TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

RECOVERY ACT

Overall the Making Work Pay Credit Was Implemented As Intended by the Congress, but Resulted in Many Taxpayers Owing Taxes With Their Returns

November 1, 2010

Reference Number: 2011-41-002

Redaction Legend:
1 = Tax Return/Return Information

Phone Number | 202-622-6500
Email Address | inquiries@tigta.treas.gov
Web Site | http://www.tigta.gov

OVERALL THE MAKING WORK PAY CREDIT WAS IMPLEMENTED AS INTENDED BY THE CONGRESS, BUT RESULTED IN MANY TAXPAYERS OWING TAXES WITH THEIR RETURNS

Highlights

Final Report issued on November 1, 2010

Highlights of Reference Number: 2011-41-002 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

The Making Work Pay Credit is being advanced to taxpayers through their wages by a decrease in Federal income tax withholding. This created the vulnerability that some taxpayers had or will have their taxes underwithheld at the end of Tax Years 2009 or 2010. If taxpayers were advanced more of the Making Work Pay Credit than they were entitled to, they may have ultimately owed taxes when they filed their Tax Year 2009 tax returns and may owe taxes when they file their Tax Year 2010 tax returns. These taxpayers may have been or could be assessed the Estimated Tax Penalty.

WHY TIGTA DID THE AUDIT

The Making Work Pay Credit, a provision of the American Recovery and Reinvestment Act of 2009, applies to most taxpayers with earned income. The Credit is effective for both 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). The tables had some inherent limitations which could negatively affect a significant number of taxpayers. The overall objectives of this review were to assess IRS efforts to implement the Making Work Pay Credit, evaluate its impact on taxpayers, and determine whether taxpayers who were negatively affected were aware of how to avoid owing taxes and penalties.

WHAT TIGTA FOUND

The IRS initiated significant outreach to inform taxpayers about the Making Work Pay Credit and its potential effects. Despite these actions, TIGTA estimates that approximately 13.4 million taxpayers were or will be negatively affected by the Making Work Pay Credit in Tax Years 2009 and 2010. The changes to the withholding tables did not take the following situations into consideration: 1) dependents who receive wages, 2) single taxpayers with more than one job, 3) joint filers when one or both spouses have more than one job or both spouses work, 4) individuals who file a return with an individual taxpayer identification number, 5) taxpayers who receive pension payments, and 6) Social Security recipients who receive wages.

A survey of the taxpayers who appeared to have been negatively affected by the reduced withholding associated with the Credit indicated that most were not aware of the Credit or its effect on their taxes. Furthermore, TIGTA estimates that approximately 108,000 taxpayers may have been assessed the Estimated Tax Penalty as a result of the Making Work Pay Credit and that an additional 1.02 million taxpayers may have had their Estimated Tax Penalty amount increased.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, should: 1) in the case of future credits that are implemented by changes in the withholding tables, consider including simplified withholding adjustment instructions on the IRS Web site for specific scenarios that could result in underwithholding and 2) identify those taxpayers that owed any Estimated Tax Penalty as a result of the Making Work Pay Credit and notify them of the their right to have the portion of the Penalty related to the Credit abated.

IRS management agreed with the first recommendation and partially agreed with the second. They plan to continue outreach efforts, but declined to contact taxpayers who owed any Penalty based on the Making Work Pay Credit. TIGTA is concerned that the IRS's corrective actions are not adequate.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

November 1, 2010

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: Final Audit Report – Overall the Making Work Pay Credit Was Implemented As Intended by the Congress, but Resulted in Many Taxpayers Owing Taxes With Their Returns (Audit # 201040139)

This report presents the results of our review to assess Internal Revenue Service (IRS) efforts to implement the Making Work Pay Credit and evaluate its impact on taxpayers. This audit was included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of 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.

Management's complete response to the draft report is included as Appendix VIII

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 Accounts Services) at (202) 622-5913.

[1] Pub. L. No. 111-5, 123 Stat. 115. (2009)

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Abbreviations

IMF	Individual Master File
IRS	Internal Revenue Service
ITIN	Individual Taxpayer Identification Number
TIGTA	Treasury Inspector General for Tax Administration

Background

The American Recovery and Reinvestment Act of 2009 (Recovery Act)[1] contained many economic stimulus provisions, one of which was the Making Work Pay Credit found in Section 1001 of the Recovery Act. This provision is effective for Tax Years 2009 and 2010. 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[2] tax credit allowed against the lesser of 6.2 percent of earned income or $400 ($800 in the case of a joint tax return). The Credit is reduced as a taxpayer's modified Adjusted Gross Income exceeds $75,000 ($150,000 for joint filers) and is completely phased out as the taxpayer's modified Adjusted Gross Income reaches $95,000 ($190,000 for joint filers).[3] 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."

In general, single filers are eligible for a Making Work Pay Credit of up to $400, while married filers are eligible for up to $800 per household.

Implementing the Making Work Pay Credit has been 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 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.

[1] Pub. L. No. 111-5, 123 Stat. 115.
[2] A refundable credit is a direct, dollar-for-dollar reduction of tax liability for which a tax refund is issued even if the taxpayer's liability drops below zero.
[3] 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 for Tax Year 2009 began phasing out at about $66,530 ($118,130 for joint filers) and phase out completely at about $84,300 ($144,800 for joint filers). The phase-out amounts for Tax Year 2010 changed to about $67,701 ($94,051 for joint filers) and phase out completely at about $87,700 ($124,050 for joint filers). In determining the number of taxpayers negatively affected, we used the phase-out amounts found in the new tables.

However, because of the difficulty inherent in modifying withholding tables to account for all the different taxpayers' situations which can affect withholding as well as eligibility for the Making Work Pay Credit, advancing the Credit to taxpayers through reduced income tax withholding creates the vulnerability that some taxpayers may have their taxes underwithheld throughout the year. Adding to the difficulty of administering the Making 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 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. If taxpayers are advanced more of the Making Work Pay Credit than they are entitled to, they may ultimately owe taxes or owe more when they file their tax returns.

On November 4, 2009, we issued an Interim Audit Report[4] that presented the results from the first phase of this audit. In that report, we estimated that more than 15.4 million taxpayers could unexpectedly owe taxes or owe more taxes than expected for Tax Year 2009 as a result of the Making Work Pay Credit because withholding tables adjusted for the Credit did not appropriately account for taxpayer situations such as:

- Dependents who received 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.
- Taxpayers filing with an individual taxpayer identification number (most often nonresident aliens).
- 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.

In addition, we estimated that more than 1.2 million of these taxpayers may be assessed the Estimated Tax Penalty or an increased Estimated Tax Penalty as a direct result of the Making Work Pay Credit.

Prior to the issuance of our report, the IRS had initiated significant outreach to inform taxpayers about the Making Work Pay Credit, including:

- In the March 2009 revision of the *New Wage Withholding and Advance Earned Income Credit Payment Tables* (Publication 15-T), the IRS instructed employers to make

[4] *Millions of Taxpayers May Be Negatively Affected by the Reduced Withholding Associated With the Making Work Pay Credit* (Reference No. 2010-41-002, dated November 4, 2009).

available to employees a notice that would make them aware of how the Making Work Pay Credit would affect their withholding.[5]

- Establishment of the 2009 American Recovery and Reinvestment Act Outreach Strategy Team. The mission of the Team was 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 included identification of the targeted audiences, explanation of the issues, key messages, and outreach activities. The Team was also developing print, video, and audio outreach products.
- On June 25, 2009, the IRS issued a special edition tax tip through its Newswire service that focused on the Making Work Pay Credit. The notice informed taxpayers of the different scenarios for which taxpayers may be negatively affected by the Credit. The Newswire article also included links to both an audio and 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 was posted on youtube.com[6] and the audio was posted on IRS.gov (the IRS public Web site).

Subsequent to these efforts, we contacted 64 taxpayers (from the taxpayer segments referred to above) to determine if they were aware of the potentially negative effects the Making Work Pay Credit might have on their income tax filing and whether they knew how to avoid these potential negative effects. The vast majority of these taxpayers were unaware of the effects or the ways they might avoid the effects.

As a result, the IRS agreed to explore every avenue for communicating to the public about the Making Work Pay Credit. Additional plans for communication included 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.

[5] The notice provided important information to employees regarding the Making Work Pay Credit. However, it did not provide employees with essential information necessary to make an informed decision. The notice did not accurately explain to employees why they would want to adjust their withholding. For example, it implies that married individuals should only adjust their withholding if their combined income places them in a higher tax bracket; this scenario is irrelevant to the Making Work Pay Credit. Had it said that withholding should be reviewed if the combined income of the married individuals would place them above the phase-out amount, then it would have been accurate. Additionally, it should have explained that if taxpayers meet certain criteria, they may have to pay back all or a portion of the Credit advanced through the reduced withholding when they file their Tax Year 2009 or Tax Year 2010 return.
[6] A video sharing Web site.

