasury has created new withholding tables that take the Making Work Pay Credit into account. The IRS issued the new tables along with instructions to employers found in *New Wage Withholding and Advance Earned Income Credit Payment Tables* (Publication 15-T) and *(Circular E), Employer's Tax Guide* (Publication 15). The IRS instructed employers to use the new withholding tables in lieu of the applicable previously published tables and to do so by April 1, 2009. In addition, the IRS instructed that the new tables should be applied to pensions. The tables were designed to advance about $400 to single filers and about $600 to joint filers by the end of Tax Year (TY) 2009. Joint filers[3] will then receive the additional $200 credit when they file their TY 2009 tax returns since they are eligible for up to $800.

These interim results of our audit to assess IRS efforts to implement the Making Work Pay Credit and to evaluate its impact on taxpayers are for the audit work completed as of August 14, 2009. Our final report will be issued in the first quarter of Fiscal Year 2010 and will include updated results.

This review was performed at the IRS Campus[4] in Ogden, Utah, and included analysis of tax data located on the Treasury Inspector General for Tax Administration's (TIGTA) Data Center Warehouse[5] as well as discussions and analysis of information provided by the United States Department of the Treasury and the IRS Wage and Investment Division. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. We will provide more detailed objectives and scope in our final report. Major contributors to the report are listed in Appendix II.

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[3] Joint filers for the purpose of this report refers to taxpayers with filing status 2 – married taxpayer filing joint return, filing status 3 – married filing a separate return and spouse is also filing a return, or filing status 6 – married filing separate return and spouse is not required to file a return.
[4] The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
[5] The Data Center Warehouse is a collection of IRS databases containing various types of taxpayer account information that is maintained by the TIGTA for the purpose of analyzing data for ongoing audits.

Results of Review

Implementation of the Making Work Pay Credit May Negatively Affect More Than 15.4 Million Taxpayers

Because of the difficulty in modifying withholding tables to account for all the different taxpayer situations which can affect total withholding as well as eligibility for the Making Work Pay Credit, advancing the Making Work Pay Credit to taxpayers through reduced income tax withholding creates the vulnerability that some taxpayers may have their taxes underwithheld at the end of the year. If taxpayers are advanced more of the Making Work Pay Credit than they are entitled to, they may ultimately owe taxes when they file their TY 2009 and 2010 tax returns.

We analyzed the changes to the tax tables as they applied to various taxpayer groups to identify groups that could potentially be advanced more Making Work Pay Credit than they are entitled to receive. We determined the tables did not account for taxpayer situations such as:

- Dependents who receive wages.
- Single taxpayers with more than one job.
- Joint filers in households where both spouses work or where one or both spouses have more than one job.
- Individuals who file a return with an Individual Taxpayer Identification Number (ITIN).[6]
- Taxpayers who receive pension payments.
- Taxpayers who are employed and receive Social Security or similar benefits referred to in Section 2201 of the Recovery Act.

To determine the extent to which such taxpayers might be negatively affected[7] by the new withholding tables, we developed computer programs to identify taxpayers in the previously discussed situations in TY 2007 and who either owed taxes with their returns and would have owed more taxes, or had small refunds but would have owed had the new withholding tables been in effect. Figure 1 shows that more than 15.4 million taxpayers, or 10.4 percent (15,473,463/149,494,988) of all taxpayers who filed, could be negatively affected.

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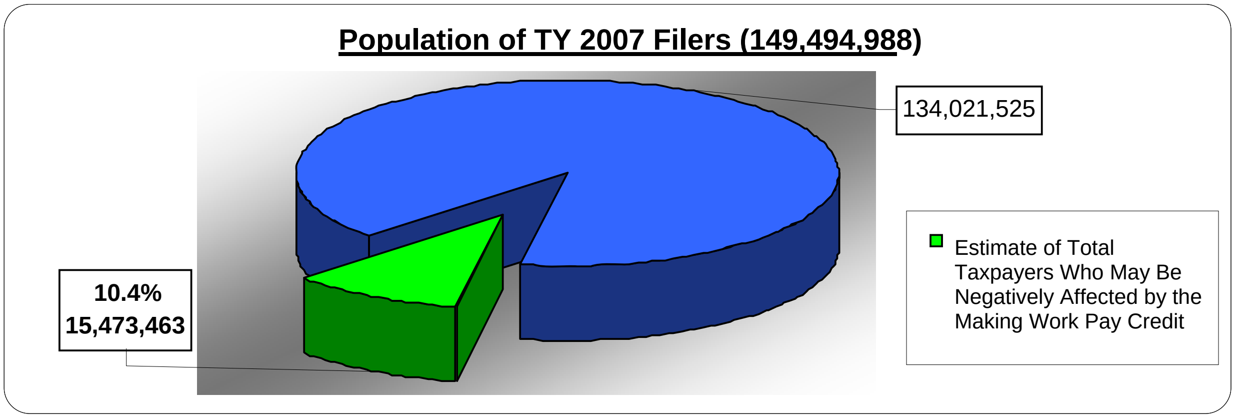
[6] The IRS issues ITINs to help noncitizens comply with the United States tax laws and to provide a means to efficiently process and account for tax returns. Only individuals who have valid filing requirements or are filing tax returns to claim refunds of over-withheld taxes are eligible to receive ITINs.
[7] Although every taxpayer in our identified scenarios will have a reduced refund, we defined “negatively affected” as those who will have a balance due or increased balance due as a result of the Making Work Pay Credit.

Figure 1: Percentage of Taxpayers Negatively Affected



Source: Data Center Warehouse Queries.

For each taxpayer situation previously discussed, an explanation and examples are given to illustrate why taxpayers would owe if their filing status and tax circumstances from TY 2007 remain the same when they file their TY 2009 income tax return.

Dependents who receive wages

The Recovery Act specifically excludes taxpayers who can be claimed as dependents on someone else's tax return from receiving the Making Work Pay Credit. However, employers are required to use the same withholding tables for these individuals as they use for all others. Many individuals who receive wages and are claimed as dependents on someone else's tax return will have the Making Work Pay Credit advanced to them throughout the year, only to be required to pay it back upon filing their TY 2009 tax returns because they do not qualify for the credit.

