System Changes Resulted in Successfully Processed Third-Party Income Documents, but Processes for Using the Information Need Improvement

March 26, 2018
Reference Number: 2018-20-019

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SYSTEM CHANGES RESULTED IN SUCCESSFULLY PROCESSED THIRD-PARTY INCOME DOCUMENTS, BUT PROCESSES FOR USING THE INFORMATION NEED IMPROVEMENT

Highlights

Final Report issued on March 26, 2018

Highlights of Reference Number: 2018-20-019 to the Internal Revenue Service Commissioner for the Wage and Investment Division and the Chief Information Officer.

IMPACT ON TAXPAYERS

Section 201 of the Protecting Americans from Tax Hikes Act of 2015 modifies the due dates of Form W-2, Wage and Tax Statement, and Form 1099-MISC, Miscellaneous Income. It requires returns and statements related to employee wage information and nonemployee compensation to be filed on or before January 31. It also specifies that no credit or refund can be made to taxpayers who claimed the Earned Income Tax Credit (EITC) or Additional Child Tax Credit (ACTC) until February 15, 2017, for the 2017 Filing Season. The intent is to provide the IRS sufficient time to effectively match tax returns and return information before refund issuance.

WHY TIGTA DID THE AUDIT

This audit was initiated to ensure that the IRS was in compliance with the filing requirement changes in Section 201 of the Protecting Americans from Tax Hikes Act of 2015. The overall objective was to evaluate the IRS’s coordination and implementation of changes in support of the Protecting Americans from Tax Hikes Act of 2015.

WHAT TIGTA FOUND

The Filing Information Returns Electronically System was compliant with filing season readiness requirements. According to IRS management, the IRS used the Systemic Verification tool within the Return Review Program to verify income between Forms W-2 and income tax returns before issuing EITC and ACTC refunds during the 2017 Filing Season. The IRS did not make programming modifications regarding Form 1099-MISC processing because the Wage and Investment Division management did not request changes be made. The amount of nonemployee compensation reported on Forms 1099-MISC for the 2017 Filing Season was $1.58 trillion.

Additionally, Wage and Investment Division management did not request elimination of the automatic extension to file Form 1099-MISC. If automatic extensions for filing Form 1099-MISC with nonemployee compensation were eliminated, it would provide a significant benefit by improving the ability to match income reported before refunds are paid.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division submit a request for programming modifications regarding Form 1099-MISC processing, and work with the Department of the Treasury Office of Tax Policy to determine the feasibility of eliminating automatic extensions to file Form 1099-MISC in order to improve the IRS’s ability to verify income and reduce fraud.

The IRS agreed and is working with the Department of the Treasury to eliminate automatic extensions for Forms 1099-MISC that report nonemployee compensation. The IRS disagreed with TIGTA’s recommendation to make programming modifications.
March 26, 2018

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION
CHIEF INFORMATION OFFICER

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – System Changes Resulted in Successfully Processed Third-Party Income Documents, but Processes for Using the Information Need Improvement (Audit # 201620025)

This report presents the results of our review to evaluate the Internal Revenue Service’s (IRS) coordination and implementation of changes in support of the Protecting Americans from Tax Hikes Act of 2015.1 This audit was included in our Fiscal Year 2017 Annual Audit Plan and addresses the major management challenge of Improving Tax Systems and Expanding Online Services.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Danny R. Verneuille, Assistant Inspector General for Audit (Security and Information Technology Services).

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**Abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ACTC</td>
<td>Additional Child Tax Credit</td>
</tr>
<tr>
<td>EITC</td>
<td>Earned Income Tax Credit</td>
</tr>
<tr>
<td>ESC</td>
<td>Executive Steering Committee</td>
</tr>
<tr>
<td>FIRE</td>
<td>Filing Information Returns Electronically</td>
</tr>
<tr>
<td>IRM</td>
<td>Internal Revenue Manual</td>
</tr>
<tr>
<td>IRS</td>
<td>Internal Revenue Service</td>
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<tr>
<td>IT</td>
<td>Information Technology</td>
</tr>
<tr>
<td>PATH Act</td>
<td>Protecting Americans from Tax Hikes Act of 2015</td>
</tr>
<tr>
<td>UWR</td>
<td>Unified Work Request</td>
</tr>
<tr>
<td>W&amp;I</td>
<td>Wage and Investment</td>
</tr>
</tbody>
</table>
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Background

Section (§) 201 of the Protecting Americans from Tax Hikes Act of 2015
(PATH Act)

On December 18, 2015, Congress enacted the PATH Act, which includes program integrity provisions specifically intended to reduce certain fraudulent and improper payments. The integrity provisions expanded the Internal Revenue Service’s (IRS) ability to verify earned income before refunds are paid. One of the program integrity provisions in the PATH Act is in § 201.