The IRS also agreed that to the extent an Estimated Tax Penalty was caused by the application of the change in the withholding tables, waiver of the penalties would be appropriate. Therefore, it made plans to alert taxpayers to this relief.

The IRS took steps to mitigate the negative effect of the Making Work Pay Credit on nonresident aliens for Tax Year 2010.[7] However, the IRS did not agree with our recommendation to allow pension administrators to use the withholding tables which were in place prior to the enactment of the Recovery Act, which would have significantly reduced the burden the IRS placed on taxpayers receiving a pension and would have been consistent with the process used by the Federal Government's own Office of Personnel Management. 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, it did not resolve this issue.

Since the additional 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 tables 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 taxes for many taxpayers with pensions 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 was not followed by the Federal Government. The Office of Personnel Management (the agency which administers pensions for the Federal Government) told us that it did not use any of the new tables to calculate withholding payments because the new tables apply to earned income, not pensions and

[7] For Tax Year 2010, a modified procedure went into effect for figuring the amount of income tax withholding for nonresident alien employees working in the United States. An amount is to be added to employees' wages prior to calculating the withholding. The additional wage amount is only to be used for withholding purposes. Then, employers are to use a separate set of withholding tables that apply only to nonresident aliens. The effect of the additional amounts being added to the wages and the separate withholding tables will offset the standard deduction and the Making Work Pay Credit, both of which are not allowed to nonresident aliens.

annuities. Instead, the Office of Personnel Management used the tables in place prior to the Making Work Pay Credit.

During the second phase of this audit, we selected samples of nonrefund tax returns from those taxpayer segments we had previously identified as at risk of being negatively affected by the Making Work Pay Credit.[8] We reviewed these samples to determine if the Making Work Pay Credit caused the taxpayers to owe taxes or to owe more taxes with their tax returns. We contacted those taxpayers to determine if they were aware of the Making Work Pay Credit's negative effects and if they knew what steps to take to avoid these effects. We also determined whether taxpayers were assessed the Estimated Tax Penalty or an increased Estimated Tax Penalty because of the Making Work Pay Credit and whether it appeared the taxpayers were aware of the relief available from this Penalty. Our work was completed as of July 22, 2009.

Phase 2 of this review was performed at the IRS Campus[9] in Ogden, Utah, and included analysis of tax data located on the Treasury Inspector General for Tax Administration (TIGTA) Data Center Warehouse,[10] a review of taxpayer account data contained on the IRS Master File,[11] and a survey of taxpayers' knowledge of the Making Work Pay Credit, as well as discussions and analysis of information provided by the Department of the Treasury and the IRS's 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. Major contributors to the report are listed in Appendix II.

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[8] Although many taxpayers in our identified scenarios will have a reduced refund, we defined "negatively affected" as those who will owe taxes or owe more taxes as a result of the Making Work Pay Credit.
[9] 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.
[10] 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.
[11] The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

Results of Review

Implementation of the Making Work Pay Credit Caused Many Taxpayers to Owe More Income Tax for Tax Year 2009

Based on an analysis of Tax Year 2007 tax return data, we estimated in our prior report that more than 15.4 million taxpayers could be negatively affected by the Making Work Pay Credit. We considered taxpayers negatively affected by the Credit if they were underwithheld at year-end and owed additional tax because of the Credit. If taxpayers' refunds were reduced, we did not consider them to have been negatively affected. Approximately 93 million taxpayers received refunds in 2010 as of April 23. Many of these taxpayers were advanced the Making Work Pay Credit and may have benefited. However, based on updated information from samples of returns filed for Tax Year 2009, we now estimate that approximately 13.4 million taxpayers were or will be negatively affected by the Making Work Pay Credit in Tax Years 2009 and 2010.

The Recovery Act contained provisions in which the Education Credit, Earned Income Credit, and Child Tax Credit increased. To ensure that our figures remained conservative, we excluded from our estimates all Tax Year 2007 returns that claimed any one of these credits. The estimates that we included in our prior report did not reflect the First-Time Homebuyer Credit and Long Term Resident Credit, which were available for Tax Year 2009 and not available for Tax Year 2007. Both of these credits significantly reduce tax liabilities and are refundable. We recognize that these new credits would reduce our estimates of taxpayers that may have ultimately owed additional tax with their Tax Year 2009 returns.

To determine if those taxpayers that we believed may be negatively affected by the Making Work Pay Credit were in fact negatively affected, we used computer programs to identify taxpayers that were underwithheld and owed tax on their Tax Year 2009 U.S. Individual Income Tax Return (Form 1040).[12] Through processing cycle 18 (May 8, 2010), the IRS had processed 6,366,979 tax returns on which the tax owed exceeded withholding, estimated tax payments, and other credits. From these tax returns, we identified 4,848,933 returns filed by taxpayers with those specific conditions that we had previously determined may cause the taxpayers to be negatively affected by the Making Work Pay Credit. We selected a statistical sample (weighted stratified sample) of returns from each cycle. A total of 465 accounts were selected and reviewed to determine if the taxpayers were negatively affected by the Making Work Pay Credit. (See Appendix V for a breakdown of our sample selection).

[12] The returns examined were processed during cycles 4 through 18, representing the time period from January 24 through May 8, 2010. A cycle is 1 week's processing at a Campus or at Martinsburg or Tennessee Computing Centers. There are 52 cycles in a year.

Our analysis of these 465 returns indicated that 405 taxpayers (87 percent) were negatively affected by the reduced withholding associated with the Making Work Pay Credit. We further found that in Tax Year 2009, 186 (46 percent) of these 405 taxpayers owed taxes with their returns (rather than receiving a refund) for the first time in at least the prior 3 years. We made certain assumptions in determining whether the taxpayers were negatively affected by the reduced withholding associated with the Making Work Pay Credit. Those assumptions are shown in Appendix VII.

In a recent publication, the IRS reported that the average dollar amount of refunds had increased for Tax Year 2009.[13] Nevertheless, fewer refunds were issued when compared with the same time period from the prior year. There are a number of factors that indicate that the reduced withholding associated with the Making Work Pay Credit could have caused taxpayers who were normally accustomed to receiving refunds to owe additional tax when they filed their returns.

- A recently issued TIGTA report[14] noted that the taxpayer demand for toll-free telephone assistance had been higher than planned as of March 6, 2010. According to the report, the IRS provided 960,161 services on the Individual Master File Balance Due application. This was a 34 percent increase from the services (716,248) provided the same period last year.
- A specific IRS SERP (Servicewide Electronic Research Program) Alert[15] was issued to telephone assistors in response to a large number of telephone calls received from taxpayers inquiring about their reduced withholding. The Alert provided instruction on how to deal with taxpayers who have received refunds in the past and are now concerned that they will owe or will owe more.
- IRS statistics that compared the number and amount of refunds issued during Processing Year 2009 with Processing Year 2010 showed that despite the implementation of several major tax credits, the number of refunds being issued for Tax Year 2009 were down in comparison to the same point in time for Tax Year 2008. As of April 23, 2010, the number of refunds issued had declined 3.5 percent from the same point last year (IRS figures show the number of individual income tax returns declined 2.7 percent during that same period) even though the average amount of the refund had gone up 8.6 percent. In fact, the number of refunds that the IRS issues each year had been steadily increasing since 2005 (see Figures 1 and 2).

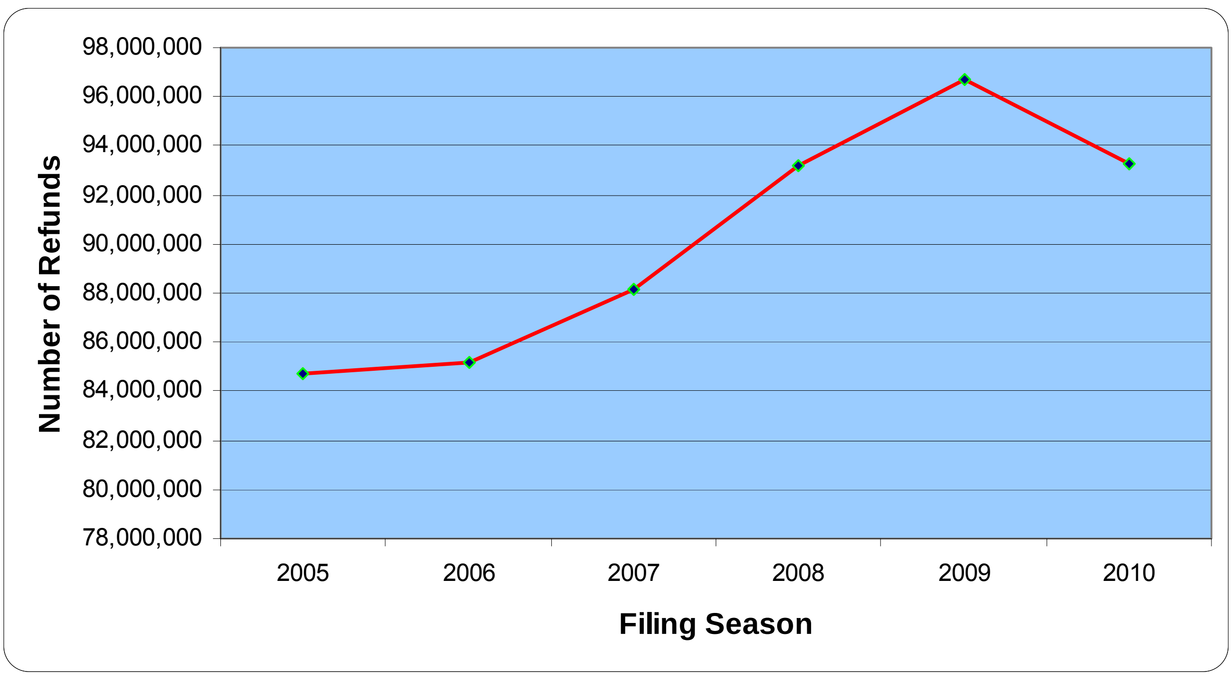
[13] IRS Newswire – March 23, 2010 – Issue Number: IR-2010-035.
[14] *Interim Results of the 2010 Filing Season* (Reference No. 2010-41-047, dated March 31, 2010).
[15] An IRS internal alert that notifies IRS employees of significant current issues and provides instruction to address those issues.

