



*Case Selection Processes Result in
Billions of Dollars in Potential Employer
Underreported Tax Not Being Addressed*

July 26, 2017

Reference Number: 2017-40-038

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HIGHLIGHTS

CASE SELECTION PROCESSES RESULT IN BILLIONS OF DOLLARS IN POTENTIAL EMPLOYER UNDERREPORTED TAX NOT BEING ADDRESSED

Highlights

Final Report issued on July 26, 2017

Highlights of Reference Number: 2017-40-038 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed and the Wage and Investment Divisions.

IMPACT ON TAXPAYERS

The Combined Annual Wage Reporting (CAWR) Program compares the employee wage and withholding information reported to the IRS on employment tax forms to withholding documents filed with the Social Security Administration. The purpose of the IRS-CAWR Program is to ensure that employers report the proper amount of employment taxes and Federal income tax withholding on their employment tax returns.

WHY TIGTA DID THE AUDIT

This audit was initiated to evaluate whether the IRS-CAWR Program's document matching process accurately identifies and selects the most productive cases.

WHAT TIGTA FOUND

Billions of dollars of potential employer underreported taxes are not being addressed because most discrepancy cases are not worked. TIGTA's analysis of 137,272 Tax Year (TY) 2013 discrepancy cases found that the IRS worked only 23,184 (17 percent). The remaining 114,088 (83 percent) discrepancy cases that were not worked had a potential underreported tax difference of more than \$7 billion.

In addition, discrepancy case selection processes do not ensure that priority is given to working discrepancy cases with the highest potential tax assessment. TIGTA analyzed the 114,088 discrepancy cases that were not worked to identify those 23,184 with the highest potential underreported tax amounts by case

type. It turned out that these had total potential underreported tax of more than \$6.8 billion.

Further, TIGTA's analysis of the 114,088 TY 2013 unworked IRS-CAWR discrepancy cases showed that if the IRS had selected the 23,184 auto-generated cases with a higher average assessment potential to work, it would have selected cases with more than \$128 million in assessment potential. In addition to changing its selection methodology to work case types with the highest potential tax assessment, the IRS could further increase its return on investment by including prior year discrepancy cases when working current year discrepancy cases for the same employer. TIGTA's analysis found that 3,137 of the discrepancy cases identified in TY 2013 also had discrepancy cases in TY 2012, with potential underreported tax totaling more than \$448 million for TY 2012.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division, evaluate the current agreement and workload processes with the Social Security Administration, as required, to determine if changes could be made; revise its case selection criteria to include auto-generated cases with the highest potential tax assessment; coordinate with the Information Technology organization to review and prioritize programming enhancements; and take actions necessary to implement the proposed upgrade to include prior year discrepancy cases when current year discrepancy cases are selected for the same employer.

The IRS agreed with six of seven recommendations. IRS management did not agree to include prior year discrepancy cases when current year discrepancy cases are selected for the same employer. However, it will consider employers that have a prior year discrepancy case as part of the selection criterion for current year cases.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 26, 2017

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

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Case Selection Processes Result in Billions of Dollars in Potential Employer Underreported Tax Not Being Addressed (Audit # 201540030)

This report presents the results of our review to evaluate whether the Internal Revenue Service's Combined Annual Wage Reporting Program document matching process accurately identifies and selects the most productive cases. This review is included in our Fiscal Year 2017 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

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

Copies of this report are also being sent to the Internal Revenue Service 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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Abbreviations

BMF	Business Master File
CAP	Combined Annual Wage Reporting Automated Program
CAWR	Combined Annual Wage Reporting
EIN	Employer Identification Number
FTE	Full-Time Equivalent
FY	Fiscal Year
IRS	Internal Revenue Service
OPERA	Office of Program Evaluation and Risk Analysis
SB/SE	Small Business/Self-Employed
SSA	Social Security Administration
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year



Case Selection Processes Result in Billions of Dollars in Potential Employer Underreported Tax Not Being Addressed

Background

Employers are required to annually report to the Social Security Administration (SSA) wage and withholding information for each employee on Form W-2, *Wage and Tax Statement*, through a process called the Annual Wage Reporting. Prior to Calendar Year 2017,¹ employers were required to submit their Forms W-2 to the SSA by March 31 each year along with a Form W-3, *Transmittal of Wage and Tax Statements*, which is a summary of the submitted Forms W-2. Employers are also required to report and submit to the Internal Revenue Service (IRS) Federal taxes withheld from employees on Form 941, *Employer's QUARTERLY Federal Tax Return*; Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees*; Form 944, *Employer's ANNUAL Federal Tax Return*, or Form 945, *Annual Return of Withheld Federal Income Tax*² (collectively referred to hereafter as an employment tax return).

Combined Annual Wage Reporting (CAWR) Program

The SSA and the IRS have an agreement to exchange employment tax data. The CAWR Program consists of two parts: SSA-CAWR and IRS-CAWR. The purpose of the SSA-CAWR Program is to ensure that employees receive proper credit for covered earnings.³ The purpose of the IRS-CAWR Program is to ensure that employers report the proper amount of taxes and Federal tax withholding (hereafter referred to as withholding). The CAWR Program is a document matching program that compares the employee wage and withholding information reported by the employer to the IRS on an employment tax return to what was reported to the SSA on Forms W-3, W-2, W-3c, *Transmittal of Corrected Wage and Tax Statements*, W-2c, *Corrected Wage and Tax Statement*, and to the IRS on Forms 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, and W-2G, *Certain Gambling Winnings*. The IRS refers to this annual comparison of SSA and IRS records as the Annual Wage Reporting Reconciliation, which results in the identification of

¹ The Consolidated Appropriations Act of 2016, Pub. L. No. 114-113, requires employers to submit third-party income and withholding information, *i.e.*, Forms W-2 and any returns or statements required to report nonemployee compensation, on or before January 31 of the following tax year. This will be effective for Tax Year 2016 and requires that third-party income and withholding information be submitted to the SSA on or before January 31, 2017.

² Wages and withholding are also reported on Schedule H, *Household Employment Taxes*, attached to Form 1040, *U.S. Individual Income Tax Return*, or Form 1041, *U.S. Income Tax Return for Estates and Trusts*.

³ SSA-CAWR cases are discrepancy cases for which employers report more Social Security and Medicare wages to the IRS on their employment tax returns than is reported to the SSA on Forms W-2. A worker's covered earnings, as documented in the SSA's records, determine both eligibility for Social Security benefits and the proper amount of such benefits.



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CAWR discrepancy cases. A discrepancy case is identified when the amount of wages and withholding reported by an employer on Forms W-2/W-3 submitted to the SSA or Forms 1099-R or W-2G submitted to the IRS do not agree with the amount of wages and withholding the employer reported to the IRS on its employment tax return.

Form W-3 perfection process

Form W-3 is essential to the CAWR Program and the Annual Wage Reporting Reconciliation because the amounts associated with Form W-3 are used to identify employers that are underreporting or not reporting wages and withholding on their tax return. Once Forms W-3 are received from the SSA, the IRS's Information Technology organization loads the Forms W-3 data onto the IRS's Business Master File (BMF).⁴ However, before the Form W-3 data can be loaded onto the BMF, validity checks are performed to ensure that the Employer Identification Number (EIN)⁵ and name control⁶ on the Forms W-3 match IRS records. A name control and EIN that matches IRS records is needed for the IRS to match the Forms W-3 to any corresponding tax return filings to determine whether an employer reported the complete amount of wages and withholding to the IRS. When the name control or EIN listed on the Form W-3 does not match IRS records, the Form W-3 is considered unpostable. Unpostable Form W-3 records are sent to the IRS's Unpostable function located at the Cincinnati, Ohio, Submission Processing Center, where IRS employees attempt to perfect the documents.

Identification of IRS-CAWR discrepancy cases

The IRS-CAWR Program identifies discrepancy cases to be worked two tax years behind the current tax year to allow employers time to file Forms W-3/W-2 and Forms W-2c/Forms W-3c with the SSA, as well as employment tax returns with the IRS. For example, in April 2016, the CAWR Program began working Tax Year (TY) 2014 IRS-CAWR discrepancy cases. Discrepancy cases are identified by an automated process that compares an employers' wage and withholding information reported on Forms W-3/W-2 to the wage and withholding information reported on the employers' employment tax return. As part of this comparison, the automated process computes the total potential underreported tax for the discrepancy cases. For TY 2014,⁷ the total potential underreported tax is calculated by summing the following amounts:

⁴ The IRS database that consists of Federal tax-related transactions of accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

⁵ A unique nine-digit number used to identify a taxpayer's business account.

⁶ The first four letters of the taxpayer's last name (in the case of individuals) and the first four letters of the business name (in the case of partnerships, corporations, *etc.*). The name control is used to check the Master File and assure that the Taxpayer Identification Number corresponds with the proper taxpayer.

⁷ The Social Security and Medicare tax percentages were the same as shown for our review of the TY 2013 IRS-CAWR discrepancy cases.



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- Social Security Tax – Social Security tax owed is the amount of underreported Social Security wages multiplied by 12.4 percent.
- Medicare Tax – Medicare tax owed is the amount of underreported Medicare wages multiplied by 2.9 percent.
- Federal Income Tax – Federal income tax withheld and not reported or paid to the IRS.

