



Treasury Inspector General for Tax Administration Office of Audit

PROCESSES ARE NEEDED TO LINK THIRD-PARTY PAYERS AND EMPLOYERS TO REDUCE RISKS RELATED TO EMPLOYMENT TAX FRAUD

Issued on March 2, 2015

Highlights

Highlights of Report Number: 2015-40-023 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

Employers can appoint or enter into an agreement with a third party to take over some or all of the employer's Federal employment tax withholding, tax return preparation, reporting, and tax payment responsibilities. Approximately 40 percent of small firms use a third-party payer for tasks ranging from paying employees to Federal employment taxes. There are four common types of third-party payer arrangements: Payroll Service Provider (PSP), Reporting Agent, Section 3504 Agent, and Professional Employer Organization (PEO).

WHY TIGTA DID THE AUDIT

Third-party payer arrangements usually work as intended; however, there have been instances in which third-party payers receive funds from employers for payment of payroll taxes, but they have not remitted those taxes to the IRS. This causes significant problems for employers because the funds have been expended but the taxes are still due. TIGTA evaluated whether controls are adequate to protect the taxpayer's and Government's interests when third-party payroll providers are not compliant with payment and filing requirements.

WHAT TIGTA FOUND

Processes still have not been established to link employers with all third-party payers. Of the four most common types of third-party payer arrangements, only Reporting Agents and Section 3504 Agents are required to submit an authorization form that discloses the relationship between an employer and a third-party payer. The IRS does not require a similar authorization for employers that use a PSP or a PEO. The inability of the IRS to identify employers that use the services of a PEO is a concern TIGTA raised in prior reports.

In addition, authorization forms are not always accurately processed. Our review of 85 agent authorization forms processed in Calendar Year 2013 identified 11 forms with errors. Because of these errors, authorizations provided by employers to their Reporting Agents were incorrectly reflected in IRS systems.

Finally, the IRS has not established an effective process to ensure that indicators are accurately assigned to Section 3504 Agent and employer tax accounts. Review of the tax accounts associated with Section 3504 Agents filing 78 Forms 2678, *Employer/Payer Appointment of Agent*, identified 13 that contained erroneous indicators. The errors incorrectly identified Section 3504 Agents as employers and vice versa.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS partner with the Bureau of the Fiscal Service to develop a plan to use the Electronic Federal Tax Payment System[®] to link a PSP with an employer; establish a program in which employers can inform the IRS of the PEOs they authorize to file and pay employment taxes; require those PEOs with a service agreement to attach a Schedule R (Form 941), *Allocation Schedule for Aggregate Form 941 Filers*, to employment tax returns; and, develop processes and procedures to ensure authorization information and Section 3504 Agent indicators are accurate.

The IRS agreed with three of TIGTA's five recommendations and partially agreed with two. The IRS is working on establishing the voluntary certification program for PEOs that was enacted into law in December 2014. While the voluntary certification program will link PEOs that certify to employers, it will have no effect on PEOs that do not certify. The IRS will continue to be unable to readily identify noncompliance with payment and filing requirements on the part of these non-certifying PEOs.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2015reports/201540023fr.pdf>.