



*Due to the Lack of Enforcement, Taxpayers
Are Avoiding Billions of Dollars in Backup
Withholding*

September 14, 2016

Reference Number: 2016-40-078

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

2 = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

DUE TO THE LACK OF ENFORCEMENT, TAXPAYERS ARE AVOIDING BILLIONS OF DOLLARS IN BACKUP WITHHOLDING

Highlights

Final Report issued on September 14, 2016

Highlights of Reference Number: 2016-40-078 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

The purpose of backup withholding is to make sure that the Government is able to collect taxes on all appropriate income, particularly income that is not usually subject to withholding.

Although backup withholding legislation was enacted more than 30 years ago, *****2*****
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WHY TIGTA DID THE AUDIT

In September 2015, TIGTA issued a report that identified deficiencies with backup withholding and other reporting requirements related to payment cards. This audit continues TIGTA's assessment of the IRS's actions to ensure compliance with backup withholding provisions.

WHAT TIGTA FOUND

TIGTA's review found that although the majority of information returns are submitted by payers with valid TINs, nearly \$9 billion in backup withholding tax was not withheld by payers submitting Tax Year (TY) 2013 information returns with missing or incorrect TINs as required.

TIGTA's review identified 13,647 payers that submitted 27,576 information returns with the same missing payee TIN for two years in a row (TYs 2012 and 2013). These returns reported payments of about \$14.3 billion. As such, payers were required to immediately withhold

nearly \$4 billion from these payees, yet just more than \$1 million was withheld.

TIGTA identified 62,714 payers that submitted 203,751 information returns for which the payee TIN was incorrect in four consecutive years. These returns reported payments totaling nearly \$17 billion. As such, payers were required to withhold nearly \$5 billion from these payees, yet only \$1 million was withheld.

*****2*****
*****2*****
*****2***. Because the IRS is unable to match these documents with tax returns, tax revenue may be lost each year. Therefore, enforcing payer backup withholding requirements is essential to ensuring that the Government is able to collect taxes on all appropriate income, particularly income that is not usually subject to withholding.

TIGTA also found that there is no justification for criteria used to exclude payers from receiving backup withholding notices that include missing or incorrect TINs. For example, the IRS notified payers of the missing or incorrect TINs associated with only 10.8 million (57 percent) returns of the 18.9 million that were identified.

Finally, TIGTA's review of TY 2013 information returns identified 2.3 million returns were submitted for 1.6 million individuals with reportable payments totaling more than \$4 billion for which the payee TIN was that of a deceased individual.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division, establish a Service-wide information returns backup withholding enforcement strategy, document criteria used to exclude payers from receiving a notice, and include specific actions that will be taken to address information return reporting of income under a deceased individual TIN as part of the development of the IRS's Service-wide information returns strategy.

The IRS agreed with our recommendations and will use the findings and recommendations from this report when finalizing and implementing its backup withholding strategy.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 14, 2016

**MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION**

FROM:

Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Due to the Lack of Enforcement, Taxpayers Are
Avoiding Billions of Dollars in Backup Withholding
(Audit # 201540029)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) actions to ensure compliance with backup withholding provisions. This audit is included in our Fiscal Year 2016 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included in Appendix VI.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Russell P. Martin, Assistant Inspector General for Audit, Returns Processing and Account Services.



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of Dollars in Backup Withholding*

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Abbreviations

CP	Computer Paragraph
I.R.C.	Internal Revenue Code
IRMF	Information Returns Master File
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
SSA	Social Security Administration
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number
TY	Tax Year



Due to the Lack of Enforcement, Taxpayers Are Avoiding Billions of Dollars in Backup Withholding

Background

Congress enacted the Tax Equity and Fiscal Responsibilities Act of 1982¹ and the Interest and Dividend Tax Compliance Act of 1983,² which require payers to backup withhold³ tax from certain reportable payments. The purpose of backup withholding is to make sure that the Government is able to collect taxes on all appropriate income, particularly income that is not usually subject to withholding.⁴ Collectively, these acts require the payer of certain income types to deduct and withhold tax if:

- The payee fails to furnish a Taxpayer Identification Number (TIN)⁵ to the payer (hereafter referred to as a missing TIN).
- The Internal Revenue Service (IRS) notifies the payer that the payee name and TIN submitted to the IRS does not match its records (hereafter referred to as an incorrect TIN).
- The IRS notifies the payer that a payee has underreported income from interest and dividends.
- The payee fails to certify that they are not subject to backup withholding.

Subsequent laws added other reportable payments. The intent of the legislation was to ensure that income reported on certain information returns is reported under valid and correct TINs to the IRS.

Payee TIN validation processes

Each year, payers are required to provide information returns to the IRS by February 28 if submitted on paper and March 31 if submitted electronically.⁶ Once information returns are received, the IRS uses its Information Returns Processing Validation process in an attempt to match the *****2***** provided on the information return against records the IRS receives from the Social Security Administration (SSA). Information returns with

¹ Pub. L. No. 97-248, 96 Stat. 324.

² Pub. L. No. 98-67, Title I, Aug. 5, 1983; 97 Stat. 369, Pub. L. Section (§) 104(a).

³ Backup withholding provisions require payers to withhold 28 percent of certain reportable payments associated with payees that do not provide the payer with a TIN or payees that provide the payer with an incorrect TIN.

⁴ See Appendix V for a list of information returns subject to backup withholding.

⁵ A TIN is used by the IRS in the administration of tax laws. It is issued either by the Social Security Administration (SSA) for Social Security Numbers (SSN) or by the IRS for Employer Identification Numbers and Individual Taxpayer Identification Numbers.

⁶ Pub. L. No. 114-113, 129 Stat. 3076 requires Form 1099-MISC, *Miscellaneous Income*, to be filed on or before January 31, 2017, when reporting nonemployee compensation in box 7.



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***** fail validation because the IRS has no ability to match the *****. For those information returns for which no match is found for the *****. Payee documents that pass this validation process are considered valid and automatically sent for upload to the Information Returns Master File (IRMF).⁷

The remaining invalid documents are then sent to the IRS's *****. ***** is a process that uses computer systems to build indicators from *****⁸. In addition, the ***** also searches for common mistakes that include ***** which can cause a TIN to be invalid and attempts to match by *****. Information returns that are perfected are checked again against SSA or IRS records and if confirmed are posted to the IRMF as valid. *****⁹. Figure 1 shows the number of Tax Year (TY)⁹ 2013 information returns with reportable payments that may be subject to backup withholding (hereafter referred to as information returns) that had a valid TIN, missing TIN, or incorrect TIN/name combination.