Figure 1 illustrates how the information from the employment tax return, Form W-3, and Forms W-2 is compared. In this hypothetical example, the comparison of the employment tax return information to the Forms W-3/W-2 information identifies that the employer underreported Social Security wages and tips, Medicare wages, and Federal income tax withheld.

Figure 1: Hypothetical Example of CAWR Document Matching Process

	Amount Reported on the Employment Tax Return	Amount Reported on Form W-3	Amount Reported on Forms W-2	Difference in Amounts on the Employment Tax Return and Form W-3	Potential Underreported Tax (Calculated)
Social Security Wages and Tips	\$93,000	\$130,000	\$130,000	\$37,000	\$4,588
Medicare Wages	\$93,000	\$130,000	\$130,000	\$37,000	\$1,073
Federal Income Tax Withheld	\$9,000	\$13,000	\$13,000	\$4,000	\$4,000
TOTAL					\$9,661

Source: Hypothetical IRS-CAWR discrepancy case.

The Annual Wage Reporting Reconciliation is an automated matching process that creates a CAWR module for each employer on the BMF. Each CAWR module is a summary of an employer’s employment tax activity for that year. If the amounts match or if the potential underreported tax is within a certain dollar tolerance, the module is considered balanced and no further action will be taken. If the amounts do not match or the potential underreported tax change is more than the dollar tolerance, the module has an out-of-balance condition and is loaded onto the CAWR Automated Program (CAP)⁸ system. Once a CAWR module is added to the CAP system, all future account activity, *i.e.*, filing of corrected Forms W-2/W-3 or filing of additional tax returns, *etc.*, relative to the specific module will result in updates to the potential underreported tax.

⁸ A computer application that stores the CAWR inventory, correspondence, and reports; aids document preparation; and provides updates to the BMF. The CAP system contains both IRS-CAWR and SSA-CAWR discrepancy cases.



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The matching process will also identify nonfiler cases in which an employer submits Forms W-2/W-3 to the SSA but fails to file employment tax returns with the IRS, or where the IRS corrects an unpostable Form W-3 and cannot find a corresponding employment tax return. Although these cases are loaded on the CAP system, they are not worked by the CAWR Program. Rather they are transferred to the IRS's Employment Tax and Collection functions to be addressed. Figure 2 provides the results of the annual reconciliation process of the CAWR case modules on the BMF for TYs 2012 and 2013.

Figure 2: Results of Reconciliation Process for TYs 2012 and 2013

Category	TY 2012	TY 2013
Number of CAWR Modules	10,540,274	10,548,243
Number of Balanced Modules	9,980,782	9,855,302
Number of Out-of-Balance Modules	559,492	692,941

Source: The IRS's Information Technology organization Applications Development function. Data are through May 21, 2016.

This review assessed whether the IRS-CAWR Program selects the most productive cases. It should be noted that a prior review evaluated the SSA-CAWR Program.⁹ This review was performed at the CAWR office in the Document Matching Office, Compliance Services, Small Business/Self-Employed (SB/SE) Division in Philadelphia, Pennsylvania; the Unpostables Department Office in the Input Corrections Operation, Cincinnati Submission Processing Center, Wage and Investment Division, in Covington, Kentucky; and with information obtained from the Examination function, SB/SE Division, in Cincinnati, Ohio, during the period of July 2015 through October 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁹ Treasury Inspector General for Tax Administration, Ref. No. 2015-40-090, *Employers Who Do Not Comply With Requests to Provide Complete and Accurate Wage Documents Are Not Always Assessed Penalties* (Sept. 2015).



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Results of Review

Billions of Dollars of Potential Employer Underreported Taxes Are Not Being Addressed Because Most Discrepancy Cases Are Not Worked

Our analysis of 137,272 TY 2013 IRS-CAWR discrepancy cases¹⁰ the IRS identified found that the IRS worked only 23,184 (17 percent). The remaining 114,088 (83 percent) discrepancy cases that were not worked had a potential underreported total tax difference of more than \$7 billion. We estimate that it would take about 55 full-time equivalents (FTE)¹¹ for a total of about \$2.7 million to address these cases. Figure 3 shows the number of discrepancy cases not worked as well as the type and amount of potential underreported tax.

Figure 3: Volume and Potential Underreported Tax Amounts for TY 2013 Discrepancy Cases Not Worked by the IRS

Unworked Discrepancy Cases	Amount of Potential Underreported Social Security Tax	Amount of Potential Underreported Medicare Tax	Amount of Potential Underreported Withholding	Total Potential Underreported Tax ¹²
114,088	\$2,272,280,275	\$626,278,424	\$4,115,401,256	\$7,013,959,955

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of TY 2013 BMF data.

For the 23,184 discrepancy cases worked, 18,667 (81 percent) resulted in total tax assessments of \$64 million. In general, the remaining 4,517 discrepancy cases resulted in the employers submitting either corrected Forms W-2 or employment tax returns, or filing missing employment tax returns for a net tax assessment for the 23,184 cases worked of \$61 million. In each of the discrepancy cases, the IRS's comparison of what the employers reported to the SSA to what the employers reported on their filed tax returns showed that these employers withheld tax from employees but did not fully report those withholdings to the Federal Government as required.

¹⁰ Population does not include discrepancy cases that had indicators that the employer's account was in bankruptcy; currently not collectible; or under criminal investigation, examination, or collection.

¹¹ A measure of labor hours in which one FTE is equal to eight hours multiplied by the number of compensable days in a particular fiscal year. For Fiscal Year 2015, one full-time equivalent was equal to 2,088 staff hours.

¹² The potential underreported total tax difference amount is based upon data as of April 2016, and the amount may be different from when the cases were originally identified as discrepancies in April 2015. The IRS does not maintain data to identify the amount of the potential underreported tax when the CAWR discrepancy module was created.



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As we previously indicated, the IRS-CAWR discrepancy cases involving employers that do not file a tax return are not worked by the CAWR Program. We identified a total of 63,477 additional discrepancy cases with a potential underreported total tax difference of more than \$2.9 billion for which the employer did not file a tax return. We plan to perform a separate review to assess the IRS's actions to resolve these cases.

Management cites limited resources as the reason that most discrepancy cases are not addressed

When we raised our concern to management that most IRS-CAWR discrepancy cases are not being worked, they advised us that limited resources prevent them from working all of the discrepancy cases. Figure 4 shows that there was a 61 percent reduction in the FTEs (from 57 to 22) that the IRS allocated to working TYs 2011 and 2013¹³ IRS-CAWR discrepancy cases.

Figure 4: CAWR Program FTE Allocation for Fiscal Years (FY) 2013 Through 2016¹⁴

Category	FY 2013	FY 2014	FY 2015	FY 2016
IRS-CAWR	57	43	22	14
SSA-CAWR	57	62	71	68
Total FTEs Allocated to the CAWR Program	114	105	92 ¹⁵	82

Source: The IRS's Campus Operations Business Results Reports through September 2016.

A lawsuit settlement agreement requires the IRS to work all SSA-CAWR cases. Management explained that the resources they allocate to work IRS-CAWR discrepancy cases are contingent upon the resources available after they are allocated to working all of the mandated SSA-CAWR cases. In April 1988, the National Committee to Preserve Social Security¹⁶ filed a lawsuit to force prompt resolution of the backlog of unreconciled cases, *i.e.*, wage information was not being timely recorded to earnings records. In addition, the lawsuit sought the adoption of measures to ensure that the problem does not recur in the future. As part of a settlement agreement resulting from the lawsuit,¹⁷ the IRS is required to work all SSA-CAWR cases. The current agreement with the SSA states that:

¹³ We reviewed the TY 2013 IRS-CAWR discrepancy cases worked by the IRS in FY 2015. As such, we did not review FY 2016 FTEs expended to work TY 2014 IRS-CAWR discrepancy cases.

¹⁴ In general, IRS-CAWR work performed in FYs 2013 through 2016 corresponds to TYs 2011 through 2014.

¹⁵ Difference is due to rounding.

¹⁶ The organization subsequently changed its name to the National Committee to Preserve Social Security and Medicare.

¹⁷ *National Committee to Preserve Social Security v. Bowen*, 735 F. Supp. 1069 (D.D.C. 1990).



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IRS will reconcile discrepancies between employer W-2/W-3 wage reports provided SSA and employment tax returns provided IRS in which more Social Security/Medicare wages/tips were reported by employers to the IRS than to SSA. Such reconciliation activity will include contacting employers when SSA is unable to resolve discrepancies based upon its own records. For these non-tax-related cases, IRS' reconciliation will be subsequent to SSA's initiating contact with employers. IRS will also assess penalties in cases where non-filing employers fail to respond to SSA and IRS contacts.

In September 2015, we reported¹⁸ that for TY 2011, the SSA referred 133,836 cases to the IRS. Penalty assessments totaling more than \$456 million were made for 70,502 (53 percent) of these cases, with 54,923 (41 percent) resulting in no penalties assessed. Figure 5 provides the results of our analysis of assessments and abatements made on cases referred by the SSA to the IRS during TY 2011.

Figure 5: Penalty Assessments and Abatements on SSA-CAWR Cases Referred to the IRS for TY 2011

	Cases	Penalty Amount
Cases Referred to and Worked by the IRS	133,836	
Assessments	78,913	\$550,412,882
Abatement of Penalty ¹⁹	8,411	(\$94,213,958)
No Penalty Assessed	54,923	\$0

Source: TIGTA's analysis of the BMF as of April 30, 2015.