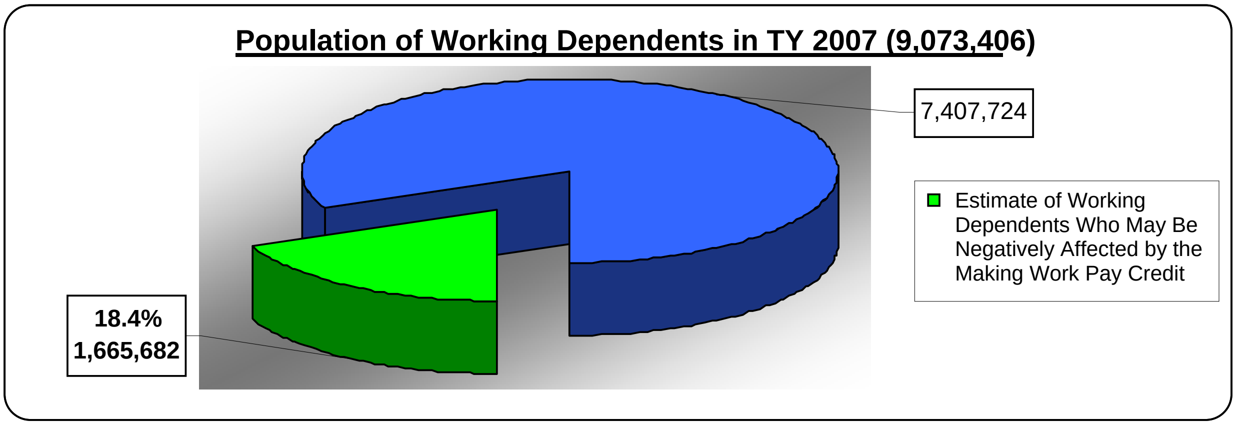
More than 1.6 million working dependents could be negatively affected by reduced withholding associated with the Making Work Pay Credit.

Using TY 2007 data, we identified 1,665,682 taxpayers who met the following criteria: single, claimed as a dependent on someone else's return, earned wages and had taxable income, had withholding, did not make estimated tax payments, did not receive pension or Social Security income, and had a refund of $400 or less. This represents 18.4 percent (1,665,682/9,073,406) of all working dependents who filed. If these taxpayers' situations remain the same for TY 2009, they could find themselves owing taxes when they are accustomed to receiving a tax refund or could find themselves owing significantly more than they have in the past.

Example: A taxpayer is claimed by his or her parents and works for the entire year during TY 2009. By the end of the year, this taxpayer will have had $400 less withheld from his or her wages. Since he or she is claimed as a dependent, this taxpayer is not eligible for the Making

Work Pay Credit and will therefore have to pay back the $400 that he or she was advanced in the form of decreased withholding during the year. If this taxpayer usually receives a $200 refund, he or she will owe $200 when his or her TY 2009 tax return is filed. This scenario is exacerbated if taxpayers hold more than one job.

Figure 2: Percentage of Working Dependents Negatively Affected



Source: Data Center Warehouse Queries.

Single filers who have multiple jobs

Individuals who receive wages from more than one employer may have more of the Making Work Pay Credit advanced to them than they qualify to receive. These taxpayers will be responsible for paying back the excess Making Work Pay Credit they received throughout the year when they file their TY 2009 tax return.

Using TY 2007 data, we identified 2,514,536[8] taxpayers who met the following criteria: single, had multiple Wage and Tax Statements (Form W-2), had taxable income, had withholding, did not make estimated tax payments, did not receive pension or Social Security income, and had a refund of $400 or less. This represents 9.5 percent (2,514,536/26,469,163) of all single filers with multiple Forms W-2. If these taxpayers' situations remain the same for TY 2009, they could owe taxes when they are accustomed to receiving a tax refund or could owe significantly more than they have in the past.

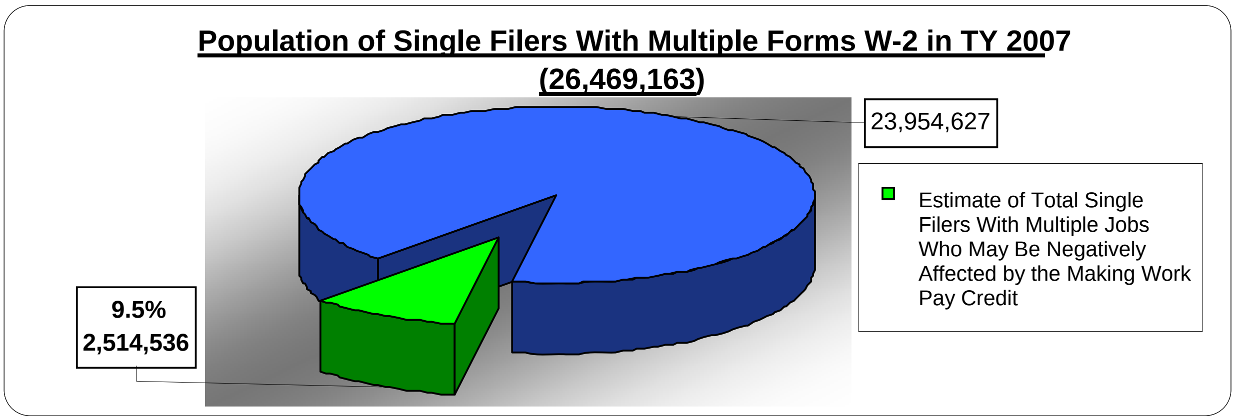
More than 2.5 million single taxpayers could be negatively affected by the Making Work Pay Credit.

Example: An unmarried taxpayer has two jobs for all of Calendar Year 2009. By the end of the year, this taxpayer will have received $800 through reduced withholding. As a single filer, the

[8] Our computer programs identified taxpayers with multiple Forms W-2; however, we could not determine whether the taxpayers' jobs were concurrent or not. The negative impacts described would occur only if the jobs were concurrent.

taxpayer is eligible for only $400 of the Making Work Pay Credit and will therefore have to pay back the extra $400 that he or she was advanced in the form of decreased withholding during the year. If this taxpayer usually receives a $200 refund, he or she will owe $200 when his or her TY 2009 tax return is filed. This scenario is exacerbated if taxpayers have more than two jobs.

Figure 3: Percentage of Single Filers With Multiple Forms W-2 Negatively Affected



Source: Data Center Warehouse Queries.