Section 201 of the PATH Act modifies the filing due dates of Form W-2, Wage and Tax Statement, and Form 1099-MISC, Miscellaneous Income. It requires returns and statements related to employee wage information and nonemployee compensation be filed on or before January 31. Prior to the 2017 Filing Season, the due date for a paper Form W-2 and Form 1099-MISC was February 28; for an electronically filed Form W-2 and Form 1099-MISC, the due date was March 31. Section 201 of the PATH Act also specifies that no credit or refund can be made to taxpayers who claimed the Earned Income Tax Credit (EITC) or the Additional Child Tax Credit (ACTC) until the 15th day of the second month following the close of the taxable year (i.e., February 15, 2017, for the 2017 Filing season). This change allows the IRS to take additional time to review refund claims before issuing refunds with the EITC or the ACTC in order to reduce fraud and improper payments.

The Filing Information Returns Electronically (FIRE) System

The FIRE system is an Internet-based system through which filers transmit information returns and other forms electronically to the IRS. According to the IRS, the FIRE system performs preliminary checks of submitted files, manages the file transfer of data to downstream systems, and receives statuses from the downstream systems. The FIRE system receives Form 1099-MISC and Form 8809, Application for Extension of Time to File Information Returns.

This review was performed with information obtained from the IRS Information Technology (IT) organization’s Applications Development and Enterprise Services organizations located in the New Carrollton Federal Building in Lanham, Maryland, and from the IRS Wage and

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2 See Appendix V for a glossary of terms.
3 Codified into Internal Revenue Code §§ 6071 and § 6402.
4 Or self-employment income.
5 See Appendix IV for a list of information returns and other forms the FIRE system receives.
Investment (W&I) Division, Customer Account Services office located in the Peachtree Summit Federal Building in Atlanta, Georgia, during the period October 2016 through October 2017. 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.
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Results of Review

The Filing Information Returns Electronically System Was Ready for the 2017 Filing Season

Internal Revenue Manual (IRM) Section 2.16.1, Enterprise Lifecycle Guidance (dated December 22, 2015), details a framework which provides guidance and requirements for IRS projects as they progress from planning through system deployment. One component of the enterprise life cycle framework is project definition in which the IRM delineates between two types of IRS projects: new development and maintenance projects. For maintenance projects, the following paths may be followed:

- **Planned Maintenance Path** – manages change in an organized manner, minimizes the disruption caused by frequent system changes, and increases the efficiency and effectiveness of the system change process.
- **Emergency Maintenance Path** – immediate system maintenance required to address a sudden or unexpected disruption of a system or application.

The IRM also specifies the enterprise life cycle artifacts required in each project phase. One of the artifacts required is the Project Management Plan which comprises several subsidiary plans including the Requirements Management Plan. The Requirements Management Plan describes the processes, techniques, and tools that will be used to manage and control project requirements and the mechanisms that will be used to establish and maintain an agreement with the customer on the requirements for a project. Specifically, the FIRE Planned Maintenance Requirements Plan outlines four phases of requirements development.

1) **Requirements Elicitation** – The business owner will identify and document the business need, often in a Unified Work Request (UWR).

2) **Requirements Analysis and Specification** – The high-level requirements are broken down into a set of detailed requirement statements.

3) **Requirements Agreement and Prioritization** – The business owner and the IT organization project team establish a common understanding of the set of requirements to be implemented in one or more planned releases.

4) **Requirements Verification and Validation** – The project will ensure the work products meet their specified requirements.

In January 2016, the Electronic Product Services Support group within the W&I Division submitted a UWR. The UWR documented 18 business requirements needed to comply with the
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legislative changes for the 2017 Filing Season due to § 201 of the PATH Act. We obtained the FIRE Requirements Specification document dated January 2017, which documented 13 information technology requirements to be implemented for the 2017 Filing Season. We compared the requirement identification numbers and content of the UWR requirements to the FIRE Requirements Specification document to perform tracing of business requirements to information technology requirements. We also met with the FIRE system technical lead to review our analysis. During our discussions, we learned:

- Six of the original 18 UWR requirements were removed for the following reasons: one requirement was already included in a separate UWR, two requirements were duplicates, and three requirements were determined to be out of scope.
- Two of the 18 UWR requirements were combined into one information technology requirement.
- Two requirements were missed in the original UWR submission and subsequently added to the FIRE Requirements Specification document.