Figure 1: Filing Season Statistics

	Filing Season					
	2005	2006	2007	2008	2009	2010
Number of Refunds	84,741,000	85,151,000	88,168,000	93,183,000	96,673,000	93,289,000
Average Refund	$ 2,144	$ 2,237	$ 2,303	$ 2,371	$ 2,663	$ 2,892
Change in Number of Refunds		0.5%	3.5%	5.7%	3.7%	-3.5%[16]
Change in Average Refund		4.3%	3.0%	3.0%	12.3%	8.6%
Date Effective	4/22/2005	4/21/2006	4/20/2007	4/25/2008	4/24/2009	4/23/2010

Source: IRS's filing season statistics at www.IRS.gov (Number of Refunds/Average Refund) and TIGTA's calculations (Change in Number of Refunds /Change in Average Refund).

Figure 2: Change in the Number of Refunds



Source: IRS's filing season statistics available at www.IRS.gov.

In our opinion, the IRS implemented the Making Work Pay Credit in accordance with the intent of the Congress and the Department of the Treasury. As such, there was little more it could do to avoid the negative effects of the reduced withholding to most of the taxpayer segments we

[16] IRS figures show the number of individual income tax returns declined 2.7 percent during the same period.

identified as at risk. However, as mentioned, the IRS did take steps for Tax Year 2010 to mitigate the negative effect for nonresident aliens who do not qualify for the Credit. Based on the analysis presented in our prior report, we estimate that this action will lessen the burden on approximately 87,000 nonresident aliens. In addition, we believe that if the IRS had taken similar steps for pensioners, as recommended in our prior report, the negative effect of the Credit could have been avoided for approximately 11 million pensioners over Tax Years 2009 and 2010.

Despite Substantial Efforts to Inform Taxpayers About the Making Work Pay Credit, Taxpayers Negatively Affected by the Reduced Withholding Are Still Unaware of the Problem and the Solution

In response to our prior report addressing the potential negative effects of the Making Work Pay Credit, the IRS stated in October 2009 that it planned to explore every avenue for communicating to the public about the Credit. The IRS planned to continue to tailor the information to the specific media vehicle used. Additional plans for communication included 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. Additional actions include the following:

- The IRS's free email subscription service (IRS Tax Tips) addressed the Credit in January 2010 and July 2010.
- Public service announcements (Spanish and English) ran nationwide from September to December 2009.
- The Credit was included in all six 2010 Tax Forums.
- Additional information about the Credit was included in a number of IRS publications.

A survey of taxpayers negatively affected by the Making Work Pay Credit showed that these taxpayers had little knowledge of the Credit or what to do to avoid being negatively affected

To assess the effectiveness of the IRS's efforts, we sent 501 questionnaires to taxpayers who filed their Tax Year 2009 individual income tax returns and who we determined were negatively affected by the Making Work Pay Credit. From the 501 questionnaires sent, we received 236 responses. Of those taxpayers responding to the questionnaire, 208 (88 percent) responded that they had no knowledge of the Making Work Pay Credit and its potential

Eighty-eight percent of the taxpayers that responded to TIGTA's questionnaire were not aware of the Making Work Pay Credit and its potential for causing insufficient withholding.

for causing insufficient withholding before receiving the questionnaire. Five percent of the taxpayers responding were aware of the Credit and had adjusted their withholding. The other 7 percent were aware of the Credit, but had still not adjusted their withholding despite owing taxes with their Tax Year 2009 return. Based on the results of this survey and our previous contacts with taxpayers reported in our prior report, it appears that the IRS efforts to inform those taxpayers who may be negatively affected by the Making Work Pay Credit have been largely ineffective. As a result, millions of taxpayers may once again unexpectedly owe additional taxes when they file their Tax Year 2010 individual income tax returns.

Recommendation

Recommendation 1: In the case of future credits that are implemented by changes in the withholding tables, the Commissioner, Wage and Investment Division, should consider including simplified withholding adjustment instructions on the IRS Web site for specific scenarios that could result in underwithholding.

> ***Management's Response:*** IRS management agreed with this recommendation and stated that its current processes will ensure such consideration is given if this situation occurs.
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> ***Office of Audit Comment:*** We acknowledge the IRS's agreement to our recommendation. However, based on the fact that no such specific instructions were included on its Web site in this situation, we question whether current processes will ensure that such consideration is given in the future if the situation occurs.

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

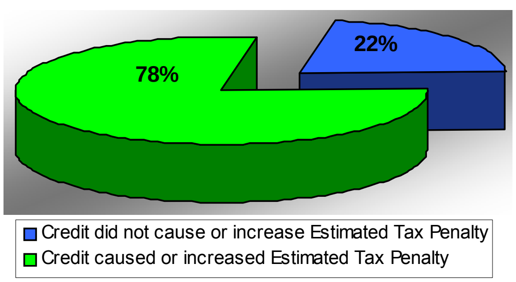
The United States income tax system operates on a "pay as you go" basis, meaning that taxpayers must pay their income taxes throughout the year as their income is earned. Taxpayers accomplish this either through quarterly estimated tax payments or through withholding on their earnings. If taxpayers have significantly underpaid their taxes at the time they file their individual income tax returns, they may be assessed an Estimated Tax 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. 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 Estimated Tax Penalty. On June 19, 2009, we issued an audit alert to the IRS discussing this issue and recommending that the IRS make preparations to identify taxpayers who will have the Estimated Tax Penalty assessed or increased due to the Making Work Pay Credit and take steps to waive or abate the related Penalty amounts. The IRS stated 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 appropriate. It took steps to alert taxpayers to the availability of this relief by adding additional content to *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 Form 1040 on how affected taxpayers should request a waiver of their Estimated Tax Penalty.

Using computer programming, we identified individuals who were assessed Estimated Tax Penalties on their Tax Year 2009 tax returns and who were from those taxpayer segments we determined would be likely to be negatively affected by the Making Work Pay Credit. We then selected a sample of 116 returns[17] and analyzed the taxpayers' accounts to determine if the Making Work Pay Credit could have caused the taxpayers to owe the Estimated Tax Penalty or owe more Estimated Tax Penalty. We further analyzed the accounts to identify those taxpayers who had not owed the Estimated Tax Penalty in the prior 3 years. See Appendix VII for the assumptions we used in our analysis of these taxpayers' returns.

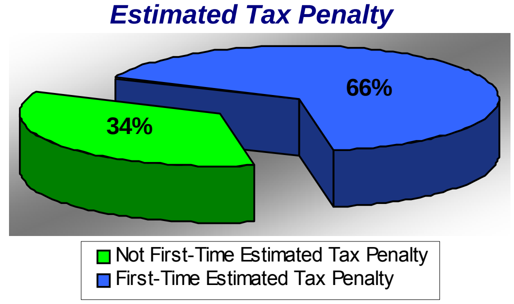
From our sample of 116 taxpayers, we determined that the Making Work Pay Credit caused 91 taxpayers (78 percent) to owe or owe more Estimated Tax Penalty. We also found that 60 (66 percent) of the 91 taxpayers reviewed who owed the Penalty were assessed the Estimated Tax Penalty for the first time since at least Tax Year 2005. (See Figures 4 and 5)

Figure 4: Results of Estimated Tax Penalty Return Case Reviews



Source: Case reviews.

Figure 5: First-Time Estimated Tax Penalty



Source: Case reviews.