Joint filers who have multiple jobs

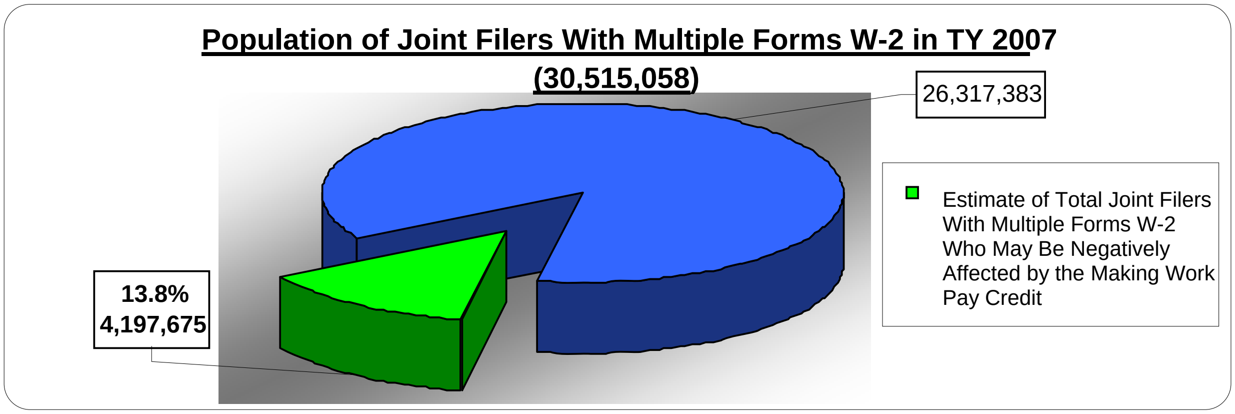
Households in which both spouses work, or in which only one spouse is employed but has more than one job, may have more of the Making Work Pay Credit advanced to them than they qualify to receive. These taxpayers will be responsible for paying back the excess credit they received during the year when they file their TY 2009 tax returns. The Recovery Act states that joint filers qualify to receive $800 in Making Work Pay Credit. The withholding tables that account for the Making Work Pay Credit provide $600 of the $800 allowed. The remaining $200 will be received when the taxpayers file their TY 2009 tax return. The tax tables do not take into consideration whether an employee has more than one job or has a spouse who is employed. In these cases, the employee will most likely receive excess Making Work Pay Credit in advance.

More than 4.1 million taxpayers filing jointly could be negatively affected.

Using TY 2007 data, we identified 4,197,675 taxpayers who met the following criteria: filed jointly, had multiple Forms W-2, had taxable income, had withholding, did not make estimated tax payments, did not receive pension or Social Security payments, and had a refund of $400 or less. This represents 13.8 percent (4,197,675/30,515,058) of all joint filers with multiple Forms W-2. These taxpayers could owe taxes or owe more taxes in TY 2009 because of the excess Making Work Pay Credit that they received.

Example: For a household in which both spouses were employed for the whole year during Calendar Year 2009, by the end of the year, these taxpayers will have had $1,200 less withheld from their wages. As joint filers, they are eligible for $800 and will therefore have to pay back the extra $400 that they received through reduced withholding during the year. If these taxpayers usually receive a $200 refund, they will owe $200 when they file their TY 2009 tax return. This scenario is exacerbated if either spouse has more than one job.

Figure 4: Percentage of Joint Filers With Multiple Forms W-2 Negatively Affected



Source: Data Center Warehouse Queries.

Taxpayers filing with an ITIN

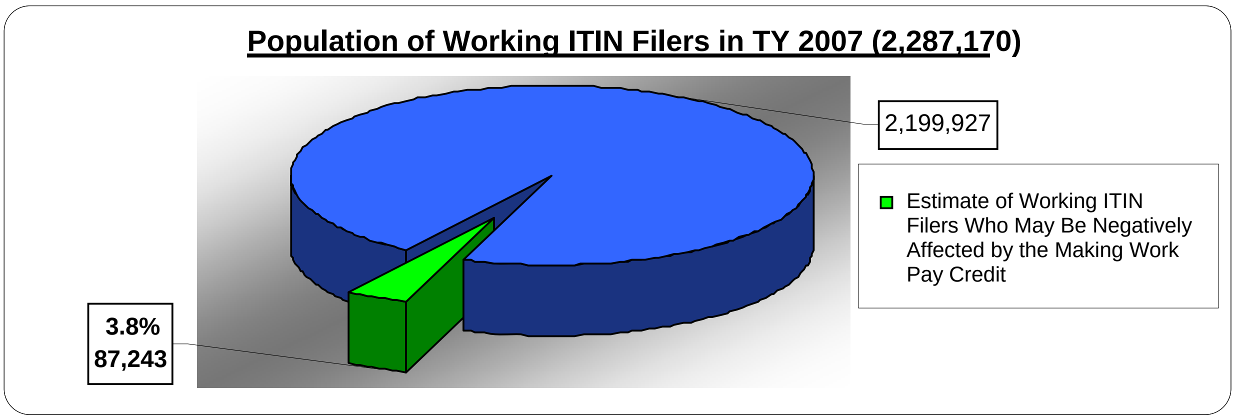
The Recovery Act specifically excludes individuals whose returns do not include a Social Security Number from receiving the Making Work Pay Credit. In other words, if an individual files an income tax return using an ITIN issued by the IRS, this taxpayer is precluded from receiving the Making Work Pay Credit. Taxpayers with ITINs will have the Making Work Pay Credit advanced to them throughout the year, but will have to pay it back when they file their TY 2009 tax returns.

More than 87,000 taxpayers filing returns with ITINs could be negatively affected.

Using TY 2007 data, we identified 87,243 taxpayers who met the following criteria: filed with an ITIN, had taxable income, had withholding, did not make estimated tax payments, did not receive pension or Social Security payments, and had a refund of $600 or less if married and filed a joint tax return, or $400 or less if they filed a single tax return. This represents 3.8 percent (87,243/2,287,170) of all working ITIN filers. These taxpayers could owe taxes or owe more taxes in TY 2009 because of the Making Work Pay Credit that they received.

Example: Married taxpayers who have ITINs rather than Social Security Numbers were employed for the whole year during Calendar Year 2009. By the end of the year, these taxpayers will have had $1,200 less withheld from their wages ($600 each). Because they have ITINs rather than Social Security Numbers, they are not eligible for the Making Work Pay Credit and will have to pay back the $1,200 that they were advanced during the year through decreased withholding. If these taxpayers usually receive a $200 refund, they will owe $1,000 when they file their TY 2009 tax return. This scenario is exacerbated if either spouse has more than one job.

Figure 5: Percentage of Working ITIN Filers Negatively Affected



Source: Data Center Warehouse Queries.

Taxpayers who receive pension payments

The Recovery Act states that the Making Work Pay Credit is the lesser of 6.2 percent of **earned income** of the taxpayer or $400 ($800 for taxpayers filing a joint return). Internal Revenue Code Section 32(c)(2)(A), in defining earned income, states "The term "earned income" means wages, salaries, tips and other employee compensation…" Section 32(c)(2)(B)(ii) continues the definition and states, "no amount received as a pension or annuity shall be taken into account." Therefore, by definition, pension payments are not earned income, and recipients of such payments were not intended by the law to receive the Making Work Pay Credit. However, when developing the new withholding tables, the Department of the Treasury provided the same tax tables to pension fund administrators as it did to employers. In discussions with the TIGTA, officials from the Department of the Treasury and IRS stated that their reasoning for treating pensions and wages the same was found in Internal Revenue Code Section 3405(a)(1) which states "The payor of any periodic payment (as defined in subsection (e)(2))[9] shall withhold from such payment the amount which would be required to be withheld from such payment if such payment were a payment of wages by an employer to an employee for the appropriate payroll period." Since pensions are periodic payments, the Department of the Treasury and the IRS

[9] Internal Revenue Code Section 3405(e)(2). The term "periodic payment" means a designated distribution which is an annuity or similar periodic payment.

stated that pensions should therefore be treated as wages for withholding purposes. In its instructions related to newly developed tables, the IRS stated "for the calculation of income tax withholding on pensions, these new withholding tables also apply."