We requested documentation to support the collaboration efforts between the Electronic Product Services Support group and the IT organization regarding the requirements changes. In February 2016, representatives from the W&I Division, Enterprise System Testing group, and the FIRE Project Office conducted a peer review of the requirements. The purpose of the peer review was to evaluate the requirements for clarity and to agree on changes to the requirements statements. In October 2016, the FIRE system team met with the Electronic Product Services group to conduct a demonstration of the FIRE system to ensure agreement to the changes. Based on our analysis and discussions with the IRS, we concluded the W&I Division and the IT organization worked together to trace the 18 business requirements to 13 information technology requirements needed to comply with the legislative changes for the 2017 Filing Season due to § 201 of the PATH Act.

We also reviewed requirements testing documentation to ensure that all 13 requirements were tested and system functionality met expectations prior to implementing the changes into the production environment. IRM § 2.127.2, Software Testing Standards and Procedures, IT Software Testing Standards and Procedures (dated March 17, 2015), specifies that test cases must be created and executed with a determination of pass/fail status based on comparison of actual results to expected results. If actual results do not match expected results, the Enterprise System Testing group must create a problem ticket, or a Knowledge, Incident/Problem, Service Asset Management system ticket. Once the system tester is notified that the correction to address the identified problem is completed, the requirement is tested again.

The IRS created 22 test cases to validate the 13 FIRE system requirements. Our review of the test cases identified the following:

- All 22 test cases documented the detailed steps required to execute the test case.
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- All 22 test cases had a specific expected result for each step of the test case execution.
- All 13 requirements had at least one test case to ensure that every requirement was tested.

The IRS reported that 20 of the 22 test cases passed. We reviewed test execution results for each reported passed test case by reviewing screen shots from the FIRE system to verify actual results matched expected results. We agree with the IRS’s conclusion that 20 test cases passed.

According to the Enterprise System Testing group, the remaining two test cases were waived because the functionality to be tested was no longer required. Additionally, all problem tickets encountered in testing were tracked and resolved prior to the 2017 Filing Season. Based on our analysis, we concluded that each of the 13 requirements were tested for acceptance prior to being placed into production.

**The IRS mitigated risks to the FIRE system’s downstream systems**

The IRM states a risk management plan should describe the processes, techniques, and tools that will be used to track, manage, and control project risks. The Applications Development Risk and Issue Management Plan defines risk management as the act or practice of controlling risk. The process includes identifying and tracking risk areas, developing risk mitigation plans as part of risk handling, monitoring risks, and performing risk assessments. Risk assessments provide the probability of a risk occurring and an assessment of the risk impact. Risk mitigation plans detail the steps needed to address risks or issues and provide details on how the selected risk strategy will be executed or how the issue will be managed and a timeline for all activities in the plan.

The FIRE system has four downstream systems that process Forms 1099-MISC received through the FIRE system. The Applications Development organization stated the FIRE system and the four downstream systems that process Forms 1099-MISC are governed by the Applications Development Risk and Issue Management Plan.

The PATH Act’s changes to the filing due date for selected forms could have affected the FIRE system and its downstream systems. For example, the increase in files received in January 2017 could have caused an increase in form processing errors and discrepancies in the downstream systems. A risk assessment and mitigation plan for the FIRE system’s downstream systems would show the potential impact of such risks and how they were mitigated.

However, the IRS did not conduct a formal risk assessment and prepare a mitigation plan on the FIRE system’s four downstream systems to address any potential processing risks due to the change in legislation. We did not take exception for the following reasons:

1) In January 2017, IRS management agreed to increase processing capacity on two of its downstream systems as a mitigation strategy due to the potential increase in volume of Forms 1099-MISC received in January 2017. Because the IRS did not report any

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problems with the FIRE system or its downstream systems processing the increased volume of files during the 2017 Filing Season, it appears this strategy was appropriate and addressed the potential risk.

2) The FIRE system project team indicated the system can receive about five and one-half times more files than its downstream systems. During peak processing periods, the FIRE system suspends delivery of additional files to ensure that it does not send more files than the downstream systems can process on a daily basis.