Figure 1: Volumes of Information Returns With a Valid, Missing, or Incorrect TIN for Tax Year 2013

Form Type	Valid TIN	Missing TIN	Incorrect TIN	Total
1099-B, <i>Proceeds From Broker and Barter Exchange Transactions</i>	1,092,283,063	311,502	8,920,103	1,101,514,668
1099-INT, <i>Interest Income</i>	142,055,900	1,291,425	1,110,618	144,457,943
1099-MISC, <i>Miscellaneous Income</i>	85,754,300	638,598	4,709,881	91,102,779
1099-DIV, <i>Dividends and Distributions</i>	83,488,966	731,559	649,525	84,870,050
W-2G, <i>Certain Gambling Winnings</i>	10,701,788	11,223	N/A ¹⁰	10,713,011
1099-K, <i>Payment Card and Third Party Network Transactions</i> ¹¹	9,227,422	31,456	419,116	9,677,994

⁷ Creates a Master File of current tax year information returns and maintains access to nine prior years.
⁸ Individual Master File is the IRS database that maintains transactions or records of individual tax accounts. Business Master File is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.
⁹ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.
¹⁰ Forms W-2G with incorrect TINs are not subject to backup withholding.
¹¹ The volumes of Forms 1099-K are included in Figure 1 for information only. This review did not include analysis of Forms 1099-K because this information was addressed in a prior report (see page 4).



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Form Type	Valid TIN	Missing TIN	Incorrect TIN	Total
1099-OID, <i>Original Issue Discount</i>	2,228,277	39,251	19,611	2,287,139
1099-PATR, <i>Taxable Distributions Received From Cooperatives</i>	1,769,010	9,929	26,630	1,805,569
Total	1,427,508,726	3,064,943	15,855,484	1,446,429,153¹²

Source: IRS Information Technology organization analysis for TY 2013.

Notification is sent to payers identifying information returns submitted with payee missing or incorrect TINs

Once information returns with missing or incorrect TINs are identified, the IRS sends payers either a Computer Paragraph (CP) 2100 notice, *Please Check Your Backup Withholding List*, to large¹³ and midsize¹⁴ payers or a CP 2100A, *Please Check Your Backup Withholding List*, to small payers.¹⁵ Once the payer receives the notice of missing or incorrect payee TINs, the payer is required to obtain valid TIN information from the payee. Backup withholding requirements apply to information returns as follows:

- **Missing TIN** – the IRS defines a missing TIN as one that is not provided, has more or less than nine numbers, or has an alpha character as one of the nine positions. Payers are required to **immediately** backup withhold 28 percent on payments to the payee. Backup withholding should occur at the time the payee refuses or neglects to provide a TIN to the payer. Payers must make an initial solicitation for a valid TIN when the payee opens the account or when the payment transaction occurs. If the payee does not provide a TIN after the initial request, backup withholding must begin immediately on all reportable payments to the payee.
- **Incorrect TIN** – the IRS defines a TIN as incorrect if it is in the proper format but the name/TIN combination does not match or cannot be found on the IRS's or SSA's records. Backup withholding of 28 percent is required on payments to payees no later than 30 business days after the IRS has notified the payers of the incorrect TIN by sending CP 2100/2100A notices. These notices are sent in October of each year, subsequent to the IRS identifying the TIN as incorrect, and backup withholding occurs on payments made after that time. For example, payers that submitted TY 2013 information returns (due by March 2014) with incorrect TINs would not be notified until

¹² Some payees may have received more than one type of Form 1099.

¹³ Large payers are those that submit 250 or more missing or incorrect payee TINs.

¹⁴ Midsize payers are those that submit between 50 and 249 missing or incorrect payee TINs.

¹⁵ Small payers are those that submit less than 50 missing or incorrect payee TINs.



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October 2014, and backup withholding is required to start 30 business days after the notice if the payer does not provide a Form W-9, *Request for Taxpayer Identification Number and Certification*.

Payers must make an annual solicitation to payees in response to the CP 2100/2100A notice. Payers must send a backup withholding notice (“B” notice) and Form W-9 within 15 business days after receiving the CP 2100/2100A notice as the first solicitation. Payers must send the second “B” notice to a payee after receiving a second CP 2100/2100A notice within a three calendar-year period. Subsequent to the receipt of a second notice, the payee must provide the payer with a copy of a Social Security card with his or her correct name and Social Security Number (SSN). Payers may rely upon a Social Security card as being correct only if the name and SSN combination appearing on the card differ from the name and SSN combination appearing on the second B notice. If the TIN is an Employer Identification Number, the payee must contact and receive a letter from the IRS validating the Employer Identification Number.

A prior Treasury Inspector General for Tax Administration (TIGTA) report identified deficiencies with payment card reporting requirements

In September 2015,¹⁶ we reported that although the IRS developed processes to identify underreporting of reportable payment card transactions, additional actions were needed to enforce Form 1099-K reporting requirements. Specifically, our Calendar Year 2013 review identified 10,216 Forms 1099-K for which the payee TIN was missing. These Forms 1099-K reported gross transactions totaling more than \$10.6 billion. As such, payers were required to withhold almost \$3 billion from these payees, yet no backup withholding was reported. The \$3 billion in backup withholding is 28 percent of the gross amount of transactions reported.

Because we previously made recommendations to address the identified deficiencies and quantified the impact in our outcome measures, we excluded Forms 1099-K from the various backup withholding analyses that we performed for this review. This review was performed with information obtained from the Small Business/Self-Employed (SB/SE) Division located in Lanham, Maryland, during the period July 2015 through May 2016. 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.

¹⁶ TIGTA, Ref. No. 2015-40-089, *Additional Actions to Enforce Payment Card Reporting Requirements Could Reduce the Tax Gap* (Sept. 2015).



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In April 2016, the IRS published its most recent estimate of the Tax Gap.²⁰ The IRS estimated the average annual Tax Gap for TYs 2008 through 2010 to be \$458 billion, which the IRS reports is the amount of true tax liability that is not paid voluntarily and timely. Findings from earlier Tax Gap analyses show that compliance is higher when amounts are subject to information reporting and even higher when also subject to withholding. The extent of coverage by information reporting and withholding is called “visibility” because incomes that are reported to the IRS are more “visible” to both the IRS and taxpayers. *****2***** contributes to its continual inability to reduce the Tax Gap. In May 2016, the IRS announced plans to hire between 600 and 700 new employees in its enforcement areas. Given these additional resources, the IRS should address this important area of noncompliance.