On May 7, 2009, we issued an audit alert to the IRS discussing this issue and recommending immediate action, including seeking a technical correction to the law if necessary to resolve the issue and allow pension administrators to use the withholding tables in place prior to the implementation of the Making Work Pay Credit. Subsequent to our audit alert, the IRS issued Additional Withholding for Pensions for 2009 (Notice 1036-P). Rather than allowing pension administrators to simply use the withholding tables in place prior to the Making Work Pay Credit, this notice contained additional withholding tables that were applicable only to pensions and were to be used in conjunction with the other Making Work Pay Credit withholding tables. These new pension withholding tables were designed to offset the Making Work Pay Credit. The IRS made the use of the new pension tables optional. While this action may have reduced the negative effects for some pensioners, we do not believe it fully resolved this issue.

Since the new tables are to be used in conjunction with the previously issued tables, it imposes a significant burden on pension administrators. One State retirement agency that we contacted stated they simply could not program the additional table into their computer system. This State agency contacted IRS personnel seeking to resolve the multiple table issue and was told it could use whatever table would withhold more tax. This instruction is inconsistent with the Department of the Treasury guidance since the tables that would withhold more tax are those that were in effect prior to the implementation of the Recovery Act. Because of this burden, and because the use of the tables in Notice 1036-P was optional, other pension administrators may choose not to use them. We contacted a major United States insurance company that services pensions for other companies and found that they chose to not use the optional withholding tables. This could cause many taxpayers whose pensions are administered by this company to be underwithheld, requiring them to repay the Making Work Pay Credit erroneously advanced to them.

The Department of the Treasury guidance for pension administrators is different from what the Federal Government follows. In discussions with the TIGTA, the Office of Personnel Management (the agency which administers pensions for the Federal Government) stated that they did not use any of the new tables to calculate withholding payments because the new tables apply to earned income, not pensions and annuities. Instead, the Office of Personnel Management is using the tables in place prior to the Making Work Pay Credit.

Adding to the difficulty of administering the Making Work Pay Credit for pensioners are Sections 2201 and 2202 of the Recovery Act which address other economic recovery benefits to be received by certain taxpayers. These benefits affect the amount of Making Work Pay Credit that these taxpayers are eligible to receive.

Section 2201 provides for one-time payments of $250 to be made to recipients of Social Security benefits, railroad retirement benefits, veterans' disability compensation, or veterans' pension benefits. Generally, these taxpayers will not be eligible for the Making Work Pay Credit. However, if they earn wages in addition to their other benefits, they may be eligible for a reduced Making Work Pay Credit. The amount of any Making Work Pay Credit they are eligible for must be reduced by their one-time payment. Consider the following example: a single taxpayer, who is employed, receives a $250 check because he or she is a recipient of Social Security benefits. Instead of qualifying for the full $400 of the Making Work Pay Credit, this taxpayer now qualifies for $150 ($400 - $250).

Section 2202 of the Recovery Act addresses a special credit for certain Government retirees (Federal and State). The amount of this credit is $250. It is not made directly to the taxpayers, but is a credit available to them when they file their individual income tax returns. Again, the amount of any Making Work Pay Credit these taxpayers are eligible for must be reduced by the amount of this special credit. Consider the following example: a joint filing Federal retiree, who is employed but whose spouse does not work, is eligible to claim a $250 credit upon filing his or her TY 2009 individual income tax return. As a result, this husband and wife are no longer eligible for the full $800 Making Work Pay Credit, but rather $550 ($800 - $250).

More than 6.3 million pensioners may be negatively affected.

Using TY 2007 data, we identified 6,321,313 taxpayers who met the following criteria: had taxable income, had withholding, did not make estimated tax payments, received pension payments,[10] and had a refund of either $650, $600, or $400 or less depending on the other criteria described below. This represents 22.2 percent (6,321,313/28,451,932) of all pensioners. These taxpayers could owe taxes or owe more taxes in TY 2009 when they are accustomed to receiving a tax refund. The following examples[11] show why we used the refund amounts of $650, $600, and $400.

Example: A single taxpayer receives pension payments, receives Social Security benefits, and is employed for the whole year during Calendar Year 2009. This individual will receive $400 through his or her pension, $400 through his or her wages, and $250 from the Social Security Administration. By the end of the year, this household will have received an extra $1,050. As a single filer who is employed, this individual is eligible for $400 and will therefore have to pay back the extra $650 that he or she received during the year. This scenario is exacerbated if taxpayers have more than one job. We identified approximately 1.8 million taxpayers who met this or similar situations.

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[10] From the information in our extract, we were unable to identify the number of Federal retirees in this estimate. On an income tax return, annuities are reported on the same line as pensions. Therefore, we also were unable to identify the number of annuity recipients in this estimate.

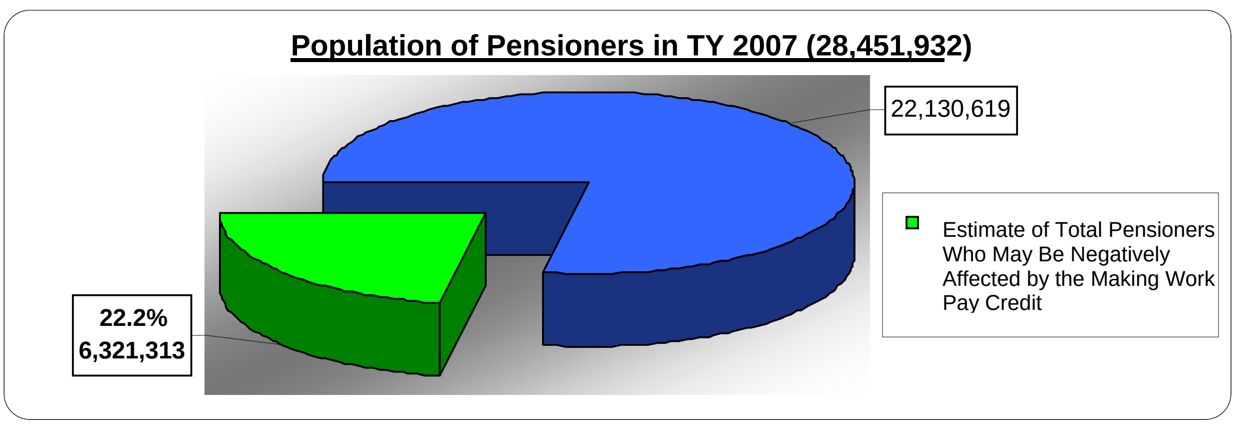
[11] For joint filers in each of the given examples, it is assumed that there is only one pension, one social security recipient, and one wage earner, if applicable.