However, we also found that none of these taxpayers requested a waiver of the Penalty. In its efforts to provide taxpayers relief from Estimated Tax Penalties caused by underwithholding due to the Making Work Pay Credit, the IRS assumed that the taxpayers in need of relief from unfair Estimated Tax Penalties would know about the Making Work Pay Credit, its effect on their withholding, and the resulting effect on their Estimated Tax Penalty. As stated earlier, our survey of taxpayers negatively affected by the Credit indicated that 88 percent of these taxpayers

[17] Eight returns were selected from each of cycles 5 through 18. Four returns were selected from cycle 4 because there were only four Estimated Tax Penalty returns available in that cycle.

were not even aware of the Credit. Therefore, most of these taxpayers would not have known to request a waiver of the Estimated Tax Penalty based on the Making Work Pay Credit.

Based on Tax Year 2007 data, we estimated that more than 122,000 taxpayers may be assessed the Estimated Tax Penalty in Tax Year 2009 as a result of the Making Work Pay Credit. We also estimated that an additional 1.15 million taxpayers may have their Estimated Tax Penalty amount increased slightly due to the Making Work Pay Credit.[18] Based on our sample of 116[19] taxpayers who were assessed the Estimated Tax Penalty, we are reducing our estimates to ensure that our estimates are conservative. Our revised estimate is that approximately 108,000 taxpayers may have been assessed an Estimated Tax Penalty who otherwise would not have, and an additional 1.02 million taxpayers may have had their Estimated Tax Penalty amount increased, both as a result of the Making Work Pay Credit. The amount of Estimated Tax Penalty that may have been assessed because of the Making Work Pay Credit for Tax Year 2009 totaled approximately $12.0 million (over 2 years this would be about $24.1 million).

Recommendation

Recommendation 2: The Commissioner, Wage and Investment Division, should develop proactive steps to identify those taxpayers who were assessed Estimated Tax Penalties in Tax Year 2009 and who may be liable for the Penalty in Tax Year 2010 as a result of the Making Work Pay Credit. Those taxpayers should then be informed that the IRS can waive or abate the portion of the Estimated Tax Penalty related to the Credit.

> ***Management's Response:*** IRS management partially agreed with this recommendation. They will continue to provide outreach to all taxpayers to remind them to check for underwithholding and related penalty issues; however, they do not plan to take additional steps to identify or make direct contact with taxpayers who may be liable for the incremental portion of the penalty attributed to the Making Work Pay Credit in Tax Year 2010.
>
> ***Office of Audit Comment:*** We believe the IRS needs to ensure that the outreach it provides is extensive and focused enough to reach all appropriate taxpayers. Furthermore, while the IRS does incur a cost to contact taxpayers directly, if these taxpayers owed more rather than less, the IRS would make direct contact to secure payment. As such, we are concerned that the IRS's decision is solely based on the revenue effect rather than making sure the amount collected is correct.

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[18] The Recovery Act contained provisions in which the Education Credit, Earned Income Credit, and Child Tax Credit were increased. To ensure that our figures remained conservative, we excluded from our estimates all Tax Year 2007 returns that claimed any one of these credits.

[19] This sample was a statically valid, stratified sample based on a 95 percent confidence level. Based on the stratified sample, the average error rate and point estimate of taxpayers negatively affected is 88.78 percent with a precision (range) between 79.30 percent and 98.25 percent.

Appendix I

Detailed Objectives, Scope, and Methodology

Interim (Phase 1) 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 Tax Year 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's 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 Tax Year 2007 and had a refund of less than $400. For example, 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 ($600 x 2) less withheld from their wages. As joint filers, they are eligible for $800 and will therefore have to pay back the extra $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 Tax Year 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 of 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

[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.

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 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 Tax Year 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 Tax Year 2007 and had a refund of $650, $600, or $400 depending on their situation. See the following examples:

   $650 – 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.

   $600 – 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 Tax Year 2009 return. This scenario is exacerbated if each spouse is receiving a pension.

$400 – 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 Tax Year 2009 return. This scenario is exacerbated if each spouse is employed or receives a pension.

A single taxpayer who receives a pension during Tax Year 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.

2. Assessed the reliability of the data by reviewing a random sample of 5 records or accounts (for each of the 8 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 individual taxpayer identification number (ITIN) that could be negatively affected by the Making Work Pay Credit.

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

$600 – 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 Tax Year 2009 tax return. This scenario is exacerbated if either spouse has more than one job.

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 Estimated Tax 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 Estimated Tax Penalty 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 Estimated Tax Penalty 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 Data Center Warehouse data to identify taxpayers (married or single) who received both Social Security benefits and wages and who had a refund of $50 or less if married and $250 or less if single. See the following examples:

   $50 – A joint filing household who receives Social Security benefits will receive a $250 stimulus check from the Secretary of the Treasury in Tax Year 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.

   $250 – A single taxpayer who receives Social Security benefits will receive a $250 stimulus check from the Secretary of the Treasury in Tax Year 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.

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 actions that have been taken (e.g., newsletters published) to inform taxpayers about the Making Work Pay Credit and what they can do to avoid owing taxes in Tax Years 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 avoid the negative effects.

3. Contacted an additional 50 taxpayers in July 2009 to determine the effectiveness of the IRS's general awareness campaign to notify taxpayers of the Making Work Pay Credit.

4. Contacted an additional 14 taxpayers in August 2009 from the categories of single filers and joint filers with multiple jobs to determine the effectiveness of the IRS's general awareness campaign to notify taxpayers of the Making Work Pay Credit.

Final (Phase 2) Detailed Objectives, Scope, and Methodology

For this phase of the audit, the overall objective was to evaluate the negative impact of the Making Work Pay Credit on taxpayers' Tax Year 2009 income tax returns and to determine taxpayer awareness of the potential negative impacts of the Making Work Pay Credit and what to do to avoid those negative impacts. To accomplish our objectives, we:

[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.

I. Identified taxpayers negatively affected by the Making Work Pay Credit in the form of a balance due or increased balance due return[5] upon filing their Tax Year 2009 return.[6]

A. Quantified the number of taxpayers that were negatively affected by the Making Work Pay Credit in Tax Year 2009.

1. Obtained balance due and full paid[7] account data from the IRS Master File[8] for Tax Year 2009.
2. Assessed the reliability of the data by reviewing the initial data set and verifying that the data met the extract criteria and was valid per IRS files.
3. Filtered the data obtained from the request to separate the different groups of taxpayers who were negatively affected by the Making Work Pay Credit.
4. Analyzed a statistical sample[9] (see "Sample methodology" below) of taxpayer accounts to determine whether they were negatively affected by the Making Work Pay Credit. [Considered that other tax effects could account for the changes (e.g., loss of other credits, deductions, or exemptions; increases in self-employment income; decreases in estimated tax payments; etc.)].
5. Contacted 405 of the taxpayers that were negatively affected by the Making Work Pay Credit to determine whether they were aware of the potential negative effects of the Making Work Pay Credit and if they took any action to adjust their withholding.

B. Quantified the number of taxpayers that had not owed taxes (balance due) for at least the prior 3 years upon filing their Tax Year 2009 return.

1. Obtained balance due and full paid account data from the IRS's Master File for Tax Year 2009.
2. Matched the data found in Step 1 above with tables containing taxpayers who received a refund or didn't file in Tax Years 2006, 2007, and 2008.

[5] A balance due return is a return for which the tax owed exceeded withholding, estimated tax payments, and other credits and the taxpayer did not pay the amount of tax due with his or her return
[6] The returns examined were processed during cycles 4 through 18, representing the time period from January 24 through May 8, 2010. A cycle is 1 week's processing at a Campus or at Martinsburg or Tennessee Computing Centers. There are 52 cycles in a year. Whenever a reference is made to the review or request of Tax Year 2009 returns, the data were obtained from cycles 4 through 18 as previously stated.
[7] A full paid return is a return that would have been a balance due return, but the taxpayer paid the amount owed with his or her return.
[8] The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
[9] A statistical sample was selected because the results were to be used to adjust our estimate of negatively affected taxpayers based on Tax Year 2007 data previously reported.

II. Identified taxpayers negatively affected by the Estimated Tax Penalty as a result of the Making Work Pay Credit.

A. Quantified the number of taxpayers that owed the Estimated Tax Penalty as a result of the Making Work Pay Credit for Tax Year 2009.

1. Obtained account data from the IRS's Master File for taxpayers who owed an Estimated Tax Penalty for Tax Year 2009.

2. Filtered the account data obtained in Step 1 above to separate the different groups of taxpayers who were assessed the Estimated Tax Penalty.

3. Analyzed a statistical sample of taxpayer accounts (see "Sample methodology" below) to determine whether they were assessed the Estimated Tax Penalty or an increased Estimated Tax Penalty as a result of the Making Work Pay Credit.

4. Contacted 96 taxpayers who were assessed the Estimated Tax Penalty as a result of the Making Work Pay Credit to determine whether: (1) they were aware of the potential negative effects of the Making Work Pay Credit on their withholding or (2) they had taken or will take any action to adjust their withholding.

B. Quantified the number of taxpayers who had not owed Estimated Tax Penalty for at least the prior three years upon filing their Tax Year 2009 return.