*******2***** when payers submit information returns with missing TINs**

Our review of TY 2013 information returns identified 130,358 payers that submitted 310,779 information returns for which the payee TIN was missing. These returns reported payments totaling \$145 billion. As such, payers were required to immediately withhold almost \$41 billion from these payees, yet only \$5 million was withheld. Internal Revenue Code (I.R.C.) Section (§) 3406 requires payers to immediately backup withhold at a rate of 28 percent on reportable payments to a payee that refuses or neglects to provide a TIN.

After further analysis, we identified that 21 information returns made up \$121 billion²¹ of the \$145 billion in reported payments, and that many of these payers only submitted these very large information returns for one year. This could indicate that some of the amounts were incorrectly reported to the IRS by some of these payers. Thus, to help eliminate this potential, we identified those payers who submitted information returns for the same payee with a missing TIN for two years in a row. Our analysis identified 13,647 payers that submitted 27,576 returns with the same missing payee TIN, payee name, and payee ZIP code for two consecutive tax years (TYs 2012 and 2013). These 27,576 returns reported payments totaling about \$14.3 billion.²² As such, payers were required to immediately withhold nearly \$4 billion, yet just more than \$1 million was withheld.

²⁰ The Tax Gap is the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.

²¹ These payments ranged from more than \$1 billion to \$14 billion.

²² Our analysis identified 13,649 payers that submitted 27,578 returns with reportable payments totaling nearly \$15 billion. Upon further review of information returns reporting the highest dollar amounts, we identified and removed *****1*****.



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*****2***** **when payers submit information returns with incorrect TINs**

Our review of TY 2013 information returns identified 62,714 payers that submitted 203,751 information returns for which the payee TIN was incorrect for four consecutive years (TYs 2010 through 2013). These returns reported payments totaling \$17 billion in TY 2013. As such, payers were required to withhold nearly \$5 billion from these payees, yet only \$1 million was withheld. I.R.C. § 3406 requires payers to backup withhold at a rate of 28 percent on reportable payments to a payee after notification that the payee TIN is incorrect.

Unlike information returns with missing TINs that require payers to immediately backup withhold, payers are not required to backup withhold on payments to the payee until 30 business days after the IRS sends the payer a CP 2100 or CP 2100A notice notifying them of the incorrect payee TIN and the payer does not receive Form W-9 from the payee. If a second notice in a three calendar-year period is sent to the payer, backup withholding must begin 30 business days after the notice is sent and the payer does not receive a copy of the payee’s Social Security card or IRS letter validating the TIN from the payee.

Figure 2 provides the timeline for backup withholding requirements on information returns with incorrect TINs. Also included in this figure are the results of our analysis to identify noncompliant payers and calculate the amount of income reported, amount of backup withholding required to be withheld, and amount of backup withholding actually withheld.

Figure 2: Timeline for Information Returns With Incorrect TIN Information Subject to Backup Withholding

Date	IRS Processes and Corresponding TIGTA Analysis
March 2011	TY 2010 information returns due to the IRS and used to identify payers that submitted returns with incorrect TINs.
Results of TIGTA’s Analysis: Our analysis identified 842,863 payers that submitted 3.8 million TY 2010 information returns with an incorrect TIN.	
October 2011	CP 2100/2100A notices sent to payers that submitted TY 2010 returns with incorrect TINs. Payers send an initial backup withholding notice and Form W-9 to the payees to have the payees certify the TINs within 15 days of the payers’ receipt of the notices.
November 2011	If payee TINs were not corrected by the payees, the payers are required to begin backup withholding on subsequent payments (November and December 2011). Payers must stop backup withholding for any payees that submit required certifications, <i>i.e.</i> , Forms W-9 are received from the payees with the TIN information provided.



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Date	IRS Processes and Corresponding TIGTA Analysis
March 2012	TY 2011 information returns due to the IRS and used to identify payers that submitted TY 2011 returns with incorrect TINs.
Results of TIGTA's Analysis: Our analysis identified 268,112 payers (from the payers identified in TY 2010) that continued to submit one million TY 2011 information returns with the same incorrect TINs used on the TY 2010 returns.	
October 2012	CP 2100/2100A notices sent to payers that submitted TY 2011 returns with incorrect TINs. Payers send a second backup withholding notice and include instructions to have the payees verify the TIN by providing a copy of their Social Security card or a letter from the IRS within 15 days of the payers' receipt of the notices.
November 2012	If payee TINs were not corrected by the payees, the payers are required to begin backup withholding on subsequent payments (November and December 2012). Payers must stop backup withholding for any payees that submit required documentation, <i>i.e.</i> , a copy of their Social Security card is received from the payee with the correct TIN information provided.
March 2013	TY 2012 information returns due to the IRS.
Results of TIGTA's Analysis: Our analysis identified 134,358 payers (from the payers identified in TY 2011) that continued to submit 404,986 TY 2012 information returns with the same incorrect TINs used on the TY 2010 and TY 2011 returns. ²³	
March 2014	TY 2013 information returns due to the IRS.
Results of TIGTA's Analysis: Our analysis identified 62,714 payers that submitted 203,751 returns in TY 2013 with the same incorrect TINs used on the TYs 2010, 2011, and 2012 information returns. These TY 2013 returns reported payments totaling nearly \$17 billion. As such, payers were required to potentially withhold nearly \$5 billion, yet only \$1 million was withheld.	

Source: TIGTA analysis of TYs 2010 through 2013 IRMF; IRS Publication 1281, Backup Withholding for Missing and Incorrect Names/TIN(s); and IRS management.

When we discussed these results with IRS management on May 19, 2016, our analysis provided a three year trending (TY 2011 through TY 2013). The IRS raised concerns regarding the timing of the notices to payers and the fact that it may take payers some time to obtain the correct TIN information. To address management's concerns, we expanded our analysis to include TY 2010; thereby, providing a four year trending analysis.

²³ Backup withholding was only required for payments made in November and December 2012. Therefore, we did not include these TY 2012 returns in our outcome measure.