The FIRE system received its largest number of files totaling 151,775 on January 31, 2017. This represents 137 percent more files received compared to January 31, 2016.

There was communication about the FIRE system's progress

The Standards for Internal Control in the Federal Government\(^8\) instructs management to internally communicate the necessary information to achieve the entity’s objectives. Management should select the appropriate methods to communicate that information, such as written documents (in hard copy or electronic formats) or face-to-face meetings. The Filing Season Readiness Executive Steering Committee (ESC) Charter states the ESC’s purpose is to provide assurance the IRS is in a state of readiness for the upcoming filing season. The ESC communicates challenges and risks, such as a potential impact to taxpayers not being properly addressed.

According to W&I Division personnel, the ESC has four executive co-chairs which includes senior management from the IT organization. The executive co-chairs host meetings with representatives from various IRS organizations, including a representative from Electronic Products and Services Support function within the W&I Division, who provides the status of FIRE system issues. The meetings are based on the higher prioritized action items incorporated into the ESC Action Plans. Our review of the ESC Action Plans showed the FIRE system action plan items were updated regularly and closed timely. There were no specific action items related to § 201 of the PATH Act.

Analysis of communications within the IT organization and between the IT organization and the W&I Division revealed collaborative efforts. Communications about the changes to the FIRE system were primarily made electronically and by telephone. The IRS also held meetings that kept staff and management apprised of any challenges due to legislative changes including concerns about requirements testing and implementation. Related issues were conveyed to senior management.

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\(^7\) A file contains between one and 2,500,000 records.

\(^8\) Government Accountability Office, GAO-14-704G (September 2014).
Actions Should Be Taken to Ensure That

Section 201 of the PATH Act stipulates that no credit or refund shall be issued to taxpayers before February 15 if the taxpayers claimed the EITC or the ACTC on their tax return. This provision of the PATH Act enables the IRS to more effectively match tax returns and return information before refund issuance, as the IRS will have more data, e.g., Form W-2 and Form 1099-MISC, to verify income before issuing EITC and ACTC refunds. In a prior Treasury Inspector General for Tax Administration audit report,\(^9\) we reported that... We recommended that the IRS... The IRS agreed with our recommendation.

For the 2017 Filing Season, the IRS stated that it used Form W-2 data to verify income on income tax returns with EITC or ACTC claims. IRS management stated that... Further, the IRS believes... At this time, the IRS...

W&I Division management... Because § 201 of the PATH Act enables the IRS...
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Figure 1 provides the number of Forms 1099-MISC with nonemployee compensation filed and the amount of nonemployee compensation reported.

**Figure 1: Filing Season 2017 Forms 1099-MISC With Nonemployee Compensation**

<table>
<thead>
<tr>
<th>Form</th>
<th>2017 Filing Season Volume</th>
<th>2017 Filing Season Nonemployee Compensation Dollar Amount (in Trillions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form 1099-MISC With Nonemployee Compensation</td>
<td>19,618,854</td>
<td>$1.58</td>
</tr>
</tbody>
</table>

Source: Information Return Master File reports that provide data on electronically filed Forms 1099-MISC.10

**Recommendation**

**Recommendation 1:** The Commissioner, W&I Division, should ensure that

Management's Response: The IRS disagreed with the recommendation and stated that

Office of Audit Comment: The IRS should eliminate automatic extensions to file Form 1099-MISC to ensure more forms are available to verify nonemployee compensation

Internal Revenue Code § 6081 states that the IRS may grant a filer an extension to file information returns. In order for a filer to be granted an extension, the filer must submit Form 8809 electronically through the IRS’s FIRE system or by paper. Prior to the 2017 Filing Season, filers who submitted Form 8809 received an automatic 30 calendar day extension to file

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10 Due to time and resource constraints, we did not audit the IRS systems to validate the accuracy and reliability of the data.
Form W-2 and Form 1099-MISC. The IRS eliminated the automatic extension to file Form W-2 for the 2017 Filing Season but did not eliminate the automatic extension to file Form 1099-MISC. However, Internal Revenue Code § 6081 does not preclude the IRS from eliminating the automatic extension to file Form 1099-MISC. By eliminating the automatic extension, the IRS would have additional information to use in their identity theft and refund fraud detection processes.

W&I Division management did not request the removal of the automatic extensions to file Form 1099-MISC for the 2017 Filing Season. According to Internal Revenue Bulletin 2015-35 dated August 31, 2015, the IRS intends to eventually remove the automatic extension to file Form 1099-MISC and various other forms, although no definite date is given.