The agreement with the SSA can be modified or terminated only if the Secretary of the Treasury and the Commissioner of Social Security agree in writing to do so. The original agreement went into effect more than 38 years ago and was superseded 10 years ago by the current agreement. We asked IRS management if discussions had been held with the SSA to review the current agreement and processes to carry out this work to determine if any changes can be made. Management indicated that they have not had these discussions with the SSA, even though the agreement includes a requirement for the IRS and SSA to annually review the agreement by conducting joint and independent studies to evaluate the effectiveness of the CAWR process. However, IRS management stated that they have held internal discussions to evaluate the

¹⁸ TIGTA, Ref. No. 2015-40-090, *Employers Who Do Not Comply With Requests to Provide Complete and Accurate Wage Documents Are Not Always Assessed Penalties* (Sept. 2015).

¹⁹ These are part of the 78,913 penalty assessments for which the penalty was subsequently abated.



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language of the current agreement, the risks in potential changes, and the level of service that can be provided in the future.

The lack of enforcement in this area contributes to the Government's inability to reduce the Tax Gap²⁰

Management's continual reduction in resources allocated to working discrepancy cases directly contributes to the IRS's inability to reduce the billions of dollars it reports each year as being lost as a result of the Tax Gap. In May 2016, the IRS published its most recent estimate of the Tax Gap. 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, with a portion (\$87 billion) being attributed to the underreporting and underpayment of employment taxes.

In addition, 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. For each of the unworked discrepancy cases, the IRS has information reporting documents from the SSA (Forms W-2 and Forms W-3), as well as information the employer reported on its employment tax return. As we previously discussed, resources expended to address the discrepancy cases result in good tax administration with either the employer being assessed the amount of underreported tax, filing missing employment tax returns, or filing corrected Forms W-3/W-2 or employment tax returns.

The lack of IRS efforts to address employers' potential underreporting appears to be contrary to the Department of Justice Tax Division's priorities.

Our review also identified that the IRS's administration of the CAWR Program does not appear to show the same significance of employer underreporting of withheld tax as the Department of Justice's focused efforts of holding employers accountable. According to its website, the Department of Justice Tax Division reflects civil and criminal employment tax enforcement among one of its highest program priorities, stating the following:

When employers willfully fail to collect, account for and deposit with the IRS employment tax due, they are stealing from their employees and ultimately, the United States Treasury. In addition, employers who willfully fail to comply with their obligations and unlawfully line their own pockets with amounts withheld are gaining an unfair advantage over their honest competitors.

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.



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When we brought our concerns to management's attention, they noted that, despite the decreased emphasis on the IRS-CAWR Program, they take their role in civil and criminal enforcement seriously and use a wide range of tools to increase employer compliance, including education and outreach, civil enforcement, and referrals to the Department of Justice for criminal prosecution. As to referrals to the Department of Justice for criminal prosecution, a recent TIGTA review²¹ found that referrals to the Department of Justice for employers that willfully fail to comply with their tax obligation are relatively infrequent. In nearly every case, the IRS does not pursue criminal prosecution and instead relies on its civil enforcement authorities, *e.g.*, assessing penalties, to encourage compliance such as filing Notices of Federal Tax Lien, serving Notices of Levy, and assessing the Trust Fund Recovery Penalty rather than pursuing a felony or misdemeanor case.

Recommendation

Recommendation 1: The Commissioner, SB/SE Division, should evaluate the current agreement and workload processes with the SSA, as required, and ensure that the IRS is expending resources to work the most productive SSA-CAWR cases.

Management's Response: The IRS agreed with this recommendation. IRS management responded that they plan to hold a discussion with the SSA to evaluate the current agreement and workload processes. As part of this discussion, the IRS will look for opportunities to reduce the number of SSA-CAWR cases which cannot be successfully resolved prior to referral to the IRS.

Discrepancy Case Selection Processes Do Not Ensure That Priority Is Given to Cases With the Highest Potential Tax Assessment

The IRS uses a computer software package to randomly select the IRS-CAWR discrepancy cases that will be worked. The selections are made without any regard to the dollar amount of the IRS computed potential underreported taxes. Further, the manner in which the IRS selects the discrepancy cases is contrary to the results of an internal study. At the request of IRS management, the IRS's Office of Program Evaluation and Risk Analysis (OPERA) completed an analysis of the CAWR Program to estimate the results achieved by working the various discrepancy case types and identifying which case types have the highest potential tax assessment. The OPERA issued its report in August 2006 concluding that,²² "Case Types²³

²¹ TIGTA, Ref. No. 2017-IE-R004, *A More Focused Strategy Is Needed to Effectively Address Egregious Employment Tax Crimes* (Mar. 2017).

²² IRS OPERA, *Combined Annual Wage Reporting Program – Phase I Report* (Aug. 2006).

²³ Appendix V lists all 13 discrepancy case categories.



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“04A,” “06A,” and “10A” result in the highest average assessment.” Additionally, the report concluded that, “...if the average assessment amount is known for each type of IRS-CAWR case, then management can allocate budgeted FTEs to the case types in a manner that will maximize assessments.” However, the report also noted that the case type can change at any time prior to closure, and CAP system reports do not capture the actual closed case assessment amount.

The OPERA also indicated that the most productive discrepancy cases (starting with Case Type 04A) should be worked first whether it is experiencing a year with increased budget resources or a year with reduced budget resources. In contrast to the results and recommendations from this study, as resources declined, IRS management revised their internal guidelines to require the automated random selection of discrepancy cases, without focusing on those cases with the highest potential tax assessment.

The random selection of discrepancy cases

There are 13 different case types used by the IRS to define a discrepancy case. The case types are defined by why the discrepancy occurred, and some types are further defined by the dollar amount of the discrepancy. Figure 6 shows an example of three discrepancy case types, including how they are defined.

Figure 6: Example of IRS-CAWR Discrepancy Case Types and Ranges

Case Type	*****2*****	*****2*****.			
		2	**2**_	****2****	**2**
	2	**2**	**2**	**2**	**2**
2	*****2***** *****2***** *****2*****	**2**	**2**	**2**	**2**
2	*****2*****. *****2*****24	**2**	**2**	**2**	**2**
2	*****2***** *****2*****	**2**	**2**	**2**	**2**

Source: Excerpt from Internal Revenue Manual Section 4.19.4.1, Apr. 10, 2014.

The IRS’s internal guidelines outline the order in which it will select discrepancy cases to be worked as follows:

- **Auto-Generated Cases:** According to these guidelines, auto-generated discrepancy cases are to be worked first because the IRS can send automated letters and work these

²⁴ This category definition included Advance Earned Income Credit amounts. However, we removed those amounts from the table because the credit is no longer available to taxpayers.



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cases with fewer resources.²⁵ In general, the IRS defines auto-generated cases as those discrepancy cases for which the employer *****2***** **
*****2*****26*****
*****2*****
*****2*****; and from one of the following case types: 04, 06, or 10. According to the IRS, it developed these criteria based on years of experience screening IRS-CAWR discrepancy cases to identify those cases that are most viable for assessment. The IRS uses software that has a special function to randomly select which auto-generated cases will be worked. Within the population of cases that fit the auto-generated case criteria, the random selection of those to be worked is made without any regard to the dollar amount of the discrepancy.

- **Additional Cases:** If additional resources are available, the IRS will then manually screen and select additional discrepancy cases with the following case types:
 - 04A, 06A, 10A.
 - 04B, 06B, 10B.
 - 04C, 06C, 10C.
 - 04D, 06D, 10D.

According to IRS management, it has been at least four years since the IRS had resources to screen and select from these cases.

- **Other Cases:** All other discrepancy case types are to be worked at IRS Headquarters' direction only.

Random selection of auto-generated cases does not ensure that cases within this population that have the highest dollar potential are worked

Our analysis of the 114,088 TY 2013 unworked IRS-CAWR discrepancy cases showed that if the IRS had selected the 23,184 auto-generated cases with a higher average assessment potential to work, it would have selected cases with more than \$128 million in potential assessments, more than two times what the IRS actually assessed. In comparison, the IRS's random selection of the 23,184 auto-generated cases worked had an actual net underreported tax assessment amount of more than \$61 million. Figure 7 shows a comparison of the cases the IRS auto-generated using its random selection method and the auto-generated cases it should have worked, based on higher total potential assessment.

²⁵ The IRS also refers to auto-generated cases as mass-generated available inventory.

²⁶ *****2*****
*****2*****.