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Management also stated that corrective actions, including those based on a similar recommendation made in a prior TIGTA report dealing with backup withholding on Forms 1099-K²⁴ would be dependent on process review results. Further, management indicated that the exception cases identified in our current review represent less than 1 percent of all filed information returns and that they would need to determine if it was cost effective to address the noncompliance. They also stated that any proposed actions would be dependent on adequate funding to implement the changes.

Finally, management raised concerns that some of the payers may have received a Form W-9 from a payee which would result in no backup withholding. *****2*****
*****2*****. As such, we were unable to account for this in our analysis. Notwithstanding, if some of the 62,714 payers received a Form W-9, it brings into question the effectiveness of the Form W-9 process. Our analysis shows each of the 203,751 information returns filed by the 62,714 payers continued to use an incorrect TIN for four consecutive years. As a result, *****2*****
*****2*****.

Further, management's statement that the exception cases we identified represent less than 1 percent of all filed information returns seems to further support their lack of understanding of how these less than 1 percent may contribute to billions of dollars in the Tax Gap. The dollar amount at risk alone, regardless of the percentage it represents of all information returns, should warrant management's immediate attention to address the lack of processes to enforce payer compliance with backup withholding requirements.

It should be noted that despite management's position as to the significance of the noncompliance we identified, the IRS informed us that it initiated a strategy, in response to our prior report, to help address information return compliance. The strategy includes a Service-wide view of the information returns system including the scope of information returns and their related processes, risks, and risk mitigation efforts and opportunities. In addition, the IRS will look at the current processes for treating noncompliance and address any gaps in those processes along with identifying deficiencies. The IRS plans to have this strategy completed by December 2016.

Recommendation

Recommendation 1: The Commissioner, SB/SE Division, should establish a Service-wide information returns backup withholding enforcement strategy. This should include specific time frames and actions that will be taken to identify and enforce payer noncompliance with backup withholding provisions.

²⁴ TIGTA, Ref. No. 2015-40-089, *Additional Actions to Enforce Payment Card Reporting Requirements Could Reduce the Tax Gap* (Sept. 2015).



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Management's Response: The IRS agreed with this recommendation. As a result of TIGTA's prior audit, the IRS is already evaluating its backup withholding process, identifying improvement opportunities, and determining overall oversight responsibility. These efforts will form the framework for the establishment of an enforcement strategy. However, management disagreed with our outcome measure and cited a number of factors they believe may affect the outcome. Factors cited by the IRS include the possibility that the population could include entities that are exempt from backup withholding or payments below the backup withholding threshold. In addition, a payer is only required to withhold until it receives a TIN and is not required to continue to withhold until that TIN is reported to the IRS. Moreover, for documents with invalid TINs, a payer is not required to withhold once a W-9 is received, *****2*****. *****2*****. Furthermore, amounts withheld by the payer are refundable if the recipient certifies the income was reported.

Office of Audit Comment: The IRS does not have data to indicate whether the potential factors cited above are applicable and they provided no analysis or support for the concerns they raised. To the extent that information was available, we considered it in our analysis. For example, TIGTA's analysis excluded payments below the backup withholding threshold, so there are no such cases included in the outcome.

The fact remains that *****2*****. *****. As we state in our report, the actual amount in potential revenue protected is dependent upon the IRS implementing an effective process to *****2***** with backup withholding provisions.

There Is No Justification for Criteria Used to Exclude Payers From Receiving Missing or Incorrect TIN Notices

Although the IRS identified more than 18.9 million TY 2013 information returns subject to backup withholding with missing or incorrect payee TINs, it only notified payers associated with 10.8 million (57 percent) of these returns. The remaining 8.1 million were excluded from the payer notification process. The IRS uses filter criteria to exclude payers of specific information returns containing a missing or incorrect TIN. The IRS indicated that the filter criteria were established to promote compliance and minimize payer burden. Figure 3 illustrates the criteria to exclude information returns from receiving a notice and their associated volumes.



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Figure 3: IRS Notice Criteria and the Volume of Information Returns Excluded From Receiving a Notice in Tax Year 2013

Filter Criteria	Number of Information Returns
*****2*****	11
*****2*****	193,201
*****2*****	1,147,285
*****2*****	1,918,118
*****2*****	321,142
*****2*****	516,860
*****2*****	930,567
*****2*****	1,909,751
*****2***** ²⁵	1,201,442
*****2*****	
*****2*****	
Total Number of Information Returns Excluded From the Notice File	8,138,377

Source: IRS Information Technology organization management.

We requested the justification for each of the filters to assess the IRS’s basis for excluding certain information returns from the notice issuance process. However, management stated that the criteria used to exclude payers from the notice file were developed many years ago and that they did not know why certain criteria were being used.

Because a notice is required to be issued to payers that submit information returns with incorrect TINs before backup withholding is required and the IRS can enforce backup withholding from a payer that fails to withhold, it is important for the IRS to establish specific criteria and ensure that notices are being properly sent to payers.

Recommendation

Recommendation 2: The Commissioner, SB/SE Division, should evaluate and document the criteria used to exclude information returns with missing or incorrect TINs from payer notification.

²⁵ The Payer Master File is a database of information relating to filers of information returns e.g., Form 1099 series and is maintained for five tax years.



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Management's Response: The IRS agreed with this recommendation. The IRS is validating existing business rules used to currently generate CP 2100/2100A notices and will reestablish the repository of business rules for the generation of CP 2100/2100A notices. The IRS will institute required updates within Information Technology capacity and resource restraints.

Forms 1099-G, Certain Government Payments, Are Erroneously Excluded From Backup Withholding

Subsequent to completing our analysis of backup withholding, we identified that the IRS erroneously excluded Forms 1099-G, *Certain Government Payments*, with missing or incorrect TINs from the payer identification and notice issuance processes. I.R.C. § 3406 requires backup withholding related to certain taxable grants and agriculture payments reported on Form 1099-G to payees with missing or incorrect TINs. In addition, our review also identified that Publication 1281 and certain information on the IRS website was incomplete as it relates to Form 1099-G and backup withholding provisions. When we brought this to management's attention, they confirmed that certain reportable payments reflected on Form 1099-G are in fact subject to backup withholding. However, they also pointed out that the Form 1099-G instructions contain information that payments in boxes 6 (taxable grants) and 7 (agricultural payments) are subject to backup withholding.