Internal Revenue Bulletin 2015-35 also indicates the IRS recognizes the importance of eliminating the automatic extension on Form 1099-MISC and states:

> Removing the automatic 30 [calendar] day extension of time to file is an affirmative step to accelerate the filing of information returns so they are available earlier in the filing season for use in the IRS’s refund fraud detection processes.

IRS records show 19,618,854 Forms 1099-MISC with nonemployee compensation were filed during the 2017 Filing Season. Of this, only 184,947 were filed in January 2017. Additionally, 155,232 automatic extension requests to delay filing Form 1099-MISC with nonemployee compensation were received in January 2017. Each payer’s automatic extension request may include multiple payees that receive Form 1099-MISC with nonemployee compensation. However, the number of payees covered by the extension requests is not known. If automatic extensions for filing Form 1099-MISC with nonemployee compensation had been eliminated, there could have been significantly more Forms 1099-MISC with nonemployee compensation filed by January 31, 2017. As such, and elimination of the automatic extension to file Form 1099-MISC could significantly improve the and the ability to identify tax refund fraud and improper payments.

**Recommendation**

**Recommendation 2:** The Commissioner, W&I Division and the IRS Office of Chief Counsel, should work with the Department of the Treasury Office of Tax Policy to determine the feasibility of eliminating automatic extensions to file Form 1099-MISC and various other forms, although no definite date is given. If the automatic extension is eliminated, the Commissioner, W&I Division, should ensure that a UWR is created to implement the necessary programming modifications.

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\(^{11}\) References with respect to automatic extensions to file Form 1099-MISC include automatic extensions to file Form 1099-MISC with nonemployee compensation.
Management’s Response: The IRS agreed with the recommendation and stated Chief Counsel is working with the Treasury Department’s Office of Tax Policy to finalize the regulation to achieve this. A UWR will not be necessary for IRS systems to process Forms 1099-MISC after the ability to obtain an automatic extension is eliminated. The new regulation is expected to be in effect for the 2019 Filing Season; however, it is dependent on agreement by the Department of the Treasury. Therefore, the IRS cannot commit to an implementation date.
Appendix I

**Detailed Objective, Scope, and Methodology**

Our overall objective was to evaluate the IRS’s coordination and implementation of changes in support of the PATH Act.¹ To accomplish our objective, we:

I. Evaluated the completeness, testing, and business unit functionality acceptance of system changes due to the PATH Act.
   
   A. Reviewed IRM system development, requirements testing guidance, and the Government Accountability Office’s *Standards for Internal Control in the Federal Government*² to ensure that controls and procedures were followed.
   
   B. Reviewed the initial and updated requirements management plans.
   
   C. Traced the W&I Division’s requirements to the IT organization’s requirements to ensure that all requirements were incorporated and functionality acceptance by the business system owner was approved prior to the system being placed into production.
   
   D. Reviewed requirements testing documentation such as test schedules, tests conducted, and test results to ensure that adequate testing of all requirements functionality and that defects were resolved prior to the FIRE system being placed into production.
   
   E. Reviewed the risk assessment and analysis performed and the mitigation plan developed to address the potential risk to downstream tax processing systems, *i.e.*, increased number of tax return errors and discrepancies identified, due to the new filing requirements specified in the PATH Act.

II. Evaluated the coordination between the W&I Division and the IT organization to ensure that business needs were met for the 2017 Filing Season.

   A. Obtained and reviewed guidance documentation (including, but not limited to, IRM Section 11.55.2, desktop procedures, and the Government Accountability Office’s *Standards for Internal Control in the Federal Government*) to determine how information should be communicated and coordinated to satisfy business needs.

   B. Interviewed W&I Division and IT organization personnel to determine coordination efforts.

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² Government Accountability Office, GAO-14-704G (September 2014).
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C. Researched the problems and issues IRS management anticipated.

D. Reviewed documentation to determine how the implementation process was communicated from inception to implementation.

E. Reviewed documentation to determine how progress of the modifications was monitored and managed.

III. Determined the impact of the IRS allowing automatic 30 calendar day extensions for Form 1099-MISC.

A. Researched the Internal Revenue Code to determine whether the law precludes the IRS from taking away the automatic 30 calendar day filing extension for Form 1099-MISC.