1. Obtained account data from the IRS's Master File for those taxpayers who owed an Estimated Tax Penalty for Tax Year 2009.

2. Matched the data found in Step 1 above with Master File data containing taxpayers who were not assessed the Estimated Tax Penalty in Tax Years 2006, 2007, and 2008.

III. Determined the effectiveness of the IRS's outreach efforts for Tax Year 2010.

A. Reviewed mediums that the IRS used to inform taxpayers about the Making Work Pay Credit and its potential negative effects.

B. Reviewed the IRS's actions that would help reduce the negative effects of the Making Work Pay Credit.

Sampling methodology

A statistical sample was selected because the results were to be used to adjust our estimate of negatively affected taxpayers based on Tax Year 2007 data previously reported. The population of taxpayer accounts available from cycles 4 through 18 could not be determined at the time the sample was selected. An even number of accounts were randomly selected from each cycle as the data were obtained. The results from each cycles' analysis were then weighted based on a

95 percent confidence level to calculate the precision (plus or minus 7.29 percent for Estimated Tax Penalty accounts and plus or minus 5.64 percent for balance due/full paid accounts).

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the IRS's policies, procedures, and practices related to the implementation of the Making Work Pay Credit. To assess these controls we:

- Analyzed balance due/full paid accounts to determine the negative effects of the Making Work Pay Credit.
- Analyzed accounts with the Estimated Tax Penalty to determine the negative effects of the Making Work Pay Credit .
- Reviewed mediums the IRS used to inform taxpayers about the Making Work Pay Credit and its potential negative effects.
- Reviewed the IRS's actions that would help reduce the negative affects of the Making Work Pay Credit.

Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)
Kyle R, Andersen, Director
Bill R. Russell, Audit Manager
W. George Burleigh, Lead Auditor
Roy E. Thompson, Senior Auditor
Lance J. Welling, Auditor
Brian Hattery, Information Technology Specialist
Martha Stuart, Information Technology Specialist

Appendix III

Report Distribution List

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Director, Accounts Management, Wage and Investment Division SE:W:CAS:AM
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Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Counsel OS:CFO:CPIC:IC
Audit Liaison: Chief, Program Evaluation and Improvement, Wage and Investment Division
SE:W:S:PRA:PEI

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable effect that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Reduction of Burden on Taxpayers – Actual; 87,243 nonresident alien taxpayer accounts affected (see page 6).

Methodology Used to Measure the Reported Benefit:

Using TIGTA Data Center Warehouse[1] queries, we identified 87,243 ITIN filers (based on Tax Year 2007 data) that could either be in a balance due[2] or increased balance due situation upon the filing of their Tax Year 2009 tax return as a result of the Making Work Pay Credit. In Tax Year 2007, 2,287,170 individuals with an ITIN (2 ITINs for a joint return) filed income tax returns. This population was filtered by refund amount to reach the final figure. For ITINs, we only wanted those single filers whose refund was less than or equal to $400 ($600 joint[3]), since that is the amount of the Making Work Pay Credit they will receive during Tax Year 2009 and will have to pay back when filing their Tax Year 2009 return. Although many ITIN filers will be affected due to the fact that they will have a reduced refund, we defined "negatively affected" as those that will be in a balance due situation.

The IRS has taken corrective action that applies to Tax Year 2010. This will reduce the burden on an estimated 87,243 taxpayers. This modified procedure went into effect for figuring the amount of income tax withholding for nonresident alien employees working in the United States. An amount is to be added to employees' wages prior to calculating the withholding. The additional wage amount is only to be used for withholding purposes. Then employers are to use a separate set of withholding tables that apply only to nonresident aliens. The effect of the

[1] 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.
[2] A balance due return is a return for which the tax owed exceeded withholding, estimated tax payments, and other credits and the taxpayer did not pay the amount of tax due with his or her return.
[3] $600 – 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 Tax Year 2009 tax return. This scenario is exacerbated if either spouse has more than one job.

additional amount being added to the wages and the separate withholding tables will offset the standard deduction and the Making Work Pay Credit that would have been advanced to these taxpayers even though they do not qualify for the Credit.

Type and Value of Outcome Measure:

- Reduction of Burden on Taxpayers – Potential; 11,061,034 taxpayer accounts affected over 2 years (see page 6).

Methodology Used to Measure the Reported Benefit:

Using Data Center Warehouse queries, we identified 6,321,313 pensioners (based on Tax Year 2007 data) that could either be in a balance due or increased balance due situation upon the filing of their Tax Year 2009 tax return as a result of the Making Work Pay Credit. Based on our sample (see Appendix V for sample detail) of 465 taxpayers who were negatively affected by the Making Work Pay Credit when they filed their Tax Year 2009 returns, we are reducing our estimates.[4] We now estimate that 5,530,517[5] pensioners may have been negatively affected as a result of the Making Work Pay Credit. In Tax Year 2007, 28,451,932 tax returns were filed that reported some form of a pension (gross or taxable). This population was filtered by refund amount to reach the final figure. For pensioners, we only wanted those whose refund was less than or equal to $650, $600, or $400 (see Appendix I, pages 16–17) since these are the excess amounts of the Making Work Pay Credit they will receive during Tax Year 2009 and will have to pay back when filing their Tax Year 2009 return. Although many pensioners will be affected due to the fact that they will have a reduced refund, we defined “negatively affected” as those that will be in a balance due situation.

If the IRS took our recommended actions, it could have reduced burden on 11,061,034 taxpayers over a 2-year period.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; $24,143,843 (over 2 years) affecting 2,269,158 taxpayer accounts (see page 10).

Methodology Used to Measure the Reported Benefit:

Using data from the Data Center Warehouse and the IRS Master File, we identified 1,277,967 taxpayers (based on Tax Year 2007 data) who could be either assessed the Estimated Tax Penalty or be assessed a larger Estimated Tax Penalty than expected upon the filing of their Tax Year 2009 tax return. The Making Work Pay Credit is administered to taxpayers through

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[4] This sample was a statically valid, stratified sample based on a 95 percent confidence level. Based on the stratified sample, the average error rate and point estimate of taxpayers negatively affected is 87.49 percent with a precision (range) between 79.56 percent and 95.41 percent.
[5] 5,530,517 equals .8749 (see footnote above) multiplied by the estimated 6,321,313 pensioners.

reduced withholding. Those taxpayers who receive too much of the Credit or receive the Credit when they do not qualify will be underwithheld and will be required to pay back the amounts they received in excess of what they are eligible for. Of those individuals, anyone who meets or almost meets the criteria of the Estimated Tax Penalty could be assessed the Penalty or an increased Penalty as a result of the administration of the Making Work Pay Credit. This could be done through no fault of their own.

Approximately 122,066 taxpayers may be assessed the Estimated Tax Penalty who would have otherwise not met the Penalty's criteria. Approximately 1,155,901 taxpayers may be assessed an unexpected increase in the amount of their Estimated Tax Penalty. Based on our sample of 116 taxpayers (see Appendix V for sample detail) who were assessed the Estimated Tax Penalty when they filed their Tax Year 2009 returns, we are reducing our estimates to ensure that our estimates are conservative.[6] We estimate that 108,370 taxpayers may have been assessed the Estimated Tax Penalty as a result of the Making Work Pay Credit. We also estimate that an additional 1,026,209 taxpayers may have had their Estimated Tax Penalty amount increased due to the Making Work Pay Credit.[7] We estimate that the amount of Estimated Tax Penalty that may have been assessed because of the Making Work Pay Credit for Tax Year 2009 totaled $12,071,922.

The total estimated amount of the Estimated Tax Penalty assessed because of the Making Work Pay Credit ($12,071,922) is the result of multiplying the number of taxpayers affected (108,370 + 1,026,209) by $10.64. The amount of $10.64 is the increment by which the Estimated Tax Penalty will increase for each underpayment of $400 beyond $1,000. The average underpayment of the Estimated Tax Penalty cases as a result of the Making Work Pay Credit was $462 above the $1,000 threshold. To maintain our conservative approach of the estimate, we used $10.64.

Projected over 2 years, $24,143,843 ($12,071,922 x 2) in Estimated Tax Penalty may be assessed taxpayers, as a result of the Making Work Pay Credit, affecting 2,269,158 taxpayer accounts ((108,370+1,026,209) x 2).

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[6] This sample was a statically valid, stratified sample based on a 95 percent confidence level. Based on the stratified sample, the average error rate and point estimate of taxpayers negatively affected is 88.78 percent with a precision (range) between 79.30 percent and 98.25 percent.
[7] The amounts 108,370 and 1,026,209 equal .8878 (see footnote above) multiplied by estimated 122,066 and 1,155,901 respectively.

Appendix V

Sampling Process

The raw data from our computer programs contained the following:

1) All Tax Year 2009 balance due[1] and full paid[2] returns processed in Calendar Year 2010 from cycles[3] 4 through 18 that had withholdings.
2) All Tax Year 2009 returns processed in Calendar Year 2010 from cycles 4 through 18 that had withholdings and an Estimated Tax Penalty.