Recommendations

The Commissioner, SB/SE Division, should:

Recommendation 3: Update payer identification and notification processes to include Forms 1099-G with missing or incorrect payee TINs.

Management's Response: The IRS agreed with this recommendation. The IRS will establish business rules to include Form 1099-G payments that are subject to backup withholding under I.R.C. §§ 6041 and 3406 (b)(3)(A), which include taxable grants and agricultural payments (Form 1099-G Box 6 or 7), and submit an appropriate Unified Work Request by November 15, 2017. However, the implementation of such programming changes is subject to budgetary constraints, limited resources, and competing priorities. Therefore, with the submission of the Unified Work Request by that date, the IRS will consider this commitment to be complete.

Recommendation 4: Update all applicable publications, instructions, and website information to include Forms 1099-G as the payments relate to backup withholding provisions.

Management's Response: The IRS agreed with this recommendation. The IRS will update Publication 1281 and include Form 1099-G. The IRS will also search



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publications, instructions, and notices which have backup withholding as a topic to ensure that they reference Form 1099-G as appropriate.

Billions of Dollars in Income Is Reported for Individuals Who Have Been Deceased for More Than Two Years

Our review of TY 2013 information returns identified 2.3 million returns submitted by payers for 1.6 million individuals in which the payee TIN was that of a deceased individual.²⁶ These 2.3 million returns had reportable payments totaling \$4 billion. A match of IRS tax records further identified that the 1.6 million deceased payee TINs were used on only 482 TY 2013 tax returns. Generally, information returns should not be submitted using the SSN of a deceased taxpayer for identification of the payee. These deceased taxpayer SSNs are likely being used because payers have not been notified about the death of a payee or *****2*****
2*. Figure 4 illustrates the information returns by type with deceased payee SSNs.

Figure 4: TY 2013 Analysis of Deceased Taxpayer SSNs Submitted on Information Returns Subject to Backup Withholding²⁷

Form Type	Total Unique Payers	Total Unique Payees	Total Number of Returns	Total Amount Reported
Form 1099-MISC	35,688	169,772	224,722	\$1,679,561,798
Form 1099-B	1,733	53,258	56,905	\$1,140,153,806
Form 1099-DIV	8,706	879,642	1,281,520	\$843,813,900
Form 1099-INT	15,417	512,253	752,460	\$378,174,788
Form 1099-PATR	1,229	18,129	19,079	\$176,086,427
Form 1099-OID	230	5,328	9,189	\$5,883,015
Form W-2G	336	769	1,285	\$2,361,105
Total	63,339	1,639,151	2,345,160	\$4,226,034,839

Source: TIGTA analysis of the IRMF and National Account Profile.

In September 2015, we reported that our review of Calendar Year 2013 Forms 1099-K found that the IRS received 2,933 Forms 1099-K with gross transactions totaling \$543.9 million for which the payee SSN was that of a deceased individual.²⁸ The IRS’s TIN Matching Program does not include an indicator to alert payers that the payee TIN they are attempting to verify is that of a

²⁶ These individuals were deceased *at least two years* prior to the issuance of the information return.

²⁷ The payers/payees are unique to each individual type of information document. However, the payers/payees are not unique when including all information documents listed in Figure 4.

²⁸ TIGTA, Ref. No. 2015-40-089, *Additional Actions to Enforce Payment Card Reporting Requirements Could Reduce the Tax Gap* (Sept. 2015).



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deceased individual. We recommended that the IRS add an indicator on the TIN Matching Program alerting a payer of a payee's use of a deceased taxpayer SSN. The IRS agreed with this recommendation, stating it would first evaluate if a general indicator can be added to the TIN Matching Program without violating disclosure rules. If such an indicator was legally permissible, then the IRS would evaluate the cost/benefit of programming changes and take the appropriate actions.

The IRS evaluated our previous recommendation but determined that alerting a payer of a payee's use of a deceased taxpayer SSN is an improper disclosure and violates I.R.C. § 6103. However, the IRS also recognizes the potential significance of this issue and requested that we provide them with the data analysis we performed to identify the 2.3 million information returns with a deceased payee TIN. The IRS stated that it would review this information to determine how best to address this issue.

Recommendation

Recommendation 5: The Commissioner, SB/SE Division, should include specific actions that will be taken to address information return reporting of income under a deceased individual TIN as part of the IRS's development of the information returns compliance strategy.

Management's Response: The IRS agreed with this recommendation. The IRS will include specific actions to address information return reporting under a decedent TIN as it develops the Information Returns Compliance Strategy. However, management noted that with respect to decedents' TINs, a significant amount of the payments are already reported by surviving spouses and estates linked to the TIN.

Office of Audit Comment: At no point during our review did the IRS provide documentation to support their statement that income related to deceased individuals was reported by surviving spouses and estates. As stated in our report, the 2.3 million returns we identified had reportable payments totaling \$4 billion. A match of IRS tax records further identified that, of the 1.6 million deceased payee TINs shown on information returns in TY 2013, only 482 of these TINs were used to file a TY 2013 tax return.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to assess the IRS's actions to ensure compliance with backup withholding¹ provisions. To accomplish our objective, we:

- I. Determined the most effective organizational structure for identifying and addressing noncompliance with backup withholding.
 - A. Reviewed current Internal Revenue Manual processes and procedures for working backup withholding cases for the various functions.
 - B. Interviewed IRS management concerning plans to address prior TIGTA recommendations to establish a process to identify and enforce backup withholding requirements on Forms 1099-K, *Payment Card and Third Party Network Transactions*.
- II. Determined the accuracy and completeness of the CP 2100/2100A, *Please Check Your Backup Withholding List*, notices sent to payers that submit information returns with missing or incorrect TINs.²
 - A. Reviewed the IRS's processes and procedures to generate systemic notices to payers that submit information returns with missing or incorrect TINs.
 - B. From the IRMF,³ identified 117,627 payers that submitted TY 2013⁴ information returns subject to backup withholding that were submitted by payers with missing or incorrect payee TINs and compared to the data extract of the CP 2100/2100A notice files⁵ to determine if all payers properly received a notice.
- III. Determined the effectiveness of the IRS's actions to identify noncompliance with backup withholding requirements for payers submitting information returns with missing or incorrect payee TINs.

¹ Backup withholding provisions require payers to withhold 28 percent of certain reportable payments associated with payees that do not provide the payer with a TIN or payees that provide the payer with an incorrect TIN.