B. Obtained the populations of Forms 1099-MISC and Forms 8809, Application for Extension of Time to File Information Returns, to determine the number of Forms 1099-MISC filed as of January 31, 2017, and the number of automatic extension requests.

**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: IRM Section 2.16.1, Enterprise Life Cycle Guidance; the Government Accountability Office’s Standards for Internal Control in the Federal Government; the Filing Season Readiness ESC Charter; the FIRE system Planned Maintenance Requirements Plan; and the Applications Development Risk and Issue Management Plan. We evaluated these controls by conducting interviews with management and staff and reviewing documentation that provided evidence of whether the IRS is adequately managing requirements for the FIRE system planned maintenance project.

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3 Due to time and resource constraints, we did not audit the IRS systems to validate the accuracy and reliability of the data.
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Appendix II

Major Contributors to This Report

Danny R. Verneuille, Assistant Inspector General for Audit (Security and Information Technology Services)
John Ledford, Director
Mike Mohrman, Audit Manager
Chanda Stratton, Lead Auditor
Craig LeQuire, Auditor
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Appendix III

**Report Distribution List**

Assistant Secretary of the Treasury for Tax Policy  
Commissioner  
Office of the Commissioner – Attn: Chief of Staff  
Deputy Commissioner for Operations Support  
Deputy Commissioner for Services and Enforcement  
Deputy Commissioner, Wage and Investment Division  
Associate Chief Information Officer, Applications Development  
Associate Chief Information Officer, Enterprise Services  
Director, Office of Audit Coordination
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Appendix IV

**Forms Received by the Filing Information Returns Electronically System**

<table>
<thead>
<tr>
<th>Form</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form 1042-S</td>
<td>Foreign Person’s U.S. Source Income Subject to Withholding</td>
</tr>
<tr>
<td>Form 1097-BTC</td>
<td>Bond Tax Credit</td>
</tr>
<tr>
<td>Form 1098</td>
<td>Mortgage Interest Statement</td>
</tr>
<tr>
<td>Form 1098-C</td>
<td>Contributions of Motor Vehicles, Boats, and Airplanes</td>
</tr>
<tr>
<td>Form 1098-E</td>
<td>Student Loan Interest Statement</td>
</tr>
<tr>
<td>Form 1098-MA</td>
<td>Mortgage Assistance Payments</td>
</tr>
<tr>
<td>Form 1098-Q</td>
<td>Qualifying Longevity Annuity Contract Information</td>
</tr>
<tr>
<td>Form 1098-T</td>
<td>Tuition Statement</td>
</tr>
<tr>
<td>Form 1099-A</td>
<td>Acquisition or Abandonment of Secured Property</td>
</tr>
<tr>
<td>Form 1099-B</td>
<td>Proceeds From Broker and Barter Exchange Transactions</td>
</tr>
<tr>
<td>Form 1099-C</td>
<td>Cancellation of Debt</td>
</tr>
<tr>
<td>Form 1099-CAP</td>
<td>Changes in Corporate Control and Capital Structure</td>
</tr>
<tr>
<td>Form 1099-DIV</td>
<td>Dividends and Distributions</td>
</tr>
<tr>
<td>Form 1099-G</td>
<td>Certain Government Payments</td>
</tr>
<tr>
<td>Form 1099-H</td>
<td>Health Coverage Tax Credit (HCTC) Advance Payments</td>
</tr>
<tr>
<td>Form 1099-INT</td>
<td>Interest Income</td>
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<tr>
<td>Form 1099-K</td>
<td>Payment Card and Third Party Network Transactions</td>
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<tr>
<td>Form 1099-LTC</td>
<td>Long-Term Care and Accelerated Death Benefits</td>
</tr>
<tr>
<td>Form 1099-MISC</td>
<td>Miscellaneous Income</td>
</tr>
<tr>
<td>Form 1099-OID</td>
<td>Original Issue Discount</td>
</tr>
<tr>
<td>Form 1099-PATR</td>
<td>Taxable Distributions Received From Cooperatives</td>
</tr>
</tbody>
</table>
### System Changes Resulted in Successfully Processed Third-Party Income Documents, but Processes for Using the Information Need Improvement