Case Selection Processes Result in Billions of Dollars in Potential Employer Underreported Tax Not Being Addressed

Figure 7: Comparison of Discrepancy Cases Randomly Selected and Worked to Case Selection Based on Higher Total Potential Assessment²⁷

Case Type	Cases Worked by the IRS ²⁸			Cases the IRS Should Have Worked		
	Number of Cases Worked	Average Assessment Per Closure	Net Tax Assessment ²⁹	Potential Number of Cases Worked ³⁰	Average Assessment Per Closure ³¹	Total Potential Assessment ³²
04(A)	1,113	\$22,189	\$24,696,124	3,093	\$22,189	\$68,630,577
06(A)	15	\$28,460	\$426,895	49	\$28,460	\$1,394,540
10(A)	**1**	**1**	**1**			
04(B)	9,222	\$2,902	\$26,758,720	20,042	\$2,902	\$58,161,884
06(B)	136	\$3,008	\$409,103			
10(B)	17	\$2,557	\$43,467			
04(C)	6,944	\$634	\$4,403,327			
06(C)	82	\$589	\$48,311			
10(C)	71	\$596	\$42,332			
04(D)	2,319	\$1,118	\$2,593,455			
06(D)	52	\$184	\$9,574			
10(D)	19	\$147	\$2,787			
All Other Cases ³³	****1****	****1****	*****1****			
Total	23,184	\$2,648	\$61,387,123	23,184	\$5,529	\$128,187,001

Source: TIGTA analysis of IRS-CAWR discrepancy cases from the CAP system.

²⁷ The IRS could not provide us with the historical clean case inventory as of April 1, 2016, but it was able to provide the clean case inventory in October 2016.

²⁸ As of the Program Completion Date of April 1, 2016.

²⁹ Differences due to rounding.

³⁰ The cases include 10,350 discrepancy cases that were worked and 12,834 discrepancy cases that were not worked.

³¹ The averages here are taken from the averages of cases worked.

³² Differences due to rounding.

³³ The IRS selected and worked these cases as Case Types 04, 06, and 10. However, by the Program Completion Date of April 1, 2016, the case types had changed to other than 04, 06, and 10.



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Current case selection does not ensure that cases with the highest dollar potential overall are selected and, in fact, eliminates certain discrepancy cases all together from being addressed

The IRS currently limits its selection of cases to only those identified as an auto-generated case. However, as the OPERA study identified, selection of cases should be made based on the highest potential tax assessment to maximize resources. We analyzed the 114,088 cases that were not worked to identify those 23,184 with the highest potential underreported tax amounts by case type.³⁴ Figure 8 shows the results.

Figure 8: TY 2013 Highest Dollar IRS-CAWR Discrepancy Cases Not Worked³⁵

Case Type	Number of Cases	Potential Underreported Tax Amount
04(A)	14,505	\$5,914,313,944
06(A)	4,708	\$750,580,601
10(A)	73	\$31,279,067
04(B)	2,798	\$29,289,259
06(B)	743	\$7,955,784
10(B)	19	\$200,234
04(C)	5	\$129,256
06(C)	****1****	****1****
04(D)	6	\$948,318
All Other Cases ³⁶	***1***	*****1*****
Total	23,184	\$6,812,860,906³⁷

Source: TIGTA analysis of IRS-CAWR discrepancy cases from the CAP.

When we brought our concern to IRS management’s attention about not selecting discrepancy cases with the highest potential tax assessment, they stated that selecting cases from only one group is not in line with the IRS’s mission. Promoting “visibility” through coverage across as many segments of taxpayers as possible to encourage compliance is desired. Management’s case selection does not provide coverage across the many segments of noncompliant employers as it

³⁴ These unworked cases include cases that meet the IRS’s criteria for auto-generated random selection, but were not selected despite their having a high potential tax assessment.

³⁵ As of the Program Completion Date of April 1, 2016.

³⁶ This includes Case Types 00, 02, 03, 11, and 13.

³⁷ Although we identified 23,184 cases with a potential underreported tax amount of \$6,812,860,906, we reduced this by 2,823 cases and \$61,164,577 in our outcome measure to account for those cases in Figure 7 that the IRS should have worked. This resulted in a net figure of 20,361 cases with a potential underreported tax amount of \$6,751,696,329. See Appendix IV for a more detailed explanation.



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only selects those cases that meet auto-generated criteria. In addition, system limitations of the CAWR Program also result in cases involving *****2*****. For example, IRS management indicated that if an employer files *****2*****, the automated matching process currently combines the amounts from *****2*****. IRS management submitted a programming request in November 2016 that would create a separate module to associate the ***2*** returns **2*** *****2*****documents. However, the programming request has not been implemented, and the IRS has not taken any interim steps to address these types of discrepancy cases. It should be noted that there are 3,218 discrepancy cases in the total 114,088 unworked cases with potential underreported taxes totaling more than \$1.9 billion³⁸ in which the employer filed a ***2*****. Furthermore, the random selection without regard to potential tax assessment is contrary to the IRS's current Future State vision for allocating its budget and resources. Specifically, this vision seeks to improve tax administration by selecting the highest value work using data analytics.

Management also indicated that some of the large-dollar discrepancies we identified could be the result of employers using *****2***** on the employment tax return. IRS management submitted a programming change in December 2015 to add a *****2***** table to help tax examiners more efficiently resolve these types of discrepancy cases. However, to date, this programming change has not been implemented. Similar to the discrepancy cases involving the *****2*****. We agree that employer's use of ***2***** complicates matters; however, *****2***** *****2***** and a discrepancy exists between the two corresponding reported amounts that needed to be addressed.

Limited resources could be further maximized if prior year discrepancy cases are included when working current year discrepancy cases for the same noncompliant employer

In addition to changing its selection methodology to work the case types with a higher potential tax assessment, the IRS could further increase its return on investment by including prior year discrepancy cases when working current year discrepancy cases for the same employer. For example, 3,137 of the 23,184 employers we identified in Figure 8 also had a discrepancy case in TY 2012. These 3,137 employer cases had potential underreported tax of more than \$448 million for TY 2012.

³⁸ ***1*** of these discrepancy cases had a potential underreported tax of nearly ***1***.



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IRS management stated that tax examiners only work cases that are identified as discrepancies in the CAP system for the current year. According to the IRS, including a prior year would complicate the current process; open the process to additional risks, such as barred statutes and system problems, with no guaranteed return on investment; and reduce coverage for the current year. Management's position is in direct contradiction to a November 2015 document entitled *CAWR Proposed Release Plan* in which IRS management outlined a proposed future upgrade to modify its CAP system to classify any new IRS-CAWR case that existed in the database the previous year to batch as a repeater case, e.g., if a TY 2014 case is loaded in March 2016 and classified as a Case Type 04A, then run a check against the program to see if a case existed for TY 2013.

Our analysis identified that 1,857 (59 percent) of the discrepancy cases, with potential underreported tax totaling more than \$399 million, had the same types of discrepancies in both years. In the current environment of reduced funding, it is important that the IRS develop processes to use available resources efficiently, such as including prior year discrepancy cases for the same employer. These processes should include selecting discrepancy cases with the highest potential tax assessment and including prior year discrepancies for the same employer to maximize the use of its compliance resources.

Recommendations

The Commissioner, SB/SE Division, should:

Recommendation 2: Revise the case selection process to include auto-generated cases with the highest potential tax assessment and expand discrepancy case selection to include cases currently excluded from the systemic selection process.

Management's Response: The IRS agreed with this recommendation. IRS management responded that they plan to adjust the inventory of discrepancy cases to include a population of cases which falls outside the criteria for auto-generated cases. The results of these manually worked cases will inform future program workload decisions. The IRS also plans to request reprogramming to stop the random selection of auto-generated cases and evaluate methods to identify cases with the highest potential for adjustment, including the consideration of a prior year discrepancy as a selection criterion.

However, the IRS disagreed with our outcome measure of more than \$6.7 billion. Management stated that many cases yield tax assessments that are less than their original discrepancy amounts. The IRS also disagreed with our outcome measure of more than \$66 million stating that in order to apply "case type" estimates, we would need to know the "case type" at the time of case selection.



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Office of Audit Comment: Management's assertion that many cases yield tax assessments that are less than their original discrepancy amounts is based on the actual results of the TY 2013 cases that were selected and worked using its current case selection processes. However, the IRS has acknowledged that these processes exclude certain discrepancy cases from being addressed and agreed that it should no longer randomly select auto-generated cases. Further, the IRS cited concerns with the data we used to perform our analysis as the data did not identify the potential underreported tax and the case type at the time the cases were selected. The data we used were the best data available at the time we did our analysis and shows the significance of how the IRS's current discrepancy case selection processes do not ensure that priority is given to cases with the highest potential tax assessment.

Recommendation 3: Coordinate with the Information Technology organization to review open Unified Work Requests to ensure prioritization for those enhancements, *i.e.*, correct creation of discrepancy cases involving ****2**** and the use of *****2*****, that will have the greatest impact on tax administration.

Management's Response: The IRS agreed with this recommendation. IRS management responded that they currently have a system in place to review and prioritize Unified Work Requests corporately to ensure that the IRS's limited technology funds are leveraged to maximize positive impact to tax administration. Requests are first reviewed and prioritized by an organizational Governance Board. Ultimately, the Senior Executive Team allocates funding to the highest priority needs.

Recommendation 4: Take actions necessary to implement the proposed upgrade to modify the CAP system to include prior year discrepancy cases when current year discrepancy cases are selected for the same employer.

Management's Response: The IRS disagreed with this recommendation. However, management stated that they plan to evaluate the IRS's methods to identify cases with the highest potential for adjustment, including the consideration of a prior year discrepancy as a selection criterion. IRS management also stated that the CAWR Release Plan was created in an informal setting along with the Information Technology organization at a time when this and other programs were planned to be covered by the Information Return Document Matching process. This process was predicated upon having true information technology analytical capability, which the IRS was never able achieve due to financial constraints. This particular Information Return Document Matching effort was later discontinued and, while some of more than 50 items in the plan were completed, many were shelved. In addition, prior year cases generally fall outside of the auto assessment, *i.e.*, auto-generated case selection, criteria, thereby requiring a tax examiner to review the case manually. Working a case manually requires additional time. As a result, working one prior year case would result in multiple current year cases not being worked. Implementing this recommendation would result in fewer cases being worked and fewer



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dollars assessed. The CAWR Program currently does not have the systemic capability to identify a taxpayer with the same issue on multiple years.