² A TIN is used by the IRS in the administration of tax laws. It is issued either by the SSA for SSNs or by the IRS for Employer Identification Numbers and Individual Taxpayer Identification Numbers.

³ Creates a Master File of current tax year information returns and maintains access to nine prior years.

⁴ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

⁵ The CP 2100/2100A notice file is used to generate notices to payers that submitted invalid information returns subject to backup withholding.



Due to the Lack of Enforcement, Taxpayers Are Avoiding Billions of Dollars in Backup Withholding

- A. Assessed the effectiveness of the IRS's backup withholding program (processes and procedures) intended to identify payers submitting information returns with missing or incorrect payee TINs that fail to backup withhold as required.
 - B. Interviewed IRS management to determine if future processes and procedures are planned to identify payers that fail to backup withhold as required.
- IV. Determined the effectiveness of the IRS's actions to enforce backup withholding requirements on payers submitting information returns with missing or incorrect payee TINs.
- A. Determined if the IRS is effectively identifying and assessing tax on payers submitting information returns with missing payee TINs that fail to immediately backup withhold as required.
 - 1. From the IRMF, identified 130,358 payers in TY 2013 that failed to immediately backup withhold as required and the tax that should have been withheld.
 - 2. From the IRMF, identified 13,647 payers in TY 2013 that submitted information returns with missing TINs in consecutive years (TYs 2012 and 2013) and failed to backup withhold as required.⁶
 - 3. Determined if the IRS effectively tracked and assessed tax on payers that failed to immediately backup withhold.
 - B. Determined if the IRS is effectively identifying and assessing tax on payers submitting information returns with incorrect payee TINs in consecutive years that fail to backup withhold as required.
 - 1. From the IRMF, identified 3.2 million TY 2011 information returns that were submitted by payers with incorrect payee TINs from the IRMF and determined if notices were properly sent to these payers by analyzing the CP 2100/2100A notice files.
 - 2. From the IRMF, determined if information returns were submitted in TYs 2011, 2012, and 2013 with the same incorrect payee name/TINs identified in TY 2010 submissions.
 - 3. From the IRMF, identified 62,714 payers that failed to backup withhold as required and the tax that should have been withheld.
 - 4. Determined if the IRS effectively tracked and assessed tax on payers that failed to backup withhold as required.

⁶ Our analysis identified 13,649 payers that submitted 27,578 returns with reportable payments totaling nearly \$15 billion. Upon further review of information returns reporting the highest dollar amounts, we identified and removed *****1*****.



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- V. Assessed the effectiveness of the IRS's Information Returns Processing validation processes and procedures intended to identify invalid payee name/TIN combinations and ensure backup withholding as required.
- A. Assessed the effectiveness of the IRS's Information Returns Processing validation processes and procedures for information returns submitted with deceased individuals as payee TINs.
1. Interviewed IRS management and reviewed the processes and procedures for identifying information returns with deceased individuals as payee TINs.
 2. Determined if the planned corrective actions for the prior TIGTA recommendation to include deceased individuals on the TIN Matching System were implemented. We determined what actions were taken and when the final corrective actions will be completed.
 3. Performed research and analysis to determine if any disclosure issues exist by having the IRS notify payers when an information document submitted by a payer contains an SSN of a deceased taxpayer.
 4. From the IRMF, identified 2.3 million TY 2013 information returns subject to backup withholding that had deceased individual SSNs as payee TINs and determined the amount reported by analyzing a data extract of the IRMF and comparing it to the SSA National Account Profile.

Data validation methodology

During this review, we relied on data stored at TIGTA's Data Center Warehouse and performed analysis of data extracted from the IRMF for TYs 2010, 2011, 2012, and 2013 and the CP 2100/2100A notice files for TY 2013. To assess the reliability of computer-processed data, programmers within TIGTA's Data Center Warehouse validated the data files we extracted while we ensured that each data extract contained the specific data elements we requested and that the data elements were accurate. For example, we reviewed judgmental samples of the data extracts and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System.⁷ As a result of our testing, we determined the data used in our review were reliable.

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 that the

⁷ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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following internal controls were relevant to our audit objective: 1) processes and procedures to identify noncompliance and enforce compliance of backup withholding requirements; 2) processes and procedures to ensure the accuracy and completeness of the Payer Master File and CP 2100/2100A notice file; and 3) processes and procedures to identify information returns with deceased individuals as payee TINs. We evaluated these controls by reviewing IRS's Internal Revenue Manuals used by various business operating divisions, interviewing IRS management, reviewing relevant I.R.C. sections and Treasury Regulations applicable to the backup withholding program, and evaluating applicable documentation and management information reports.



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Appendix II

Major Contributors to This Report

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)

Diana M. Tengesdal, Director

Larry Madsen, Audit Manager

Stephen Elix, Lead Auditor

Jeremy Berry, Auditor



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Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Services and Enforcement
Chief Information Officer
Director, Examination
Director, Office of Audit Coordination



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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact 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:

- Revenue Protection – Potential; \$3,991,077,405¹ in backup withholding² if ***2*****
*****2*****(as specified by the I.R.C.) when submitting information returns with missing payee TINs³ that are subject to backup withholding (see page 5).

Methodology Used to Measure the Reported Benefit:

We received an IRMF⁴ extract for TY 2013 information returns subject to backup withholding. We then identified information returns with missing payee TINs (by analyzing certain data fields from the extract) and removed information returns that were not subject to backup withholding, e.g., duplicate returns, certain amended returns, *****2*****.

Our review of TY⁵ 2013 information returns subject to backup withholding found that the IRS received 310,779 returns from 130,358 payers with payments totaling \$145 billion with missing payee TINs. After further analysis, we found that almost \$41 billion was subject to backup withholding. However, only \$5 million in backup withholding was taken of the almost \$41 billion subject to backup withholding. The almost \$41 billion in backup withholding is based on 28 percent of the total reportable payments amount that is subject to backup withholding net of \$5 million in backup withholding taken by the payers.

After further analysis, we identified that 21 information returns made up \$121 billion⁶ of the \$145 billion in reported payments, and that many of these payers only submitted these very large

¹ The amount of tax required to be withheld from the total reportable payments subject to backup withholding. The amount of revenue the Government could increase in relation to the income paid to payees. The net tax effect is unknown until a payee files a tax return.

² Backup withholding provisions require payers to withhold 28 percent of certain reportable payments associated with payees that do not provide the payer with a TIN or payees that provide the payer with an incorrect TIN.