Raw Data		
Cycle	**Balance Due or Full Paid**	**Estimated Tax Penalty**
Cycle 4	881	11
Cycle 5	4,896	136
Cycle 6	18,106	850
Cycle 7	46,498	3,175
Cycle 8	75,896	6,821
Cycle 9	124,715	12,421
Cycle 10	153,044	17,180
Cycle 11	251,817	30,384
Cycle 12	244,850	35,345
Cycle 13	293,873	49,124
Cycle 14	350,356	62,624
Cycle 15	519,375	89,990
Cycle 16	978,118	161,656
Cycle 17	1,634,892	394,797
Cycle 18	1,669,662	569,832
Totals	**6,366,979**	**1,434,346**

[1] A balance due return is a return for which the tax owed exceeded withholding, estimated tax payments, and other credits and the taxpayer did not pay the amount of tax due with his or her return.
[2] A full paid return is a return that would have been a balance due return, but the taxpayer paid the amount owed with his or her return.
[3] A cycle is 1 week's processing at a Campus or at Martinsburg or Tennessee Computing Centers. There are 52 cycles in a year.

Balance Due or Full Paid

Through cycle 18, the IRS had processed 6,366,979 tax returns on which the tax owed exceeded withholding, estimated tax payments, and other credits. From these tax returns, we identified 4,848,933 returns filed by taxpayers with those specific conditions that we had previously determined may cause the taxpayers to be negatively affected by the Making Work Pay Credit. (See "Categories of Taxpayers" starting on page 31). We selected a statistical sample (weighted stratified sample) of 31 returns from each cycle. A total of 465 tax accounts were selected and reviewed.

Taxpayers From Each Cycle Filing Balance Due or Full Paid Returns With Conditions That May Have Caused Them to Be Negatively Affected by the Making Work Pay Credit

Cycle	Single – Multiple Forms W-2[4]	Joint – Multiple Forms W-2	Dependents	Social Security Recipients	Pensioners	Total
Cycle 4	42	28	183	21	98	372
Cycle 5	341	320	981	170	621	2,433
Cycle 6	1,460	2,017	3,079	832	3,886	11,274
Cycle 7	3,142	5,568	7,013	2,160	15,676	33,559
Cycle 8	4,628	9,263	10,668	3,430	30,187	58,176
Cycle 9	5,466	12,838	19,601	5,711	51,204	94,820
Cycle 10	6,315	16,613	21,270	7,278	65,226	116,702
Cycle 11	7,626	25,724	28,450	12,416	112,403	186,619
Cycle 12	9,279	29,834	23,054	12,041	113,747	187,955
Cycle 13	11,232	33,728	26,492	15,199	140,609	227,260
Cycle 14	14,343	44,627	30,939	17,583	164,058	271,550
Cycle 15	19,742	64,043	41,788	25,862	245,217	396,652
Cycle 16	43,869	138,171	111,517	44,088	419,249	756,894
Cycle 17	83,643	315,954	127,178	76,445	674,255	1,277,475
Cycle 18	80,244	332,708	75,689	82,617	655,934	1,227,192
Totals	**291,372**	**1,031,436**	**527,902**	**305,853**	**2,692,370**	**4,848,933**

[4] Wage and Tax Statement.

Estimated Tax Penalty

Through cycle 18, the IRS had processed 1,434,346 tax returns with Estimated Tax Penalties. From these tax returns, we identified 1,141,453 returns filed by taxpayers with those specific conditions that we had previously determined may cause the taxpayers to be negatively affected by the Making Work Pay Credit. (See "Categories of Taxpayers" starting on page 31). We selected a statistical sample (weighted stratified sample) of eight returns from each cycle. (Cycle 4 did not have eight accounts available so only four cases were selected and reviewed). A total of 116 tax accounts were selected and reviewed.

Taxpayers From Each Cycle Assessed Estimated Tax Penalties With Conditions That May Have Caused Them to Be Negatively Affected by the Making Work Pay Credit

Cycle	Single – Multiple Forms W-2	Joint – Multiple Forms W-2	Dependents	Social Security Recipients	Pensioners	Total
Cycle 4	0	0	0	0	4	4
Cycle 5	***1***	13	0	7	31	53
Cycle 6	33	120	***1***	68	339	562
Cycle 7	147	440	8	233	1,535	2,363
Cycle 8	279	965	22	381	3,819	5,466
Cycle 9	394	1,597	34	772	7,083	9,880
Cycle 10	487	2,070	45	1,063	9,956	13,621
Cycle 11	670	3,141	134	1,858	17,780	23,583
Cycle 12	854	4,183	121	2,042	21,604	28,804
Cycle 13	1,104	6,019	153	3,113	29,422	39,811
Cycle 14	1,476	8,324	219	3,846	37,090	50,955
Cycle 15	1,921	11,672	307	5,731	51,715	71,346
Cycle 16	3,314	21,373	483	9,650	96,657	131,477
Cycle 17	10,560	77,861	1,307	23,535	210,238	323,501
Cycle 18	15,990	121,651	2,204	34,793	265,389	440,027
Totals	**37,231**	**259,429**	**5,039**	**87,092**	**752,662**	**1,141,453**

Categories of Taxpayers

Taxpayers listed below could be negatively affected by the Making Work Pay Credit because they could be advanced more of the Credit than they are eligible to claim. Our criteria for selecting cases for inclusion in our population are shown in the associated tables.

1. Single with multiple Forms W-2

If a single taxpayer worked 2 jobs concurrently from April through December 2009, he or she will have been advanced up to $400 from each job, for a total of $800. This taxpayer is only eligible for $400 total; therefore, the excess $400 had to be paid back when he or she filed his or her Tax Year 2009 return.

Filing Status	Not equal to	2
Dependent Indicator	Equal to	0
Wages	Greater than	0
Gross Social Security	Equal to	0
Taxable Social Security	Equal to	0
Taxable Social Security - CP	Equal to	0
Taxable Pension	Equal to	0
Gross Pension	Equal to	0
Number of Forms W-2	Greater than	1

2. Joint with multiple Forms W-2

If jointly filing taxpayers worked and their spouse did as well from April through December 2009, they will have been advanced up to $600 from each job, for a total of $1,200. These taxpayers are only eligible for $800 total; therefore, the excess $400 had to be paid back when they filed their Tax Year 2009 return.

Filing Status	Equal to	2
Dependent Indicator	Equal to	0
Wages	Greater than	0
Gross Social Security	Equal to	0
Taxable Social Security	Equal to	0
Taxable Social Security - CP	Equal to	0
Taxable Pension	Equal to	0
Gross Pension	Equal to	0
Number of Forms W-2	Greater than	1

3. Dependents with wages

Dependent Indicator	Equal to	1
Wages	Greater than	0

Dependents do not qualify for any portion of the Making Work Pay Credit. A dependent who worked from April 2009 to December 2009 will have been advanced up to $400. Since dependents are not eligible for the Making Work Pay Credit, the entire $400 had to be paid back when this dependent filed his or her Tax Year 2009 return. This is exacerbated if the dependent worked two or more jobs concurrently during Tax Year 2009.

4. Single Social Security recipient with wages

A single taxpayer in this category who has one job from April through December 2009 will have been advanced up to $400. This taxpayer would have also received a $250 economic recovery payment because he or she is a Social Security recipient. The Making Work Pay Credit is reduced by any economic recovery payment received, meaning that this taxpayer qualifies for the Making Work Pay Credit in the amount of $150 ($400–$250). The excess $250 received through his or her employment had to be paid back when he or she filed his or her Tax Year 2009 return.

Filing Status	Not equal to	2
Dependent Indicator	Equal to	0
Wages	Greater than	0
Gross Social Security	Greater than	0 or
Taxable Social Security	Greater than	0 or
Taxable Social Security - CP	Greater than	0
Taxable Pension	Equal to	0
Gross Pension	Equal to	0

5. Joint Social Security recipients with wages

Jointly filing taxpayers in this category with one job from April through December 2009 will have been advanced up to $600. These taxpayers would have also received at least one $250 economic recovery payment because they are Social Security recipients. The Making Work Pay Credit is reduced by any economic recovery payment received, meaning that these taxpayers qualify for the Making Work Pay Credit in the amount of $550 ($800–$250). The excess $50 received through their employment had to be paid back when they filed their Tax Year 2009 return. This is exacerbated if each spouse works or if each spouse is eligible for Social Security and received a $250 economic recovery payment (for a total of $500).