Example: A joint filer receives a pension and Social Security benefits, but does not work during Calendar Year 2009. This household will receive $600 through the pension and $250 from the Social Security Administration. By the end of the year, this household will have received $850. The household only qualifies for the Social Security Administration payment, meaning that they will owe $600 when they file their TY 2009 return. This scenario is exacerbated if each spouse is receiving a pension. We identified approximately 1.8 million taxpayers who met this or similar situations.

Example: A joint filer receives a pension, is employed during Calendar Year 2009, but does not receive Social Security benefits. This household will receive $600 through the pension and $600 through the wages, for a total of $1,200. As a joint filer who is employed, this household is eligible for $800 meaning that they will owe $400 when they file their TY 2009 return. This scenario is exacerbated if each spouse is employed or receives a pension. We identified approximately 2.5 million taxpayers who met this or similar situations.

Example: A single taxpayer who receives a pension during TY 2009 and neither works nor receives Social Security benefits will receive $400 through his or her pension. Since pensions are specifically excluded from the definition of earned income on which the Making Work Pay Credit is based, he or she will have to pay the entire amount back that was advanced to him or her. We identified approximately 241,000 taxpayers who met this or similar situations.

Figure 6: Percentage of Pensioners Negatively Affected



Source: Data Center Warehouse Queries.

Non-pensioners who receive Social Security benefits and are employed

As mentioned previously, Section 2201 of the Recovery Act states that Social Security recipients are to receive a $250 one-time payment from the Secretary of the Treasury. Social Security recipients who are employed will also be advanced $400 ($600 for joint filers) through reduced withholding from their paychecks. The Making Work Pay Credit is to be reduced by any payment received under Section 2201. Taxpayers who work and receive Social Security benefits will have the Making Work Pay Credit advanced to them during the year but will have to pay back the excess when filing their TY 2009 return.

More than 687,000 Social Security recipients who work may be negatively affected.

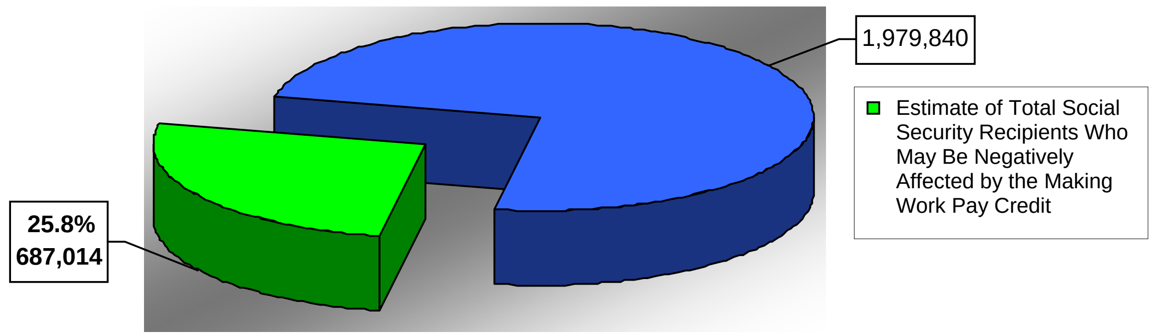
Using TY 2007 data, we identified 687,014 taxpayers who met the following criteria: had taxable income, wages, withholding, did not make estimated tax payments, received Social Security benefits, and had a refund of $250/$50 or less depending on the other criteria as described in the following examples. This represents 25.8 percent (687,014/2,666,854) of all working Social Security recipients. These taxpayers could owe taxes or owe more taxes in TY 2009 when they are accustomed to receiving a tax refund. The following examples show why we used the refund amounts of $250 and $50.[12]

Example: A single taxpayer who receives Social Security benefits will receive a $250 stimulus check from the Secretary of the Treasury in TY 2009. This individual will also have $400 advanced to him or her through decreased withholding at work. This individual will receive a total of $650 in stimulus funds even though he or she qualifies for only $400. Therefore, he or she will be required to repay the excess $250 received.

Example: A joint filing household who receives Social Security benefits will receive a $250 stimulus check from the Secretary of the Treasury in TY 2009. This household will also have $600 advanced to them through their decreased withholding at work. This household will receive a total of $850 in stimulus funds even though they qualify for only $800. Therefore, they will be required to repay the excess $50 received.

[12] For joint filers in each of the given examples, it is assumed that there is only one Social Security recipient and one wage earner.

Figure 7: Percentage of Working Social Security Recipients Negatively Affected



Source: Data Center Warehouse Queries.

IRS outreach efforts to inform taxpayers about the Making Work Pay Credit

The IRS has established the 2009 ARRA Outreach Strategy Team to inform taxpayers about the Making Work Pay Credit and other Recovery Act issues.

In April 2009, the TIGTA issued an audit alert notifying the IRS that many taxpayers could be negatively affected by the Making Work Pay Credit. The alert recommended the IRS educate taxpayers about the Making Work Pay Credit and what they may need to do to prevent its potentially negative effects on their income taxes. The IRS informed the TIGTA that it was working on a general awareness campaign to educate taxpayers about the Making Work Pay Credit and the implications it may have concerning their withholding. Since that audit alert was issued, the IRS has established the 2009 ARRA[13] Outreach Strategy Team. The Team is led by the Wage and Investment Division Stakeholder Partnerships, Education, and Communication function and consists of representatives from the Wage and Investment Division Stakeholder Partnerships, Education, and Communications function, Customer Assistance, Relationships, and Education Program Management function, Field Assistance function, Media and Publications function, Communications and Liaison function; the Small Business/Self-Employed Division; the Taxpayer Advocate Service; and the Tax Exempt and Government Entities Division. The mission of the Team is to "develop an overall outreach strategy for the provisions of the Recovery Act affecting individual taxpayers and associated business stakeholders." The outreach strategy specific to the Making Work Pay Credit includes identification of the targeted audiences, explanation of the issues, key messages, and outreach activities. The Team is also developing outreach efforts that are to include print, video, and

[13] American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5, 123 Stat. 115.)

audio products. A component of this outreach effort is to produce flyers that will address several Recovery Act issues, including the Making Work Pay Credit and its impact on pensioners.

In May 2009, we randomly contacted 50 taxpayers by telephone that fit into the scenarios in which taxpayers may be negatively affected by the Making Work Pay Credit. Five taxpayers knew that they may potentially be negatively affected. ******1***********************.

On June 25, 2009, the IRS issued a special addition tax tip through its Newswire service that focused on the Making Work Pay Credit. The notice informed taxpayers of the different scenarios in which taxpayers may be negatively affected by the credit. The Newswire article also included links to both an audio and a video presentation that stressed the importance of taxpayers checking their Employee's Withholding Allowance Certificate (Form W-4) to avoid having taxes underwithheld. The video is posted on youtube.com[14] and the audio is posted on IRS.gov (the IRS public web site). The video does not warn Social Security recipients who are employed and ITIN filers about the potential negative effect of the Making Work Pay Credit, but the audio clearly covers those groups of individuals.