The IRS also disagreed with our outcome measure of over \$448 million stating that it does not consider the costs associated with expanding the scope of work to include prior year returns.

Office of Audit Comment: Including employers with prior year discrepancies as additional selection criteria would allow the IRS to prioritize those employers who are noncompliant in more than one period. Moreover, addressing current and prior year discrepancies together is the most efficient way to address these discrepancies. The IRS cites that it does not currently have the systemic capability to identify employers with repeat discrepancy cases. However, implementing such a capability was the very intent of the system modification that the IRS proposed as part of the Information Return Document Matching process. Finally, as to the IRS's view that the outcome measure does not consider the costs associated with expanding the scope of work to include prior year returns, the IRS did not provide us with a cost/benefit analysis to support its position.

The Reconciliation Process Did Not Correctly Identify All Discrepancy Cases

Our analysis identified 4,822 employers with potential underreported tax totaling about \$20.1 million that were not accurately identified as TY 2013 IRS-CAWR discrepancy cases. These unidentified discrepancy cases included:

- 4,780 cases for which the specific potentially underreported amounts for the Social Security, Medicare, and Federal income taxes were individually less than the dollar tolerance at which the IRS would identify a discrepancy case. However, when the amounts were combined, the potential underreported tax amount was greater than or equal to the IRS's established discrepancy case dollar tolerance. Therefore, these cases should have been identified as discrepancy cases. The total underreported tax for these cases is about \$2.7 million.

When we informed IRS management that these types of discrepancy cases are not being identified correctly, IRS management agreed and acknowledged that there was a programming error. According to IRS management, the programming error was corrected on September 22, 2016.

- 42 cases for which the underreported Medicare tax is the only amount greater than the dollar tolerance used to establish a discrepancy case. The total potential underreported tax for these cases is about \$17.4 million. Programming did not correctly identify these cases as discrepancy cases. IRS management could not explain what caused this error.



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However, they indicated that they have not identified any additional cases for which this same error occurred in subsequent years. We did not have subsequent years' data to confirm that these errors were no longer occurring.

Developing an Automated Matching Process Could Improve Perfection of Unpostable Forms W-3

Our analysis of 80,950 TY 2013 unpostable Forms W-3, *i.e.*, the EIN or name control does not match IRS records, identified that the IRS was unable to perfect 29,280 (36 percent) of these unpostable Forms W-3. This means that the IRS's *****2*****. In an attempt to further perfect those Forms W-3, we developed an automated matching process and were able to perfect 7,077 (24 percent) of the 29,280 Forms W-3 that the IRS was unable to perfect. The automated process we used compared four amounts³⁹ on the Forms W-3 to the employment tax returns.⁴⁰ For each of the 7,077 Forms W-3, we were able to match these four amounts and, depending on the type of unpostable condition, either the EIN or the name control also matched. Figure 9 shows the specific data fields we compared in order to perfect the CAWR unpostables for each unpostable type.

Figure 9: Data Matched to Perfect CAWR Unpostables

Data Field Used to Match Forms W-3 to Employment Tax Returns	EIN Mismatch	Name Control
EIN	Unknown	M
Name Control	M	Unknown
Social Security Wages	M	M
Social Security Tips	M	M
Medicare Wages and Tips	M	M
Federal Income Tax Withheld	M	M

Source: TIGTA's process used to perfect CAWR unpostables. M = Matched.

The employees in the CAWR Unpostable function perform manual research of IRS and SSA records in an effort to perfect unpostable Forms W-3. For example, employees use the EIN or name control listed on the Forms W-3 to research tax data and information on the SSA's Online

³⁹ Social Security wages, Social security tips, Medicare wages and tips, and Federal income tax withheld.
⁴⁰ We only compared these four money amounts if at least one of them was a non-zero amount.



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Retrieval System,⁴¹ which contains Forms W-3 received by the SSA from taxpayers. If the tax examiners identify the correct name control, EIN, or both, then they correct the error that created the unpostable condition in the tax records so that the perfected Form W-3 can be loaded to the BMF. *****2*****
*****2*****
*****2*****
*****2*****
*****2***** Therefore, *****2*****
*****2***** cases or the creation of invalid IRS-CAWR discrepancy cases.

An automated match perfection process could also reduce costs

We used our automated match process to identify overall how many of the 80,950 TY 2013 unpostable Forms W-3 could be perfected without the need for manual research and verification. From the total population of 80,950, we were able to perfect 27,745 (34 percent), including the 7,077 the IRS was unable to perfect via its manual process. For each of these cases, no manual resources would be needed to perform an automated match in an attempt to perfect the Forms W-3. The development of an automated match process could save the IRS time and resources. For example, using the IRS's FY 2015 Cost Estimate Reference document, we identified that it costs \$1.19 to resolve each CAWR unpostable. Because the automated process we developed would systemically perfect 27,745 unpostables, we estimate that its implementation by the IRS could potentially result in reduced costs of \$33,017 (27,745 cases x \$1.19) and a more efficient use of IRS resources.

An automated perfection process would reduce Forms W-3 perfection errors

Implementation of an automated perfection process could also result in fewer errors than the current manual perfection process. Our analysis of the 51,670 CAWR unpostables that the IRS perfected identified 2,489 that were not accurately perfected. This occurred because the IRS's perfection process did not identify the correct taxpayer account that had amounts which matched to Forms W-3. As a result, 1,753 of the 2,489 unpostables that were not accurately perfected resulted in the erroneous creation of a discrepancy case. For example, a Form W-3 uploaded to the wrong taxpayer account would result in a discrepancy when compared with the employment tax return information for that same account. Conversely, the lack of a Form W-3 being loaded to the correct taxpayer account would also result in a discrepancy.

When we brought our concern to IRS management's attention, they agreed that the automated process we developed would result in a benefit to the IRS but acknowledged that there are some barriers to implementing the process. Primary among the barriers is that the employment tax return data needed to perform the match are not available on the CAWR module at the time the

⁴¹ The Online Retrieval System was created by the SSA to capture the print image of SSA-related documents, such as Forms W-2, W-2c, W-3, and W-3c.



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automated process would need to occur. However, the IRS proposed an alternative solution to generate an employment tax return report that could be used to perform the match before the CAWR module is actually created and added that this match could be completed prior to sending the unpostables to the CAWR Unpostable function.

Processes and procedures have not been established to monitor the accuracy of processing unpostables

Our review of CAWR unpostables for Calendar Years 2012 through 2015 identified varying perfection rates by calendar year and by employees working in the CAWR Unpostable function. Figure 10 shows the overall perfection rate for the CAWR unpostables as well as the range of perfection rates among employees.

Figure 10: CAWR Unpostables Function Perfection Rates for Calendar Years 2012 Through 2015

Calendar Year	Unpostable Forms W-3	Perfected	Perfection Rate	Range of Employee Perfection Rate
2012	105,712	48,476	45.9%	13 – 73%
2013	82,271	29,865	36.3%	9 – 63%
2014	66,801	36,402	54.5%	0 – 100%
2015	83,621	67,103	80.2%	62 – 95%

Source: TIGTA's analysis of the IRS's Control D Generalized Unpostable Framework 5740E report.

IRS management indicated that the sharp increase in the overall perfection rate in Calendar Year 2015 resulted from a revision made to its perfection procedures. Until January 1, 2015, if multiple cases were received with the same EIN/name, internal guidelines instructed tax examiners to correct only one of the cases⁴² and release all others. Before the IRS revised its perfection procedures, only one case was perfected, while all others were not uploaded to the BMF or matched. Regarding the fluctuation in individual employee perfection rates, management was unaware of the varying perfection rates among employees because they have not been performing reviews to evaluate whether employees accurately perfect cases. Management also acknowledged that training was lacking. Employees who work unpostable cases educated themselves on the various research tools used to resolve the cases. Although the IRS's internal guidance provides information for inputting correct codes when processing CAWR unpostable cases, it lacks specific guidance on how to research and resolve them.

⁴² A third-party payroll agency can file multiple wage and employment tax returns for different employers under its own EIN but with different names for the different employers it represents.



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Recommendations

Recommendation 5: The Commissioner, SB/SE Division, should establish a systemic process to match data fields to perfect unpostable Forms W-3.

Management's Response: The IRS agreed with this recommendation. However, the IRS cannot commit to implementing this action due to current budget levels and competing demands for limited information technology funds.

The Commissioner, Wage and Investment Division, should:

Recommendation 6: Update internal guidelines to include specific procedures for employees to follow on how to research and perfect CAWR unpostable cases. Once updated, provide training to employees on those procedures.

Management's Response: The IRS agreed with this recommendation and plans to review and update its internal guidelines, as well as provide training to employees as needed on how to research and perfect CAWR Unpostables.

Recommendation 7: Ensure that managerial reviews are performed as required to ensure that CAWR unpostable cases are properly researched and perfected.