Filing Status	Equal to	2
Dependent Indicator	Equal to	0
Wages	Greater than	0
Gross Social Security	Greater than	0 or
Taxable Social Security	Greater than	0 or
Taxable Social Security - CP	Greater than	0
Taxable Pension	Equal to	0
Gross Pension	Equal to	0

Pensioners

Dependent Indicator	Equal to	0
Taxable Pension	Greater than	0 or
Gross Pension	Greater than	0

Pensions do not qualify for the Making Work Pay Credit; however, the IRS instructed pension administrators to apply the reduced withholding tables to pensions. These tables were designed to advance the Making Work Pay Credit to wage earners. The IRS later issued additional tables that could be used by pension administrators to offset the Making Work Pay Credit. The use of the additional tables is optional.

Prior to filtering into the following eight pension categories, one overall pension filter was used to reduce repetition.

6. Single pensioner with wages and Social Security

Filing Status	Not equal to	2
Wages	Greater than	0
Gross Social Security	Greater than	0 or
Taxable Social Security	Greater than	0 or
Taxable Social Security - CP	Greater than	0

Single pensioners with wages and Social Security can be negatively affected by the Making Work Pay Credit because they can be advanced more of the Credit than they are eligible for. The Making Work Pay Credit does not apply to pensions. Take, for example, a single pensioner who receives a pension from April through December 2009, is employed for that time period, and receives Social Security for that time period. Up to $400 would have been advanced through the pension, up to $400 would have been advanced through the job, and a $250 economic recovery payment would have been received. This individual will have received $1,050. The taxpayer qualifies for the Making Work Pay Credit in the amount of $150 ($400 (job) - $250). The excess $650 ($800 advanced - $150 eligible for) of the Credit had to be paid back when he or she filed his or her Tax Year 2009 return.

7. Single pensioner with wages and without Social Security

Filing Status	Not equal to	2
Wages	Greater than	0
Gross Social Security	Equal to	0
Taxable Social Security	Equal to	0
Taxable Social Security - CP	Equal to	0

Pensioners in this category would be advanced more Making Work Pay Credit than they are eligible for. Take, for example, a single pensioner who receives a pension from April through December 2009 and has one job for that time period. Up to $400 would have been advanced through the pension and up to $400 would have been advanced through the job. This taxpayer will have received $800. He or she qualifies for $400. The excess $400 had to be paid back when he or she filed his or her Tax Year 2009 return.

8. Single pensioner with Social Security and without wages

Filing Status	Not equal to	2
Wages	Equal to	0
Gross Social Security	Greater than	0 or
Taxable Social Security	Greater than	0 or
Taxable Social Security - CP	Greater than	0

Single pensioners with Social Security can be advanced more of the Credit than they are eligible for. Pensions do not qualify for the Making Work Pay Credit. Take, for example, a single pensioner who has one job from April through December 2009 and receives Social Security during the same time period. Up to $400 would have been advanced through the pension and a $250 economic recovery check would have been received. Since the pension does not qualify for the Credit, the entire $400 would had to have been paid back.

9. Single pensioner without wages or Social Security

Filing Status	Not equal to	2
Wages	Equal to	0
Gross Social Security	Equal to	0
Taxable Social Security	Equal to	0
Taxable Social Security - CP	Equal to	0

Single pensioners without wages or Social Security can be negatively affected by the Making Work Pay Credit by being advanced the Credit when they do not qualify for it. For example, a single pensioner would have been advanced up to $400. The entire $400 would had to have been paid back.

10. Joint pensioner with wages and Social Security

Filing Status	Equal to	2
Wages	Greater than	0
Gross Social Security	Greater than	0 or
Taxable Social Security	Greater than	0 or
Taxable Social Security - CP	Greater than	0

Joint pensioners with wages and Social Security can be negatively affected by the Making Work Pay Credit because they can be advanced more of the Credit than they are eligible for. Pensions do not qualify for the Credit. Take, for example, a jointly filing couple that receives a pension from April through December 2009, holds one job for that time period, and receives Social Security for that time period. Up to $600 would have been advanced through the pension, up to $600 would have been advanced through the job, and a $250 economic recovery payment would have been received. This couple will have received $1,450. The taxpayers qualify for the Making Work Pay Credit in the amount of $550 ($800 (job) - $250). The excess $650 ($1,200 advanced - $550 eligible for) would have to be paid back when they filed their Tax Year 2009 return.

11. Joint pensioner with wages and without Social Security

Filing Status	Equal to	2
Wages	Greater than	0
Gross Social Security	Equal to	0
Taxable Social Security	Equal to	0
Taxable Social Security - CP	Equal to	0

Joint pensioners with wages can be negatively affected by the Making Work Pay Credit because they can be advanced more of the Credit than they are eligible for. Take, for example, a jointly filing couple that receives a pension from April through December 2009 and they have one job for that time period. Up to $600 would have been advanced through the pension and up to $600 would have been advanced through the job. These taxpayers will have received $1,200. They qualify for $800. The excess $400 would had to have been paid back when they filed their Tax Year 2009 return.

12. Joint pensioner with Social Security and without wages

Filing Status	Equal to	2
Wages	Equal to	0
Gross Social Security	Greater than	0 or
Taxable Social Security	Greater than	0 or
Taxable Social Security - CP	Greater than	0

Joint pensioners with Social Security can also be negatively affected by the Making Work Pay Credit by being advanced more of the Credit than they are eligible for. Take, for example, a jointly filing couple that has one job from April through December 2009 and receives Social Security during the same time period. Up to $600 would have been advanced through the pension and a $250 economic recovery check would have been received. Since the pension does not qualify for the Credit, the entire $600 would had to have been paid back.

13. Joint pensioner without wages or Social Security

Filing Status	Equal to	2
Wages	Equal to	0
Gross Social Security	Equal to	0
Taxable Social Security	Equal to	0
Taxable Social Security - CP	Equal to	0

Joint pensioners without wages or Social Security can be negatively affected by the Making Work Pay Credit by being advanced the Credit when they do not qualify for it. Pensions do not qualify for the Credit. As a result, a jointly filing couple with one pension would have been advanced up to $600, and the entire $600 would had to have been paid back.

Appendix VI

Taxpayer Questionnaire

Questionnaire Cover Letter OMB NO. 1505-0217 Expires 04/30/2012

Person to Contact:
Telephone Number (Not Toll Free):
Additional Contact
Telephone Number (Not Toll Free):
Control Number: 1

Dear Taxpayer,

The Department of the Treasury is conducting an independent review of the Internal Revenue Service's (IRS) efforts to inform taxpayers of the Making Work Pay Credit (MWPC). The Treasury Inspector General for Tax Administration (TIGTA), which is part of the Department of the Treasury but independent of the IRS, is charged with conducting these independent reviews of the IRS. Enclosed is a questionnaire containing a question(s) that will indicate your awareness of the Making Work Pay Credit and aid us in determining the effectiveness of IRS' communication efforts.

This is not a review or audit of your tax return. Please complete the enclosed questionnaire and return it to us in the post-paid envelope within three to five days of receipt. The time required to complete this questionnaire should not be more than 5 minutes. Your response is voluntary and will remain completely confidential. There are no penalties for not replying. We are prohibited by law from providing information concerning your tax accounts to anyone without your permission. Alternatively, you can contact our office by telephone at your convenience; however, we do not have a toll-free number. If you choose to call us we will immediately call you back to reduce any toll charges.

Making Work Pay Credit

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 which contains many economic stimulus provisions, one of which is the Making Work Pay Credit (MWPC). The MWPC gives single filers up to $400 and joint filers up to $800. Dependents, pension recipients, and certain other individuals do not qualify for the MWPC. The IRS is advancing the credit to workers in their paychecks through reduced withholding during 2009 and again in 2010.

We have identified situations in which individuals may be advanced more of the MWPC in their paychecks than they are eligible for. This could result in a reduced refund, owing taxes instead of receiving a refund, or owing more taxes than expected on your 2009 and 2010 tax return. Our concern is that millions of taxpayers fall into one of these situations but are unaware due to a lack of effective communication by the IRS. These situations include but are not limited to:

- Working dependents
- Joint filing, multiple income households
- Pension recipients
- Social Security recipients who work
- Single filers with multiple jobs

To help insure our independent review of the IRS, please contact only the Treasury Inspector General for Tax Administration. **Please do not forward this letter to the IRS.** If you have any questions, please call the individuals shown at the top of this letter. You can also access our website at www.treas.gov/tigta/ for more information about our agency. Thank you for your cooperation.

Sincerely,

Michael R. Phillips

Michael R. Phillips
Deputy Inspector General for Audit

Enclosures:
Questionnaire
Post-Paid Envelope

Deputy Inspector General for Audit

Privacy Act and Paperwork Reduction Act Notice

The Budget and Accounting Procedures Act of 1950 authorizes the Department of the Treasury to request this information for the purposes stated in the letter. You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid Office of Management and Budget control number. The estimated average time to comply with this letter is 5 minutes. If you have any comments concerning the accuracy of this time estimate or suggestions for making this letter simpler, please write to either the:

Treasury Inspector General for Tax Administration
Office of Audit
1125 15th Street, NW Room 700A
Washington, D.C. 20005

or

Office of Management and Budget
Paperwork Reduction Project (1505-0217)
Washington, D.C. 20503

Do not send a reply to this letter to either of these addresses.