³ A TIN is used by the IRS in the administration of tax laws. It is issued either by the SSA for SSNs or by the IRS for Employer Identification Numbers and Individual Taxpayer Identification Numbers.

⁴ Creates a Master File of current tax year information returns and maintains access to nine prior years.

⁵ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

⁶ These payments ranged from more than \$1 billion to \$14 billion.



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information returns for one year. This could indicate that some of the amounts were incorrectly reported to the IRS by some of these payers. Thus, to eliminate this potential, we identified those payers who submitted information returns for the same payee with a missing TIN for two years in a row. Our analysis identified 13,647 payers that submitted 27,576 returns with the same missing payee TIN, payee name, and payee ZIP code for two consecutive tax years (TYs 2012 and 2013). These 27,576 returns reported payments totaling about \$14.3 billion.⁷ As such, payers were required to immediately withhold nearly \$4 billion, yet just more than \$1 million was withheld.

*****2*****, it will be difficult to measure the amount of income not being reported by payees and unlikely for the IRS to ensure that payees filed tax returns to report this income or the amount of backup withholding that would ultimately be refunded.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; \$4,640,755,878 in backup withholding if *****2***** *****2***** when submitting information returns with incorrect payee TINs that are subject to backup withholding (see page 5).

Methodology Used to Measure the Reported Benefit:

We received an IRMF⁸ extract for TYs 2010, 2011, 2012, and 2013 information returns subject to backup withholding. We then identified information returns with incorrect payee name/TIN combinations (by analyzing certain data fields from the extract), and removed information returns not subject to backup withholding, e.g., duplicate returns, certain amended returns, *****2*****.

Our review of TY 2010 information returns subject to backup withholding found that the IRS received 3.8 million returns from 842,863 payers totaling \$467 billion with incorrect payee TINs. We then determined if the TY 2010 information returns we identified also had the same payee TIN, payee name, and payer TIN combination in TY 2011. We found that the IRS received one million returns from 268,112 payers totaling \$91 billion with the same incorrect payee TINs. We then determined if the information returns that had the same return information in TYs 2010 and 2011 also had the same payee TIN, payee name, and payer TIN combination in TY 2012 (three consecutive years). We found that the IRS received 404,986 returns from 134,358 payers totaling \$34 billion with the same incorrect payee TINs. We finally determined if the information returns that had the same return information in TYs 2010, 2011, and 2012 also had the same payee TIN, payee name, and payer TIN combination in TY 2013 (four consecutive

⁷ Our analysis identified 13,649 payers that submitted 27,578 returns with reportable payments totaling nearly \$15 billion. Upon further review of information returns reporting the highest dollar amounts, we identified and removed *****1*****.

⁸ Creates a Master File of current tax year information returns and maintains access to nine prior years.



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years). We found that the IRS received 203,751 returns from 62,714 payers totaling \$17 billion with the same incorrect payee TINs. After further analysis, we found that nearly \$5 billion was subject to backup withholding. However, only \$1 million in backup withholding was taken of the nearly \$5 billion subject to backup withholding. The nearly \$5 billion in backup withholding is based on 28 percent of the total reportable payments amount that is subject to backup withholding net of \$1 million in backup withholding taken by the payer.

IRS management raised concerns that some of the payers may have received a Form W-9 from a payee which would result in no backup withholding. *****2*****
*****2*****and as such we were unable to include this in our analysis. In addition, until *****2*****, it will be difficult to measure the amount of income not being reported by payees and unlikely for the IRS to ensure that payees filed tax returns to report this income or the amount of backup withholding that would ultimately be refunded.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 2,345,160 information returns subject to backup withholding could have been identified and corrected from being submitted with deceased individuals’ TINs as payee TINs (see page 13).

Methodology Used to Measure the Reported Benefit:

Our review of TY 2013 information returns subject to backup withholding found that the IRS received 2,345,160 returns from 63,339 payers totaling \$4 billion for deceased individuals who were deceased two years prior to the information return reportable payments; therefore, we assume the income likely does not belong to the taxpayer.

We received an IRMF extract for TY 2013 information returns subject to backup withholding. We then identified information returns with payee TINs of deceased individuals by analyzing the SSA file that includes dates of death. We filtered for individuals who were deceased two years prior (on or before December 31, 2012) to the information return reportable payments.



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Appendix V

*List of Information Returns
Subject to Backup Withholding*

- Form 1099-MISC, *Miscellaneous Income* – Rents and commissions, nonemployee compensation for services, royalties, reportable gross proceeds paid to attorneys, and other fixed or determinable gains, profits, or income payments.
- Form 1099-INT, *Interest Income* – Interest income (reduced by early withdrawal penalty), interest on U.S. Savings Bonds and Treasury obligations, and tax-exempt interest.
- Form 1099-K, *Payment Card and Third Party Network Transactions* – Gross amount of payment card/third party-network transactions only if the payee has received payment from the third-party settlement organization in more than 200 transactions (the monetary threshold is not considered for this purpose) within a calendar year. There are no limiting thresholds for payments made in settlement of payment card transactions.
- Form 1099-DIV, *Dividends and Distributions* – Certain dividend payments reported on the form.
- Form 1099-PATR, *Taxable Distributions Received From Cooperatives* – Patronage dividends, nonpatronage distributions, per-unit retain allocations, taxable distributions received from cooperatives, and redemption of nonqualified notices and retain allocations to the extent such payments are in cash or qualified check.
- Form 1099-OID, *Original Issue Discount* – Original issue discount (reduced by early withdrawal penalty), other periodic interest (reduced by early withdrawal penalty), and original issue discount on U.S. Treasury obligations but limited to cash paid on these obligations.
- Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions* – Certain gross proceeds required to be reported on this form.



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- Form W-2G, *Certain Gambling Winnings* – Gambling winnings reportable on Form W-2G unless subject to regular gambling withholding, which is 25 percent of gambling winnings greater than \$5,000 (net of wager) for Federal tax. If not subject to regular gambling withholding, backup withholding¹ applies only if the payee does not furnish a TIN² to the payer.
- Form 1099-G, *Certain Government Payments* – Payments related to certain taxable grants and agriculture payments.

¹ Backup withholding provisions require payers to withhold 28 percent of certain reportable payments associated with payees that do not provide the payer with a TIN or payees that provide the payer with an incorrect TIN.