Management's Response: The IRS agreed with this recommendation and plans to perform periodic program reviews to provide a more comprehensive overview of program performance in perfecting unpostable CAWR cases. IRS management will also use that analysis to identify areas for improvement and take appropriate action to achieve the goal of further improving the perfection rate.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate whether the IRS's CAWR Program document matching process accurately identifies and selects the most productive cases. To accomplish our objective, we:

- I. Determined the effectiveness of the IRS-CAWR unpostable process in perfecting Forms W-3, *Transmittal of Wage and Tax Statements*, loaded onto the BMF.¹
 - A. Determined the number of Forms W-3 sent to the Unpostable function for TY 2013.
 - B. Determined the number of Forms W-3 that the IRS was unable to perfect during the unpostable process.
 - C. Determined if the Forms W-3 identified by the IRS as unpostable could be correlated with an employment tax return.²
- II. Determined the effectiveness of the IRS-CAWR Program in correctly identifying discrepancy cases.
 - A. Reviewed IRS procedures for identifying IRS-CAWR discrepancy cases, including Internal Revenue Manual instructions and applicable Program Requirements Packages for the matching process.
 - B. Compared all TY 2013 employer CAWR modules on the BMF to TY 2013 CAWR discrepancy cases placed on the IRS CAP³ system to determine if all IRS-CAWR discrepancy cases were appropriately identified.
 1. Obtained the IRS CAP system data for all TY 2013 IRS-CAWR discrepancy cases identified by the IRS.

¹ The IRS database that consists of Federal tax-related transactions of accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

² Form 941, *Employer's QUARTERLY Federal Tax Return*; Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees*; Form 944, *Employer's ANNUAL Federal Tax Return*; Form 945, *Annual Return of Withheld Federal Income Tax*; and Schedule H, *Household Employment Taxes*, attached to Form 1040, *U.S. Individual Income Tax Return*, or Form 1041, *U.S. Income Tax Return for Estates and Trust*, are collectively referred to as an employment tax return.

³ The IRS system used by the CAWR function of the Document Matching program to work, manage, and otherwise handle the inventory of CAWR discrepancy cases. The CAP system contains both IRS-CAWR and SSA-CAWR discrepancy cases.



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2. Matched the IRS-CAWR discrepancy cases identified on the IRS CAP system in Step II.B.1. to all TY 2013 CAWR modules on the BMF to identify which returns on the BMF were not identified as discrepancy cases.
 3. Reviewed the BMF CAWR module data for the TY 2013 returns not identified as IRS-CAWR discrepancy cases to determine whether the cases were appropriately categorized.
- III. Evaluated the effectiveness of the IRS's allocation of resources to work the most productive IRS-CAWR cases.
- A. Determined whether the resources allocated to the IRS-CAWR Program were used to work an appropriate corresponding number of IRS-CAWR discrepancy cases.
 1. Reviewed IRS procedures for allocating resources to the CAWR Program.
 2. Obtained the number of FTEs⁴ that were allocated to the CAWR Program for FYs 2012 through 2016 and compared that to the number of SSA-CAWR and IRS-CAWR discrepancy cases that were worked during that time.
 3. Determined whether the number of IRS-CAWR discrepancy cases worked was reasonable given the amount of resources available for each year.
 - B. Determined whether the IRS worked the most productive IRS-CAWR discrepancy cases.
 1. Reviewed IRS procedures for selecting the IRS-CAWR discrepancy case workload.
 2. Determined whether the current selection process could be improved to work discrepancy cases that are more productive.
- IV. Determined the impact of the IRS not effectively addressing employer noncompliance with the reporting of wages, employment taxes, and Federal income tax withholding.
- A. Quantified the amount of employment taxes and Federal income tax withholding associated with IRS-CAWR discrepancy cases for TY 2013 that were not worked by the IRS.

⁴ A measure of labor hours in which one FTE is equal to eight hours multiplied by the number of compensable days in a particular fiscal year. For FY 2015, one FTE was equal to 2,088 staff hours.



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Data validation methodology

During this review, we relied on data extracted from the Data Center Warehouse⁵ of the IRS's BMF CAWR tax modules for TY 2013 and of the IRS's Generalized Unpostable Framework⁶ report for all unpostable records for Calendar Years 2012 through 2015. We also relied on an IRS data extract of all CAWR discrepancy cases on the CAP system for TYs 2012 and 2013. Before relying on the data, we ensured that each file contained the specific data elements that we requested. In addition, we reviewed random samples of each extract and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System,⁷ the CAP system, and the IRS's Return Request and Display application,⁸ as applicable for each extract.

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 following internal controls were relevant to our audit objective: processes and procedures to assess the effectiveness of the IRS's controls to ensure that employers are reporting and paying the correct amount of employment taxes, to include accurately filing employment tax returns and wage statement information returns. We evaluated these controls by reviewing policies and procedures, interviewing employees and management, and analyzing data.

⁵ A TIGTA repository of IRS data.

⁶ Closure reports for the IRS's Unpostable function containing the disposition and changes of all unpostable cases for a period of time.

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

⁸ The Return Request and Display application displays specific tax return and status information for tax returns processed by the Modernized e-File application.



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Appendix II

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Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Operations Support
Deputy Commissioner for Services and Enforcement
Chief Information Officer
Director, Office of Online Services
Deputy Associate Chief Information Officer, Applications Development
Deputy Commissioner, Small Business/Self-Employed Division
Deputy Commissioner, Wage and Investment Division
Director, Customer Account Services, Wage and Investment Division
Director, Examination Field and Campus Policy, Small Business/Self-Employed Division
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:

- Increased Revenue – Potential; \$6,751,696,329 (see page 9).

Methodology Used to Measure the Reported Benefit:

We used the following methodology to identify the 114,088 TY 2013 IRS-CAWR discrepancy cases that were not worked by the IRS:

- Identified all TY 2013 CAWR module information as of March 31, 2016, including the status history code associated with each module. This resulted in 10,556,115 cases.
- Calculated the difference between the following amounts: 1) processed Social Security wages and tips - posted Social Security wages and tips; 2) processed Medicare wages - posted Medicare wages; and 3) processed Federal income tax withheld - posted Federal income tax withheld.
- Calculated the tax difference in Social Security wages and tips and Medicare wages by multiplying: Social Security wages and tips difference times 0.124 and Medicare wages difference times 0.029.
- Calculated the total tax difference by summing the following: the tax difference in Social Security wages and tips, the tax difference in Medicare wages, and the difference in Federal income tax withheld.
- Identified IRS-CAWR discrepancy cases by filtering for the following *****2*****
*****2*****. The foregoing steps resulted in 231,072 cases.
- Removed the following cases that should be bypassed and not included in module balancing: *****2*****
*****2*****. This resulted in 225,909 cases.
- Removed 62,619 cases for which the employer did not file a tax return. This resulted in 163,290 cases.



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- Removed 4,822 cases for which the IRS did not identify the case as out of balance. This resulted in 158,468 cases.
- Removed 471 cases that the IRS worked by Letter 99C, *Letter of Employment Tax Problem (CAWR)*. This resulted in 157,997 TY 2013 unworked discrepancy cases.
- Removed 13,082 cases that were either nonfiler cases which are not worked by the CAWR Program or were being worked by the SSA. This resulted in 144,915 unworked discrepancy cases.
- Removed 30,827 cases that had indicators that the *****2*****
*****2*****
****2*****.

We analyzed the 114,088 cases that were not worked to identify those 23,184 with the highest potential underreported tax amounts by case type that the IRS should have selected and addressed. This analysis, as reflected in Figure 8 in the report body, showed that these cases had a potential underreported tax amount totaling \$6,812,860,906. We reduced the outcome by 2,823 cases and \$61,164,577 to account for the cases identified in the outcome measure reported below. This resulted in a net figure of 20,361 cases with a potential underreported tax amount of \$6,751,696,329.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$66,799,878 (see page 9).

Methodology Used to Measure the Reported Benefit:

Our analysis of the 114,088 TY 2013 unworked IRS-CAWR discrepancy cases showed that if the IRS had selected the 23,184 auto-generated cases with a higher average assessment potential to work, it would have selected cases with more than \$128 million in potential assessment. In comparison, the IRS's random selection of the 23,184 auto-generated cases worked had an actual net underreported tax assessment amount of more than \$61 million. We arrived at the \$66,799,878 by taking the difference between what the IRS could have assessed (\$128,187,001) and what the IRS actually assessed (\$61,387,123).

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$448,430,769 (see page 9).

Methodology Used to Measure the Reported Benefit:

From the 114,088 TY 2013 unworked IRS-CAWR discrepancy cases (mentioned in the first outcome measure), we identified the 23,184 employers with the highest potential underreported



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total tax difference. We then compared those 23,184 cases to the unworked TY 2012 discrepancy cases and determined that 3,137 of the 23,184 employers also had a discrepancy case in TY 2012. These 3,137 TY 2012 discrepancy cases had a potential underreported tax amount of \$448,430,769.

Type and Value of Outcome Measure:

- Reliability of Information – Actual; 4,780 discrepancy cases (see page 17).