To determine the effect of the IRS communication efforts, in July 2009, we again contacted taxpayers to determine if they were aware of the potentially negative effects the Making Work Pay Credit might have on their income tax filing. We randomly contacted an additional 50 taxpayers by telephone that fit into the scenarios in which taxpayers may be negatively affected by the Making Work Pay Credit. Our results indicated no improvement. Three taxpayers knew that they may potentially be negatively affected. *******1************** .

In August 2009, we randomly contacted an additional 14 taxpayers by telephone that fit into the scenarios of single and joint filers who have multiple jobs and may be negatively affected by the Making Work Pay Credit. Unfortunately, once again there were no signs of improvement. ***1*****. None of the taxpayers knew how to avoid being negatively affected.

Recommendations

Recommendation 1: The Commissioner, Wage and Investment Division, should increase media coverage and consider other forms of advertisement in addition to the mediums already being used. To the extent possible, the IRS should target these communications to taxpayers who may be adversely affected by underwithholding as a result of the Making Work Pay Credit.

> ***Management's Response:*** The IRS agreed with this recommendation and the importance of exploring every avenue for communicating to the public about the Making

[14] A video sharing web site.

Work Pay Credit. The Chief, National Communications and Liaison, will continue to tailor the information to the specific media vehicle used. Additional plans for communication include: distributing a radio public service announcement on the Making Work Pay Credit; distributing an Internet banner ad to a wide range of web sites that serve the affected Making Work Pay taxpayer groups; and providing English and Spanish satellite media tours to television stations nationwide, one scheduled for September and October 2009.

Recommendation 2: The Commissioner, Wage and Investment Division, should immediately work with the Department of the Treasury to allow pension administrators to use the withholding tables that were in place prior to the enactment of the Recovery Act, thereby eliminating the complexity of the current adjustment.

Management's Response: The IRS disagreed with this recommendation, stating that the new procedure issued in May 2009 by the IRS results in the pension withholding that approximates the withholding rate schedules used prior to the enactment of the Making Work Pay Credit and, thus, is correct for pensions. The IRS response also stated that traditionally there has been only one set of withholding rates for all types of payments and providing additional sets of withholding tables would be burdensome, costly, and confusing for the IRS, taxpayers, and employers.

Office of Audit Comment: The recommendation made by the TIGTA to allow pension plan administrators to use the withholding tables which were in place prior to the implementation of the Recovery Act 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.

As stated in our report, the IRS' solution to the problem associated with pensions and the Making Work Pay Credit was to issue a second set of tables to be used in conjunction with the other Making Work Pay Credit withholding tables. This created a much larger burden for the pension administrators than would be created by allowing them to revert to the pre-Making Work Pay Credit tables. As noted previously, at least one State retirement agency stated the burden was so significant they simply could not program the IRS' second set of tables into their computer system. We believe the IRS should reconsider their response to our recommendation.

Some Taxpayers May Be Assessed the Estimated Tax Penalty As a Result of the Making Work Pay Credit

The United States income tax system operates on a "pay as you go" basis, meaning that taxpayers must pay their income taxes throughout the year as their income is earned. Taxpayers accomplish this either through quarterly estimated tax payments or through withholding on their incomes. If taxpayers have significantly underpaid their taxes at the time they file their individual income tax returns, they may be assessed an estimated tax (ES) penalty. Taxpayers have the option of computing this penalty themselves or allowing the IRS to compute it for them. The Making Work Pay Credit is being administered through reduced withholding which means that those taxpayers who are advanced more of the Making Work Pay Credit through reduced withholding than they are entitled to may have their taxes underwithheld to the extent that they will be subject to the ES penalty.

More than 1.2 million taxpayers may be negatively affected through the ES penalty.

Based on TY 2007 data, we estimate that just more than 122,000[15] taxpayers may be assessed the ES penalty in TY 2009 as a result of the Making Work Pay Credit. We also estimate that an additional 1.15 million taxpayers may have their ES penalty amount increased due to the Making Work Pay Credit. Using the same criteria as found in the previously discussed scenarios, these taxpayers were identified as those who may be negatively affected through the ES penalty in addition to being in a balance due or increased balance due situation. The Recovery Act also contains provisions in which the Education Credit, Earned Income Credit, and Child Tax Credit will increase. To ensure that our figures remained conservative, we excluded all TY 2007 returns that claimed any one of these credits.

Internal Revenue Code Section 6654(e)(3)(A) addresses the issue of waiving the ES penalty in some instances in which it states "No addition to tax shall be imposed…with respect to any underpayment to the extent the Secretary determines that by reason of casualty, disaster, or other unusual circumstances the imposition of such addition to tax would be against equity and good conscience." We believe that the individuals who will be assessed the ES penalty as a direct result of the Making Work Pay Credit fall into an "unusual circumstance" and that it would not be in good conscience to assess a penalty to taxpayers when the cause of the penalty rests with the administration of the credit rather than taxpayers' actions.

On June 19, 2009, we issued an audit alert to the IRS discussing this issue and recommended that the IRS make preparations to identify taxpayers who will have the ES penalty assessed or increased due to the Making Work Pay Credit and take steps to waive or abate the related penalty amounts. The IRS initially informed us that it was aware of the potential impact on taxpayers and in response to our audit alert has made plans to address the issue. The IRS recently concluded that to the extent the penalty is caused by the application of the change in withholding tables to those taxpayers for whom the change was overbroad, waiver of the penalties would be

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[15] The IRS estimates this number to be closer to 65,000. However, we disagree with some of the assumptions the IRS used to arrive at the final number.

appropriate. It plans to alert taxpayers to the availability of this relief by adding additional content to the Tax Withholding and Estimated Tax (Publication 505), the instructions for the Underpayment of Estimated Tax by Individuals, Estates and Trusts (Form 2210), and the instructions for the U.S. Individual Income Tax Return (Form 1040) on how affected taxpayers should self-identify and how they should compute their amount of waiver of estimated tax penalty.

We estimate the amount of ES penalty that will be assessed because of the Making Work Pay Credit may total more than $24.5 million.

Appendix I

Detailed Objectives, Scope, and Methodology

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. Other objectives included evaluating the logic of the new withholding tables, quantifying the number of taxpayers who could be negatively affected, and evaluating the effectiveness of IRS efforts to inform taxpayers of the potential, negative impacts.

To accomplish our objectives, we:

I. Evaluated new withholding tables to ensure the Making Work Pay Credit will be allocated to taxpayers appropriately.

   A. Discussed with Department of the Treasury management the planning process for developing the new withholding tables and obtained available documentation.

   B. Identified the new amounts that were intended to be withheld and the reasoning for them (for both single and joint filers).