² A TIN is used by the IRS in the administration of tax laws. It is issued either by the SSA for SSNs or by the IRS for Employer Identification Numbers and Individual Taxpayer Identification Numbers.



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Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER
SMALL BUSINESS/Self-EMPLOYED DIVISION

AUG 11 2016

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Karen Schiller 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Due to the Lack of Enforcement, Taxpayers
Are Avoiding Billions of Dollars in Backup Withholding (Audit #
201540029)

Thank you for the opportunity to review the subject draft report. The purpose of backup withholding is to make sure that the Government is able to collect taxes on all appropriate income, particularly income that is not usually subject to withholding. Payers of certain income types must deduct and withhold tax if certain criteria are not met, such as the payee failing to furnish a Taxpayer Identification Number (TIN) to the payer (a missing TIN); the IRS notifying the payer that the payee name and TIN submitted to the IRS does not match its records (an incorrect TIN); the IRS notifying the payer that a payee has underreported income from interest and dividends; or the payee failing to certify that they are not subject to backup withholding.

We have substantial existing products and processes designed to assist payers in understanding and complying with their information return and backup withholding responsibilities. These include the TIN Matching Program, the instructions to the forms, our publications and other web-based information. Through the notice process, the IRS is able to identify and alert the payer to potential non-compliance. As such, we have a very high rate of compliance with this population. Indeed, for tax year 2013, 98.7 percent of information reports subject to backup withholding contained correct TINs.

We note that, as a result of your previous audit and recommendations, we had convened a team to review the back-up withholding process from beginning to end. The team has been mapping and validating the existing processes in order to identify and evaluate potential gaps. They are looking for solutions to close any identified gaps in our process that can be implemented with our current available resources. As TIGTA knows, since 2010, IRS has lost more than 5,000 employees in our enforcement area. Although we are working to add some new enforcement hires to be spread across our various compliance functions, this will not replace the deficit created by those employees who have left and continue to leave. We will continue to make measured



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allocation decisions on the best use of our limited resources amongst our program areas.

While we agree that we need to continue to work on making progress in this area, we disagree with your outcome measures, as they are overstated. For documents with missing TINs, your revenue protection estimate does not account for entities that are exempt from backup withholding or for payments below the backup withholding threshold. Also, your estimate does not account for the fact that a payer is only required to withhold until it receives a TIN and is not required to continue to withhold until that TIN is reported to the IRS. For documents with invalid TINs, your estimate is overstated because a payer is not required to withhold once a W-9 is received, *****2*****
*****2*****. In addition, amounts withheld by the payer are refundable if the recipient certifies the income was reported and thus the net potential revenue protected is less than stated in your report. Similarly, with respect to decedents' TINs, a significant amount of the payments are already reported by surviving spouses and estates linked to the TIN.

In conclusion, we agree with the recommendations contained in your report. We will utilize the recommendations and findings in your report as we finalize and implement our strategy. However, we must ensure our revised procedures are not in conflict with Internal Revenue Code Section 6103 which limits our ability to disclose tax return information to third parties. Attached is a detailed response outlining our corrective actions to address your recommendations. If you have any questions, please contact me, or a member of your staff may contact Shenita Hicks, Director, Examination, Small Business/Self-Employed Division at 240-613-2849.

Attachment



Due to the Lack of Enforcement, Taxpayers Are Avoiding Billions of Dollars in Backup Withholding

Attachment

RECOMMENDATION 1:

The Commissioner, SB/SE Division, should establish a Service-wide information returns backup withholding enforcement strategy. This should include specific time frames and actions that will be taken to identify and enforce payer noncompliance with backup withholding provisions.

CORRECTIVE ACTION:

IRS agrees with the recommendation and, as a result of your prior audit, we are already evaluating our backup withholding process; identifying improvement opportunities and determining overall oversight responsibility. These efforts will form the framework for the establishment of an enforcement strategy.

IMPLEMENTATION DATE:

March 15, 2017

RESPONSIBLE OFFICIAL:

Director, Examination Operations, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:

The Commissioner, SB/SE Division, should evaluate and document the criteria used to exclude information returns with missing or incorrect TINs from payer notification.

CORRECTIVE ACTION:

We are validating existing business rules used to currently generate Form CP 2100/2100A and will re-establish the repository of business rules for the generation of CP 2100/2100A. We will institute required updates within Information Technology capacity and resource constraints.

IMPLEMENTATION DATE:

November 15, 2017

RESPONSIBLE OFFICIAL:

Director, Examination Operations, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.



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RECOMMENDATION 3:

The Commissioner, SB/SE Division, should update payer identification and notification processes to include Forms 1099-G with missing or incorrect payee TINs.

CORRECTIVE ACTION:

We will establish the business rules to include Form 1099-G payments that are subject to backup withholding under IRC 6041 and 3406(b)(3)(A) which include taxable grants and agricultural payments (1099-G Box 6 or 7) and submit an appropriate Unified Work Request (UWR) by November 15, 2017. However, the implementation of such programming changes is subject to budgetary constraints, limited resources and competing priorities. So, with the submission of the UWR by that date, we will consider this commitment to be complete.

IMPLEMENTATION DATE:

November 15, 2017

RESPONSIBLE OFFICIAL:

Director, Examination Field and Campus Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:

The Commissioner, SB/SE Division, should update all applicable publications, instructions, and website information to include Forms 1099-G as the payments relate to backup withholding provisions.

CORRECTIVE ACTION:

IRS agrees with this recommendation. We will update Publication 1281, Backup withholding for Missing and Incorrect Name/TIN(s) question and include Form 1099-G, Certain Government Payments. We will also search publications, instructions, and notices which have backup withholding as a topic to ensure they reference 1099-G as appropriate.

IMPLEMENTATION DATE:

March 15, 2018

RESPONSIBLE OFFICIAL:

Director, Examination Field and Campus Policy, Small Business/Self-Employed Division



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CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 5:

The Commissioner, SB/SE Division, should include specific actions that will be taken to address information return reporting of income under a deceased individual TIN as part of the IRS's development of the information returns compliance strategy.

CORRECTIVE ACTION:

IRS agrees with the recommendation. We will include specific actions to address information return reporting under a decedent TIN as we develop the Information Returns Compliance Strategy.

IMPLEMENTATION DATE:

March 15, 2017

RESPONSIBLE OFFICIAL:

Director, Examination Operations

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.