<table>
<thead>
<tr>
<th>Form</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form 1099-Q</td>
<td>Payments From Qualified Education Programs (Under Sections 529 and 530)</td>
</tr>
<tr>
<td>Form 1099-QA</td>
<td>Distributions from ABLE Accounts</td>
</tr>
<tr>
<td>Form 1099-R</td>
<td>Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.</td>
</tr>
<tr>
<td>Form 1099-S</td>
<td>Proceeds From Real Estate Transactions</td>
</tr>
<tr>
<td>Form 1099-SA</td>
<td>Distributions From an HSA, Archer MSA, or Medicare Advantage MSA</td>
</tr>
<tr>
<td>Form 3921</td>
<td>Exercise of an Incentive Stock Option Under Section 422(b)</td>
</tr>
<tr>
<td>Form 3922</td>
<td>Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c)</td>
</tr>
<tr>
<td>Form 4419</td>
<td>Application for Filing Information Returns Electronically</td>
</tr>
<tr>
<td>Form 5498</td>
<td>IRA Contribution Information</td>
</tr>
<tr>
<td>Form 5498-ESA</td>
<td>Coverdell ESA Contribution Information</td>
</tr>
<tr>
<td>Form 5498-QA</td>
<td>ABLE Account Contribution Information</td>
</tr>
<tr>
<td>Form 5498-SA</td>
<td>HSA, Archer MSA, or Medicare Advantage MSA Information</td>
</tr>
<tr>
<td>Form 8027</td>
<td>Employer’s Annual Information Return of Tip Income and Allocated Tips</td>
</tr>
<tr>
<td>Form 8809</td>
<td>Application for Extension of Time to File Information Returns</td>
</tr>
<tr>
<td>Form 8955-SSA</td>
<td>Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits</td>
</tr>
<tr>
<td>Form W-2G</td>
<td>Certain Gambling Winnings</td>
</tr>
</tbody>
</table>

Source: IRS.gov.
ABLE = Achieving a Better Life Experience, ESA = Education Savings Account, HSA = Health Savings Account, IRA = Individual Retirement Account, MSA = Medical Savings Account.
## Glossary of Terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Additional Child Tax Credit</strong></td>
<td>A refundable credit designed to help low-income taxpayers. It is used to adjust the individual income tax structure to reflect a family’s reduced ability to pay taxes as the family size increases. Refundable tax credits can be used to reduce a taxpayer’s tax liability to zero. Any excess of the credit beyond the tax liability can be refunded to the taxpayer.</td>
</tr>
<tr>
<td><strong>Artifact</strong></td>
<td>The output of an activity performed in a process/procedure, which is created throughout the life cycle of a project.</td>
</tr>
<tr>
<td><strong>Automatic Magnetic Media Processing System</strong></td>
<td>A system used to track, schedule, submit, process, and balance certain data electronically and is one of the FIRE system’s downstream systems that receives Form 1099-MISC.</td>
</tr>
<tr>
<td><strong>Downstream System</strong></td>
<td>A system that receives and processes another system’s information data.</td>
</tr>
<tr>
<td><strong>Earned Income Tax Credit</strong></td>
<td>A refundable credit designed to help low-income taxpayers. It is used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment. Refundable tax credits can be used to reduce a taxpayer’s tax liability to zero. Any excess of the credit beyond the tax liability can be refunded to the taxpayers.</td>
</tr>
<tr>
<td><strong>Filer</strong></td>
<td>Any payer or transmitter submitting information returns to the IRS.</td>
</tr>
<tr>
<td><strong>Filing Season</strong></td>
<td>The period from January through mid-April when most individual income tax returns are filed.</td>
</tr>
<tr>
<td><strong>Improper Payment</strong></td>
<td>Any payment that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient.</td>
</tr>
<tr>
<td><strong>Information Return Processing Input Processing</strong></td>
<td>A function of the Information Return Processing system that conducts Taxpayer Identification Number validation among</td>
</tr>
</tbody>
</table>
### System Changes Resulted in Successfully Processed Third-Party Income Documents, but Processes for Using the Information Need Improvement