Questionnaire - Making Work Pay Credit

OMB NO. 1505-0217 Expires 04/30/2012

Control Number: 1

Instructions: For each question, please check your answer and go to the next question as indicated. If you have additional information you would like to share with us, please include it in the space provided at the end of the questionnaire, or attach a separate sheet. After completion, please return the questionnaire using the enclosed post-paid envelope; alternatively you can provide your answers by phone using the contact numbers on the cover letter, or if your prefer us to contact you by telephone please provide a contact number and a best time to call in the "Additional Information" space provided below.

1. Prior to receiving this letter, were you (and/or your spouse if filing jointly) familiar with the Making Work Pay Credit **and** its potential for causing insufficient income tax to be withheld from your pay check and/or pension?

   ☐ Yes (Continue to next question)
   ☐ No (Stop here and return the questionnaire in the post-paid envelope)

2. Are you (and/or your spouse if filing jointly) aware of what to do to avoid being negatively affected by the Making Work Pay Credit?

   ☐ Yes ☐ No

3. Did you (and/or your spouse if filing jointly) adjust your withholding amount during 2009?

   ☐ Yes ☐ No

4. If you (and/or your spouse if filing jointly) had more than one job in 2009, did you work them concurrently?

   ☐ Yes ☐ No

5. How were you informed about the Making Work Pay Credit? Check all that apply.

   ☐ www.irs.gov ☐ www.youtube.com ☐ www.recovery.gov
   ☐ Newspaper ☐ Television ☐ Radio
   ☐ Word of Mouth
   ☐ Other (please briefly describe) ____________________________________

Additional Information. Please include any additional information from the questions above, as well as anything else you feel is pertinent to our inquiry. An additional page can be attached if needed.

____

____

____

This concludes our questionnaire. Please return this page in the post-paid envelope and mail it within three to five days of receipt. Thank you for your time.

Appendix VII

Assumptions Made in Reviewing Cases

To determine if taxpayers were negatively affected by the reduced withholding associated with the Making Work Pay Credit, we used computer programs to identify taxpayers that were underwithheld and owed tax on their Tax Year 2009 U.S. Individual Income Tax Return (Form 1040). We filtered those results into the different categories of taxpayers who may be negatively affected by the Making Work Pay Credit. From this population we analyzed 465 returns filed by taxpayers in our taxpayer segments identified as at risk for being negatively affected by the Credit (31 returns from each cycle[1] were randomly sampled for a total of 465 returns).

In our analysis of the 465 tax returns, the following assumptions were applied:

1) If a taxpayer's return had multiple Wage and Tax Statements (Form W-2), it was assumed that the jobs were held concurrently unless there was evidence otherwise.
2) If Form W-2 information was not available, it was assumed that the wages came from one Form W-2 rather than multiple Forms W-2.
3) If Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. (Form 1099-R) information was not available, it was assumed that the taxable pension amount was from a single source rather than multiple Forms 1099-R.
4) In the case of pension payments, it was assumed that the pension administrator did not use the optional (additional) table provided in Additional Withholding for Pensions for 2009 (Notice 1036-P) to calculate pension withholding and the taxpayer was advanced the Making Work Pay Credit erroneously.
5) It was assumed that taxpayers did not adjust their Employee's Withholding Allowance Certificate (Form W-4).

To determine if the reduced withholding associated with the Making Work Pay Penalty could have caused taxpayers to owe the Estimated Tax Penalty or owe more Estimated Tax Penalty, we used computer programming to identify individuals from those taxpayers segments we determined would be likely to be negatively affected by the Making Work Pay Credit who were assessed Estimated Tax Penalties on their Tax Year 2009 tax returns. We then selected a sample of 116 returns and analyzed the taxpayers' accounts to determine if the Making Work Pay Credit

[1] A cycle is 1 week's processing at a Campus or at Martinsburg or Tennessee Computing Centers. There are 52 cycles in a year.

could have caused the taxpayers to owe the Estimated Tax Penalty or owe more Estimated Tax Penalty. We further analyzed this sample of Estimated Tax Penalty taxpayers to identify those that had not owed the Estimated Tax Penalty in the prior 3 years.

In our analysis of the 116 tax returns and related account information, the following assumptions were applied:

1) If a taxpayer's return had multiple Forms W-2, it was assumed that the jobs were held concurrently unless there was evidence contradicting the assumption.
2) If Form W-2 information was not available, it was assumed that the wages came from one Form W-2 rather than multiple Forms W-2.
3) If Form 1099-R information was not available, it was assumed that the taxable pension amount was from a single source rather than multiple Forms 1099-R.
4) In the case of pension payments, it was assumed that the pension administrator did not use the optional (additional) table provided in Notice 1036-P to calculate pension withholding and the taxpayer was advanced the Making Work Pay Credit erroneously.
5) It was assumed that taxpayers did not adjust their Form W-4.
6) If the taxpayer still owed over $1,000 after the analysis, it was assumed that the taxpayer owed additional Estimated Tax Penalty.
7) If the taxpayer owed less than $1,000 after the analysis, it was assumed that the taxpayer owed the Estimated Tax Penalty as a result of the Making Work Pay Credit.

Appendix VIII

Management's Response to the Draft Report

COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

RECEIVED
OCT 14 2010
BY: DMS

September 21, 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Overall the Making Work Pay Credit Was Implemented As Intended by Congress, but Resulted in Many Taxpayers Owing Taxes With Their Returns (Audit # 201040139)

We have reviewed the subject draft report and appreciate your acknowledgement of our successful implementation of the Making Work Pay Credit (MWPC), a significant provision included in the American Recovery and Reinvestment Act of 2009 (known as the Recovery Act). This provision was specifically intended to help taxpayers through the severe economic downturn by putting more money into their hands right away, in each paycheck. The Department of Treasury estimates 122 million working families and individuals benefited from this credit.

As soon as the Recovery Act was signed into law, the IRS worked quickly and effectively to ensure that taxpayers received the benefit of this credit. The IRS's new withholding tables were available to taxpayers four days after the Act was passed, which was no small accomplishment. We quickly recognized that changes to the withholding tables resulted in less tax being withheld for some taxpayers who were not eligible for the credit, and could result in underwithholding for those who held two or more jobs, or married couples whose combined income placed them in a higher tax bracket.

We embarked on a campaign throughout Tax Year 2009, and into Tax Year 2010, to encourage all taxpayers to check for any underwithholding issues. We developed and distributed a broad range of related communication products for the media, Internet, partners, and taxpayers. This effort included IRS news releases, fact sheets, public service announcements, Youtube videos, podcasts, and more. Materials were made available in English, Spanish, Chinese, Korean, Russian, and Vietnamese. Since early 2009, we have held thousands of IRS outreach events where we discussed this issue with partners and stakeholder groups, and we highlighted this issue for taxpayers at our own IRS Open House events.

While these extensive efforts significantly mitigated the risk of taxpayers being assessed a penalty as a result of the underwithholding issues, we acknowledge that some taxpayers could have been impacted. We reviewed the 91 cases in your sample where taxpayers receiving the MWPC under-withheld and were assessed an Estimated Tax Penalty or a larger Estimated Tax Penalty. In most of your cases, the MWPC was just one of several factors that contributed to the assessment of a penalty. We agree with your analysis that the amount of the estimated tax penalty attributable to the MWPC is approximately $10.64 for an individual taxpayer and $21.28 for taxpayers filing jointly.

We agree with the outcome measures you have outlined in Appendix IV of your report. Attached are our comments to your recommendations.

If you have any questions, please contact me, 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: In the case of future credits that are implemented by changes in the withholding tables, the Commissioner, Wage and Investment Division, should consider including simplified withholding adjustment instructions on the IRS web site for specific scenarios that could result in underwithholding.

CORRECTIVE ACTION
We agree with this recommendation. Our current processes will ensure such consideration is given, in the event this situation occurs.

IMPLEMENTATION DATE
Implemented and Ongoing

RESPONSIBLE OFFICIAL
Director, Office of Communications, Communications and Liaison Division

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 2: The Commissioner, Wage and Investment Division, should develop proactive steps to identify those taxpayers who were assessed Estimated Tax Penalties in Tax Year 2009 and who may be liable for the Penalty in Tax Year 2010 as a result of the Making Work Pay Credit. Those taxpayers should then be informed that the IRS can waive or abate the portion of the Estimated Tax Penalty related to the Credit.

CORRECTIVE ACTION
We partially agree with this recommendation. We will continue to provide outreach to all taxpayers to remind them to check for underwithholding and related penalty issues, however, we do not plan to take additional steps to identify or make direct contact with taxpayers who may be liable for the incremental portion of the penalty attributable to the Making Work Pay Credit in Tax Year 2010.

IMPLEMENTATION DATE
April 15, 2011

RESPONSIBLE OFFICIAL
Director, Communications and Liaison, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.