Methodology Used to Measure the Reported Benefit:

From the 163,290 unworked TY 2013 IRS-CAWR discrepancy cases for which the employer filed a tax return (mentioned in the first outcome measure), we identified 4,780 cases¹ with codes indicating a balanced case which should have been identified as discrepancy cases. These 4,780 unidentified discrepancy cases are cases in which the specific amounts underreported by the employer for the Social Security, Medicare, and Federal income taxes are individually less than the dollar tolerance at which IRS would identify a discrepancy case. However, when the amounts are combined, the potential underreported tax amount is greater than or equal to the IRS's established discrepancy case dollar tolerance. As such, these 4,780 TY 2013 cases should have been identified as discrepancy cases.

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Potential; \$33,017 in reduced costs (see page 18).

Methodology Used to Measure the Reported Benefit:

Our analysis of 80,950 TY 2013 unpostable Forms W-3, *Transmittal of Wage and Tax Statements*, i.e., EIN or name control does not match IRS records, identified that the IRS was unable to perfect 29,280 (36 percent). This means that the IRS's research was unable to ****2**
*****2*****.

Using an automated perfection process that we developed, we were able to perfect 27,745 (34 percent) of the 80,950 unpostables, including the 7,077 (24 percent) of the 29,280 Forms W-3 that the IRS was unable to perfect via its manual process.

¹ We are not claiming an outcome measure for the other 42 cases with programming errors that we identified because the IRS could not identify the same error had occurred in subsequent years and we did not have subsequent years' data to we confirm that the errors were no longer occurring.



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We performed this systemic match by comparing four amounts² on the Forms W-3 to the employment tax returns.³ For each of these, we were able to match the four amounts and, depending on the type of unpostable, either the EIN or the name control also matched.

No resources would be needed to perform manual research in an attempt to perfect the Forms W-3 for these cases. Therefore, the development of an automated match process could save the IRS time and resources. For example, using the IRS's FY 2015 Cost Estimate Reference document, we identified that it costs \$1.19 to resolve each CAWR unpostable case. Because the automated process we developed would systemically perfect 27,745 unpostable cases, we estimate that its implementation by the IRS could potentially result in reduced costs of \$33,017 (27,745 cases x \$1.19) and a more efficient use of IRS resources.

² Social Security wages, Social Security tips, Medicare wages and tips, and Federal income tax withheld. We only compared these four money amounts if at least one of them was a non-zero amount.

³ Form 941, *Employer's QUARTERLY Federal Tax Return*; Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees*; Form 944, *Employer's ANNUAL Federal Tax Return*; Form 945, *Annual Return of Withheld Federal Income Tax*; and Schedule H, *Household Employment Taxes*, attached to Form 1040, *U.S. Individual Income Tax Return*, or Form 1041, *U.S. Income Tax Return for Estates and Trust*, are collectively referred to as an employment tax return.



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Appendix V

Combined Annual Wage Reporting Case Types

Case Type	*****2*****	*****2*****.			
		2	**2**	**2**	**2**
2	*****2***** *****2*****1 *****	**2**	**2**	**2**	**2**
2	*****2***** *****2*****	**2**	**2**	**2**	**2**
2	*****2***** *****2***** *****2*****	**2**	**2**	**2**	**2**
2	*****2***** *****2*****	**2**	**2**	**2**	**2**
2	*****2***** *****2***** *****2*****	**2**	**2**	**2**	**2**
2	*****2***** *****2***** *****2*****.2	**2**	**2**	**2**	**2**
2	*****2***** *****2*****	**2**	**2**	**2**	**2**
2	*****2***** *****2*****	**2**	**2**	**2**	**2**

¹ Form 941, *Employer's QUARTERLY Federal Tax Return*; Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees*; Form 944, *Employer's ANNUAL Federal Tax Return*; Form 945, *Annual Return of Withheld Federal Income Tax*; and Schedule H, *Household Employment Taxes*, attached to Form 1040, *U.S. Individual Income Tax Return*, or Form 1041, *U.S. Income Tax Return for Estates and Trust* are collectively referred to as an employment tax return.

² This category definition included Advance Earned Income Credit amounts. However, we removed those amounts from the table because the credit is no longer available to taxpayers.



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2	*****2***** *****2*****	**2**	**2**	**2**	**2**
2	*****2***** *****2***** *****2*****	**2**	**2**	**2**	**2**
2	*****2***** *****2***** *****2*****	**2**	**2**	**2**	**2**
2	*****2***** *****2***** *****2*****	**2**	**2**	**2**	**2**
2	*****2***** *****2***** ****2*****	**2**	**2**	**2**	**2**

Source: *Excerpt from Internal Revenue Manual Section 4.19.4.1, April 10, 2014.*



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Appendix VI

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

JUN 22 2017

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *for* Mary Beth Murphy *Dretha Barber*
Commissioner, Small Business/Self-Employed Division

SUBJECT: *Case Selection Processes Result in Billions of Dollars in Potential Employer Underreported Tax Not Being Addressed*
Draft Audit Report – (Audit #201540030)

Thank you for the opportunity to review and comment on the above subject draft audit report. Employment taxes comprise nearly two-thirds of the taxes collected by the Federal Government, and are used to fund numerous Government programs (including Social Security and Medicare) that provide essential benefits to many citizens. Promoting employment tax compliance has been, and will always continue to be, a top priority for the IRS and we use a wide range of tools to increase compliance. Also, one of the IRS' first Future State initiatives was on employment tax compliance. The Combined Annual Wage Reporting (CAWR) program supports this emphasis on employment taxes. The CAWR program ensures employers submit Forms W-2, *Wage and Tax Statement*, and W-3, *Transmittal of Wage and Tax Statements*, to the Social Security Administration (SSA) and a federal withholding form to the IRS so employees' Social Security accounts can be properly credited and employment tax withholdings can be collected from employers. A comparison of the SSA and IRS records is performed each year in a process known as the Annual Wage Reporting reconciliation. The IRS-CAWR Program includes a reconciliation to identify discrepancies in which amounts reported on Forms W-2 submitted to the SSA are greater than earnings and tax withholdings reported to the IRS on filed tax returns. As you observed, we properly identified nearly 97% of all potential discrepancy errors for tax year 2013 and made net assessments of \$61.4 million. The draft report further notes that, for tax years 2012 and 2013, approximately 9.9 million accounts out of 10.5 million reconciled with no action on the part of the IRS, demonstrating that our efforts have had an impact.

TIGTA found there are a significant number of discrepancy cases which are not worked each year due, largely, to IRS limited resources. The number of discrepancy cases the IRS can handle each year relies upon a number of factors. IRS compliance efforts continue to be affected by a sharp reduction in budget resources (a reduction of nearly \$1 billion since 2010) as well as fewer enforcement staff and increased tax administration responsibility. The CAWR program has faced a more pronounced decline in staffing than the IRS as a whole during this period. As your report notes, the



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CAWR staffing has dropped by more than 50 percent. With the available staffing, the IRS is first required, per a settlement agreement reached as a result of a lawsuit, to work all SSA-CAWR cases (those cases in which Forms W-2 filed with the SSA reflect lower wage amounts than the associated employment tax returns). With the remaining staff, we are able to work some of the IRS-CAWR casework.

You found also, for those resources we have available, there appear to be more productive cases than the ones the IRS selected and worked. You recommend we evaluate the current agreement with the SSA and ensure we are expending resources to work the most productive cases. While we are required to work all SSA-CAWR cases by the terms of a settlement agreement, we agree that looking for ways to resolve more of those cases before they are referred to the IRS would be helpful and could permit the IRS to conserve our limited resources. We will meet with the SSA to evaluate the current agreement and workload processes. As a part of this discussion, we will look for opportunities to reduce the number of SSA-CAWR cases which cannot be successfully resolved prior to referral to the IRS.

You make several recommendations regarding how we select our cases. We review our case selection processes so we prioritize selection from cases with the highest potential *for* assessment instead of solely relying on the potential assessment (discrepancy) amount as you recommended. You noted that our current selection processes are not consistent with the *Combined Annual Wage Reporting Program – Phase I Report*, prepared by the IRS Office of Performance Evaluation and Risk Analysis (OPERA) in August 2006. As we shared with you, the OPERA report served as a stimulus for creating the auto-generated process. Our current selection process, based on years of experience, data analytics and focused on cases with the greatest potential *for* assessment, has resulted in 81 percent of the cases placed in process resulting in a positive tax assessment. We systemically filter cases to eliminate those likely to result in no change to revenue. However, we agree that there are opportunities to improve our current selection processes. As you noted, there are cases with certain criteria which are eliminated from our current process for a variety of reasons. We will adjust our inventory of discrepancy cases to include a population of cases which fall outside the criteria for auto-generated cases. The results of these manually worked cases will inform future program workload decisions. In addition, we will request programming to stop the random selection of auto-generated cases and evaluate methods to identify cases with the highest potential for adjustment.

Your report acknowledges we identified several opportunities for programming enhancement to our systems; however, we have been unable to make the changes because of our limited resources and competing demands. You make a recommendation we meet with Information Technology (IT) to prioritize work requests. As we explain in the attachment, IRS already has such a process in place.



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We disagree with the outcome measures you developed for the reasons detailed in the attachment. As we previously discussed, and as you acknowledge, the data used to perform your analysis affects the reliability of the measures. After a CAWR case is created, future account activity results in updates to the potential underreported tax. Neither IRS nor TIGTA can identify the potential underreported tax at the time the cases were selected. The CAWR dataset obtained by the audit team in October 2016 was used to formulate the conclusions and outcome measures documented in the draft report. While the October 2016 dataset may be the only one available to the audit team, it does not make the resulting analysis any more reliable.