   C. Determined whether tables were accurately modified to ensure stimulus payments were distributed properly.

      1. Calculated the amount of annual withholding, for a variety of income levels, using the old tables.

      2. Calculated the amount of annual withholding, for the same income levels as Step I.C.1., using the new tables.

      3. Determined the difference between the figures calculated in Steps I.C.1. and 2. We verified that single filers are having no more than $400 ($800 for joint filers) withheld by December 31, 2009.

      4. Determined whether phase-out limits[1] will be properly applied using the tables.

[1] The phase-out limits in the law are different than those limits contained in the new withholding tables. The new tables begin phasing out at about $66,530 ($118,130 for joint filers) and phase out completely at about $84,300 ($144,800 for joint filers). In determining the number of taxpayers negatively affected, we used the phase-out amounts found in the new tables. The tables were designed this way in an attempt to compromise between one and two-earner families.

II. Identified groups of taxpayers that could be negatively affected by the Making Work Pay Credit and quantified the results.

A. Quantified the number of single taxpayers who had multiple Wage and Tax Statements (Form W-2) in TY 2007 and had a refund of less than $400.

1. Obtained a list of single filers who had multiple Forms W-2 from the IRS' Information Returns Master File.[2]

2. Matched Information Returns Master File data with TIGTA Data Center Warehouse[3] data to determine how many single filers with multiple Forms W-2 had refunds less than $400.

3. Obtained figures from the IRS Statistics of Income function of the number of single filers with multiple Forms W-2 to evaluate the completeness of Information Returns Master File and Data Center Warehouse data.

4. Validated the reliability of Information Returns Master File data as well as the data from our Data Center Warehouse by reviewing a random sample of five records or accounts for each database and verifying the data met extract criteria and were valid per IRS files.

B. Quantified the number of joint filers who had multiple Forms W-2 in TY 2007 and had a refund of less than $400.

1. Obtained a list of joint filers who had multiple Forms W-2 from the Information Returns Master File.

2. Obtained a list of joint filers where both spouses had a Form W-2 in TY 2007 and a refund of less than $400 from the Data Center Warehouse.

3. Matched Information Returns Master File data with Data Center Warehouse data to determine how many joint filers with multiple Forms W-2 had refunds less than $400.

4. Obtained figures from the IRS Statistics of Income function to determine the number of joint filers with multiple Forms W-2. We used this count to evaluate the reasonableness of the Information Returns Master File data and Data Center Warehouse data.

5. Assessed the reliability of Information Returns Master File data as well as the data from our Data Center Warehouse by reviewing a random sample of five

[2] The Information Returns Master File is the IRS database that stores data from various types of information returns.
[3] The Data Center Warehouse is a collection of IRS Databases containing various types of taxpayer account information that is maintained by the TIGTA for the purpose of analyzing data for ongoing audits.

records or accounts for each database and verifying the data met extract criteria and were valid per IRS files.

C. Quantified the number of dependents who had both a Form W-2 in TY 2007 and had a refund of less than $400.

   1. Obtained a list of data from the Data Center Warehouse to determine how many dependents reported wages and had a refund less than $400.

   2. Obtained figures from the Statistics of Income function to determine the number of dependents with a Form W-2. We used this count to evaluate the completeness of the Data Center Warehouse data.

   3. Assessed the reliability of the data by reviewing a random sample of five records or accounts and verified the data met extract criteria and were valid per IRS files.

D. Determined the number of taxpayers who received pensions that could be negatively affected by the Making Work Pay Credit.

   1. Used Data Center Warehouse data to identify taxpayers (married or single) who received pensions in TY 2007 and had a refund of $650, $600, or $400 depending on their situation.

   2. Assessed the reliability of the data by reviewing a random sample of five records or accounts (for each of the eight pension scenarios for a total of 40 records) and verified the data met extract criteria and were valid per IRS files.

   3. Discussed with IRS management the use of the withholding tables for pensioners.

E. Determined whether controls were in place to prevent recipients of Social Security benefits, veterans' benefits, and railroad retirement benefits from receiving duplicate economic stimulus payments if they qualify for more than one of these benefits. This information was gathered through a discussion with an employee at the Railroad Retirement Inspector General and a review of the Social Security Administration notice regarding the economic recovery payment.

F. Determined the number of taxpayers who filed a return using an ITIN that could be negatively affected by the Making Work Pay Credit.

   1. Used the Data Center Warehouse data to identify taxpayers (married or single) who filed a return using an ITIN in TY 2007 and had a refund of $400 or less if single or $600 or less if married.

   2. Assessed the reliability of the data by reviewing a random sample of five records or accounts for single ITIN filers and five records or accounts for joint ITIN filers and verified the data met extract criteria and were valid per IRS files.

G. Determined the number of taxpayers who may be assessed the penalty for underpayment of estimated tax as a result of receiving the Making Work Pay Credit erroneously.

1. Contacted IRS management to determine the penalty computation in order to better identify taxpayers who may be directly affected.
2. Contacted the IRS to determine how it plans to work cases that are assessed the penalty for underpayment of estimated tax as a result of the Making Work Pay Credit and if the effects of the Making Work Pay Credit will be considered a reasonable cause to abate the penalty.
3. Quantified the number of taxpayers that may be assessed the penalty for underpayment of estimated tax as a result of receiving an erroneous amount of the Making Work Pay Credit.
4. Assessed the reliability of the data by randomly selecting and reviewing five records or accounts for each identified scenario.

H. Determined the number of Social Security recipients, who also have wages, that could be negatively affected by the Making Work Pay Credit.

1. Used the Data Center Warehouse data to identify taxpayers (married or single) who received Social Security benefits, wages, and had a refund of $50 or less if married and $250 or less if single.
2. Assessed the reliability of the data by reviewing a random sample of five single filer and five joint-filer records or accounts and verified the data met extract criteria and were valid per IRS files.

III. Determined the effectiveness of IRS outreach efforts to notify taxpayers of the new Making Work Pay Credit.

A. Determined whether the Department of the Treasury or the IRS attempted to identify taxpayers who could be negatively affected by the Making Work Pay Credit.

B. Performed research and obtained information from IRS management regarding the action that has been taken (i.e., newsletters published) to inform taxpayers about the Making Work Pay Credit and what they can do to avoid owing taxes in TYs 2009 and 2010 as a result of the Making Work Pay Credit.

C. Sampled taxpayers negatively affected by the Making Work Pay Credit and determined whether they are aware of the credit.

1. Selected a sample[4] of 385 taxpayers from the groups negatively affected and researched telephone numbers for them.
2. Contacted 50 of these taxpayers via telephone in May 2009 to determine their awareness of the Making Work Pay Credit and its potential negative effects, and their knowledge of what can be done to reverse the negative effects.
3. Contacted an additional 50 taxpayers in July 2009 to determine the effectiveness of the IRS' general awareness campaign to notify taxpayers of the Making Work Pay Credit.
4. Contacted an additional 14 taxpayers in August 2009 from the single filers and joint filers with multiple jobs categories to determine the effectiveness of the IRS' general awareness campaign to notify taxpayers of the Making Work Pay Credit.