Attached is a document detailing IRS responses and planned corrective actions to address your recommendations and your outcome measures. If you have any questions, please contact me, or a member of your staff may contact Brenda Dial, Director, Examination, Small Business/Self-Employed Division at (240) 613-5163.

Attachment



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Attachment

RECOMMENDATION 1:

The Commissioner, SB/SE Division, should evaluate the current agreement and workload processes with the SSA, as required, and ensure the IRS is expending resources to work the most productive SSA-CAWR cases.

CORRECTIVE ACTION:

We agree with this recommendation. Although both the IRS and the SSA currently conduct independent reviews of the CAWR program and discuss potential improvements, we will hold a discussion with the SSA to evaluate the current agreement and workload processes. As a part of this discussion, we will look for opportunities to reduce the number of SSA-CAWR cases which cannot be successfully resolved prior to referral to the IRS.

IMPLEMENTATION DATE:

September 15, 2018

RESPONSIBLE OFFICIAL:

Director, Field and Campus Policy, Examination Operations, SB/SE

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 revise the case selection process to include auto-generated cases with the highest potential tax assessment and expand discrepancy case selection to include cases currently excluded from the systemic selection process.

CORRECTIVE ACTIONS:

We agree with this recommendation.

1. We will adjust our inventory of discrepancy cases to include a population of cases which fall outside the criteria for auto-generated cases. The results of these manually worked cases will inform future program workload decisions.
2. We will request programming to stop the random selection of auto-generated cases and evaluate methods to identify cases with the highest potential for adjustment, including the consideration of a prior year discrepancy as a selection criterion.

IMPLEMENTATION DATE:

1. May 15, 2018
2. May 15, 2019



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RESPONSIBLE OFFICIAL:

Director, Field and Campus Policy, Examination Operations, SB/SE

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 3:

The Commissioner, SB/SE Division, should coordinate with the Information Technology organization to review open Unified Work Requests (UWR) to ensure prioritization for those enhancements, i.e., correct creation of discrepancy cases involving ***2*** and the use of *****2***** , that will have the greatest impact on tax administration.

CORRECTIVE ACTION:

We agree with this recommendation. The IRS currently has a system in place to review and prioritize UWRs corporately to ensure our limited technology funds are leveraged to maximize positive impact to tax administration. Requests are first reviewed and prioritized by an organizational Governance Board; ultimately, the Senior Executive Team allocates funding to the highest priority needs. As a result, there is no need for further action on this recommendation.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

N/A

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 4:

The Commissioner, SB/SE Division, should take actions necessary to implement the proposed modification of the CAWR Automated Program (CAP) system to include prior year discrepancy cases when current year discrepancy cases are selected for the same employer.

CORRECTIVE ACTION:

We do not agree with this recommendation. However, as noted in response to the second recommendation above, we will evaluate our methods to identify cases with the highest potential for adjustment, including the consideration of a prior year discrepancy as a selection criterion.



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The CAWR Release Plan referenced in the draft report was created in an informal setting along with IT, at a time when this and other programs were planned to be covered by the Information Return Document Matching (IRDM) process. This process was predicated upon having true IT analytical capability, which we never were able to achieve due to financial constraints. This particular IRDM effort was later discontinued and, while some of the 50+ items in the plan were completed, many were shelved. The discussion involved having the CAP look back to see if there was a discrepancy for the same employer in the prior year when selecting the current year inventory. This would allow the opportunity to address potential repetitive compliance concerns, while also avoiding the difficulty of working a prior year case. It was not designed to be a method to add a second, prior, year to the current year inventory selection.

Prior year cases generally fall outside of the auto assessment criteria thereby requiring a tax examiner to review the case manually. Working a case manually requires additional time; as a result, working one prior year case would result in multiple current year cases not being worked. In addition, the prior year cases that were identified by TIGTA had significantly lower potential tax than the current year cases identified that should be worked. Implementing this recommendation would result in fewer cases being worked and fewer dollars assessed.

CAWR currently does not have the systemic capability to identify a true repeater — that is, a taxpayer with the same issue on multiple years. There are multiple factors that can cause a CAWR discrepancy. Thus, one year could result in a tax assessment while another year for the same employer, could result in no assessment since the cause of each discrepancy is different.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

N/A

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 5:

The Commissioner, SB/SE Division, should establish a systemic process to match data fields to perfect unpostable Forms W-3.

CORRECTIVE ACTION:

The IRS agrees with this recommendation; however, given current budget levels and competing demands for limited information technology funds, we cannot commit to implementing the action. Several recent legislative changes requiring significant



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information technology resources have required that we significantly restrict other information technology requests. We will place this recommendation on hold.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

Director, Field and Campus Policy, Examination Operations, SB/SE

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 6:

The Commissioner, Wage and Investment Division, should update internal guidelines to include specific procedures for employees to follow on how to research and perfect CAWR unpostable cases. Once updated, provide training to employees on those procedures.

CORRECTIVE ACTION:

We agree with this recommendation and will review and update Internal Revenue Manual (IRM) 3.12.279 - *BMF/CAWR/PMF Unpostable Resolution*, by April 30, 2017 to ensure there are specific procedures for employees to follow on how to research and perfect CAWR Unpostables. Once the IRM is updated, training will be provided to employees, as needed, by June 30, 2017.

IMPLEMENTATION DATE:

July 15, 2017

RESPONSIBLE OFFICIAL:

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 7:

The Commissioner, Wage and Investment Division, should ensure that managerial reviews are performed as required to ensure that CAWR unpostable cases are properly researched and perfected.



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CORRECTIVE ACTION:

We agree with this recommendation and will perform periodic program reviews to provide a more comprehensive overview of program performance in perfecting unpostable CAWR cases. We will use that analysis to identify areas for improvement and take appropriate action to achieve the goal of further improving the perfection rate.

IMPLEMENTATION DATE:

June 15, 2018

RESPONSIBLE OFFICIAL:

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN:

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

OUTCOME MEASURE 1:

Increased Revenue – Potential; \$6,751,696,329 (highest dollar leads, full discrepancy amounts).

IRS RESPONSE:

We disagree with this dollar amount. It overstates the expected outcome for these cases. As stated on page 5 of the report, many cases yield tax assessments that are less than their original discrepancy while almost 20 percent of cases yield no tax assessment. We reviewed a judgmental sample, including some of the largest discrepancy cases (composing the majority of the dollars in this outcome measure). As mentioned earlier, our review shows that 94% of the cases had no real potential for increased revenue.

Since the workload was selected at random, we can use the results of the actual cases worked to extrapolate the true estimated potential tax assessments for the whole population. Using this information, the estimate for the total potential for all 137,000 unworked cases is about \$363 million (\pm the margin of error). Working a fraction of the 137,000 cases would yield only a part of the \$363 million, not the \$6.8 billion listed here.

OUTCOME MEASURE 2:

Increased Revenue – Potential; \$66,799,878 (highest dollar leads, based on average assessment by case type).

IRS RESPONSE:

We disagree with this figure.



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We have reviewed many of these recommended cases. For assorted technical reasons, a large number of the recommended cases have little or no tax potential.

Over the life of a CAWR case, the official “case type” fluctuates with arrival of new information. To apply “case type” estimates of the average yield per case to the set of recommended cases, we need to know the “case type” for each case at the time of case selection. The averages computed in Figure 7 of the report are based on the classification of the cases at the time of closure, which sometimes is different from a *prior* classification. For example, the applicable per case estimate for the potential yield of the recommended 3,093 type “04(A)” cases is not equal to \$22,189. The applicable estimate is the average for all cases that started as type “04(A).”

Finally, any projection from a sample needs to be properly qualified with a confidence interval.

OUTCOME MEASURE 3:

Increased Revenue – Potential; \$448,430,769 (prior year leads).

IRS RESPONSE:

We disagree with this figure. It overstates the expected outcome for these cases. As with the first outcome measure, this calculation confuses “discrepancy dollars” with the actual “potential tax assessments” for these cases. Also, the statute of limitations would prevent auditing some of these prior year returns. Another item worth considering is the expansion of the scope into additional tax periods is not cost-free. The marginal cost associated with the multi-year examinations is that fewer taxpayers would be assessed. On average, the prior year discrepancies for these 3,137 employers was less than the average current year discrepancy for the highest 23,184 cases. By substituting prior year examinations for other “high discrepancy” cases, the “average discrepancy examined” could decrease.

Pursuing prior year cases requires not pursuing all the possible high discrepancy current year cases (Recommendations 2 & 3 / Outcome Measures 1 & 2). The policy actions related to these outcome measures are mutually exclusive, not additive.

OUTCOME MEASURE 4:

Reliability of Information - Actual; 4,780 discrepancy cases (programming error for tolerance cases)

IRS RESPONSE:

We agree and acknowledged there was a programming error. We would like to emphasize that the programming error was corrected on September 22, 2016.



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OUTCOME MEASURE 5:

Inefficient Use of Resources – Potential; \$33,017 in reduced costs (automation of the process for fixing unpostable forms W-3)

IRS RESPONSE:

We disagree with this figure. An accurate measure of the net cost savings needs to factor inclusion of the cost to develop and maintain the application and to integrate it into current systems and processes.