[4] We selected a judgmental sample using the interval sampling method. A judgmental sample was used because the results were not to be projected over the population of negatively affected taxpayers (15.4 million). The additional 64 taxpayers in III.C.3 and III.C.4 were selected using the same method.

Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
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Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Chief, Program Evaluation and Improvement SE:W:S:PRA:PEI

Appendix IV

Management's Response to the Draft Interim Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

RECEIVED
OCT 1 - 2009

OCT - 1 2009

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr.
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Millions of Taxpayers May Be Negatively Affected By the Reduced Withholding Associated With the Making Work Pay Credit (Audit # 200940139)

We have reviewed your draft report and appreciate your feedback on the implementation and administration of the Making Work Pay Credit (MWPC). The IRS worked quickly and effectively to ensure that taxpayers received the benefit of this credit as soon as possible. To effect this, new withholding tables taking into consideration the credit were available to taxpayers on February 21, 2009, only 4 days after the American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law. Later that month, the IRS issued its first MWPC related news release providing information to taxpayers on calculating their withholding and encouraging taxpayers to use the IRS withholding calculator on IRS.gov to assist them in the process. Furthermore, throughout the year, the IRS has continued to inform taxpayers about the importance of monitoring their withholding and making adjustments if necessary through various means of communications.

The withholding system must approximate the tax liability of tens of millions of Americans, and, therefore, cannot be tailored precisely to fit every individual situation. For this reason, every year, the IRS advises taxpayers to review their withholding in light of their personal financial situation to determine if adjustments are necessary. This issue exists every year, and is part of the routine tax filing process.

To put the issues raised in the report in context, approximately three out of four households (more than 100 million taxpayers) receive a refund every year, averaging approximately $2,700. While the report indicates that some taxpayers will be negatively affected by this credit, it does not explain that for most households this means a reduced refund and *not* an out-of-pocket tax liability on April 15. In effect, these taxpayers will have received a portion of their refund throughout the year in the form of reduced withholding, which is exactly what the law intended. In addition, many taxpayers will see a bigger refund as a result of other new and increased credits in the ARRA.

At a more technical level, the report attempts to estimate the scope of the issue by saying that 15.4 million taxpayers will be negatively affected by the change in the withholding tables. However, that estimate is overstated, as it does not account for important categories of taxpayers for whom this issue is not present (e.g. taxpayers who have multiple, sequential jobs throughout the year, or those pensioners whose plan administrators have adjusted withholding based on the revised procedures). Rather than simply adding six separate estimates, a better estimate would need to account for taxpayers that are included in more than one of the estimates. Finally, the report makes no attempt to quantify the number of taxpayers who have already adjusted their withholding based on the changes.

Despite our disagreements on the scope of the issue, the IRS agrees that it is critical to communicate with taxpayers who may need to take action to adjust withholding in light of the MWPC. As soon as ARRA became law in February 2009, the IRS began an aggressive communications and outreach campaign specifically related to the MWPC. This included a variety of vehicles in English, Spanish, and other languages with the level of detail tailored to the audience, vehicle, media, and length of the communication. Extensive radio and television coverage has resulted from IRS news releases, fact sheets, public service announcements, outreach products, detailed web site pages, and personal contacts made by IRS staff.

Further information and outreach planned or currently underway includes:

- Distributing ARRA radio public service announcements, including one on MWPC.
- Distributing an Internet banner ad to a wide range of web sites that serve affected MWPC taxpayer groups.
- Providing English and Spanish satellite media tours (SMT) to television stations nationwide. The first SMT is scheduled for late September and the second SMT is scheduled for late October.

Finally, the report points out that some taxpayers may be subject to an estimated tax penalty as a result of insufficient withholding. That penalty is generally asserted automatically, according to a set formula that reflects the rules related to payments of tax throughout the year. However, taxpayers may request that the IRS waive the penalty when circumstances warrant. For the upcoming tax filing season, the IRS will alert taxpayers that they may qualify for a waiver and provide instructions on how to request a waiver of the penalty. We will also continue to review this issue to determine alternative means of identifying taxpayers.

3

Attached are our responses to your specific recommendations. If you have any questions or require any additional information please call me at (404) 338-7060, or a member of your staff may contact Peter J. Stipek, Director, Customer Account Services, Wage and Investment Division, at (404) 338-8910.

Attachment

Attachment

RECOMMENDATION 1
The Commissioner, Wage and Investment Division, should increase media coverage and consider other forms of advertisement in addition to the mediums already being used. To the extent possible, the IRS should target these communications to taxpayers who may be adversely affected by underwithholding as a result of the Making Work Pay Credit.

CORRECTIVE ACTION
We agree with this recommendation. We agree with the importance and value of exploring every avenue for communicating to the public about the Making Work Pay Credit (MWPC) and we plan to complete additional communication. We are building upon our already extensive radio and television outreach and MWPC news media coverage. Furthermore, we will continue to tailor the information to the specific media vehicle used. All of our communications point the target audience to IRS.gov for detailed information including extensive Frequently Asked Questions and Answers on the MWPC. Additional plans for communication include:

1. Distribute ARRA radio public service announcements, including one on MWPC.

2. Distribute an Internet banner ad to a wide range of web sites that serve the affected the MWPC taxpayer groups.

3. Provide English and Spanish satellite media tours (SMT) to television stations nationwide. The first SMT is scheduled for late September and the second SMT is scheduled for late October.

IMPLEMENTATION DATE
November 15, 2009

RESPONSIBLE OFFICIAL
Chief, National Communications and Liaison

CORRECTIVE ACTION MONITORING PLAN
This corrective action will be monitored as part of our internal management control system.

RECOMMENDATION 2
The Commissioner, Wage and Investment Division, should immediately work with the Department of the Treasury to allow pension administrators to use the withholding tables which were in place prior to the enactment of the ARRA, thereby eliminating the complexity of the current adjustment.

2

CORRECTIVE ACTION

We do not agree with this recommendation. In May, 2009, the IRS published a procedure that may be used by pension plan administrators to adjust the withholding on pension distributions to retirees who do not benefit from the Making Work Pay Credit. This procedure provides for an adjustment of the regular withholding table with the result that the pension distribution to retirees with no Making Work Pay Credit generally would not have their pension withholding reduced and, thus, would not be underwithheld. The new procedure results in the pension withholding that approximates the withholding rate schedules used prior to enactment of the Making Work Pay credit and, thus, is correct for pensions.

Traditionally, there has been only one set of withholding rates for all type of payments. Providing additional sets of withholding tables would be burdensome, costly, and confusing for the IRS, taxpayers, and employers.

Because the withholding rate schedules and accompanying lookup tables are modified annually to reflect the tax rates and other tax parameters for the tax year, for 2010 there will be only one set of withholding tables, which will reflect the Making Work Pay Credit.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A