<table>
<thead>
<tr>
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<tr>
<td><strong>other duties.</strong> It is one of the FIRE system’s downstream systems that receives Form 1099-MISC.</td>
<td></td>
</tr>
<tr>
<td><strong>Information Returns Master File</strong></td>
<td>An IRS database that contains third-party information documents for taxpayers; it is one of the FIRE system’s downstream systems that receives Form 1099-MISC.</td>
</tr>
<tr>
<td><strong>Internal Revenue Manual</strong></td>
<td>The primary official source of IRS “instructions to staff” that relates to its administration and operation. It ensures that employees have the approved policy and guidance they need to carry out their responsibilities in administering the tax laws or other agency obligations, including information technology.</td>
</tr>
<tr>
<td><strong>Nonemployee Compensation</strong></td>
<td>Applies when the payer of an individual’s income does not consider the individual an employee. Instead, the individual is considered a self-employed worker, also called an independent contractor.</td>
</tr>
<tr>
<td><strong>Payer Master File</strong></td>
<td>A system that maintains documents covering five tax years of information for all Form 1096, <em>Annual Summary and Transmittal of U.S. Information Returns</em>, and all Form W-3, <em>Transmittal of Wage and Tax Statements</em>, on a Virtual Sequential Access Method database and is one of the FIRE system’s downstream systems that receives Form 1099-MISC.</td>
</tr>
<tr>
<td><strong>Release</strong></td>
<td>A specific edition of software.</td>
</tr>
<tr>
<td><strong>Requirement Statements</strong></td>
<td>Artifacts that are textual in nature and state functional and/or nonfunctional needs of the system.</td>
</tr>
<tr>
<td><strong>Return Review Program</strong></td>
<td>A system the IRS uses to identify potentially fraudulent electronically filed tax returns. It enhances the IRS’s capabilities to detect, resolve, and prevent criminal and civil noncompliance, and reduces issuance of fraudulent tax refunds.</td>
</tr>
<tr>
<td><strong>Standards for Internal Control in the Federal Government</strong></td>
<td>Sets the standards for an effective internal control system for Federal agencies and provides the overall framework for designing, implementing, and operating an effective internal control system. An entity uses these standards to help achieve its objectives related to operations, reporting, and compliance.</td>
</tr>
</tbody>
</table>
System Changes Resulted in Successfully Processed Third-Party Income Documents, but Processes for Using the Information Need Improvement

<table>
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<tr>
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<tbody>
<tr>
<td>Test Case</td>
<td>The foundation of a test. References specific test data and the expected results associated with specific criteria.</td>
</tr>
<tr>
<td>Unified Work Request</td>
<td>A formal notification to an information technology supplier organization that a requestor organization has a business need for information technology products or services.</td>
</tr>
<tr>
<td>Virtual Sequential Access Method</td>
<td>An access method for the International Business Machines’ mainframe operating system.</td>
</tr>
</tbody>
</table>
Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

February 20, 2018

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kenneth C. Corbin /s/ Kenneth C. Corbin
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – System Changes Successfully Processed Third Party Income Documents, But Processes for Using the Information Need Improvement (Audit# 201620025)

Thank you for the opportunity to review the subject draft report and provide comments. We are pleased with the acknowledgement of the work completed by the Information Technology function to implement and test the programming changes required to the Filing Information Returns Electronically\(^1\) system required by the Protecting Americans from Tax Hikes (PATH) Act of 2015\(^2\). We also appreciate the acknowledgement of actions taken by the Information Technology function to increase the processing capacity of downstream systems, mitigating potential issues with peak daily processing periods as large volumes of information returns were received and processed.

Section 201 of the PATH Act made two significant changes to the Internal Revenue Code. The due date for filing Form W-2, Wage and Tax Statement, Form W-3, Transmittal of Wage and Tax Statements, and Form 1099-MISC, Miscellaneous Income (reporting non-employee compensation) was changed to January 31. Additionally, any refund that included claims for the Earned Income Tax Credit (EITC) or the Additional Child Tax Credit (ACTC) may no longer be paid before February 15. Prior to the passage of the PATH Act, the due date for these forms was the last day of February for paper filings, and March 31 for electronic filings.

To maximize the benefits obtained from systemic verification, on August 13, 2015, the IRS removed Treasury Regulation § 1.6081-8, which provided for an automatic 30-day extension of time to file Form W-2, and replaced it with temporary Treasury Regulation § 1.6081-8T. The temporary regulation eliminated the automatic 30-day extension for Form W-2. The intended result was to realize increased volumes of Forms W-2 received earlier in the year when the data has significant value during return processing. The passage of the PATH Act on December 18, 2015, which accelerated the filing deadline for all Form W-2 submissions, further assisted our efforts in increasing the volume of wage data available earlier in the filing season.

The January 31 due date became effective for the applicable information returns required to be filed for the 2016 tax year. We worked with the Social Security Administration (SSA) to ascertain that Forms W-2 could be filed by employers as early as December 2016 and would be transmitted daily to the IRS. Recognizing the significant impact the change of the filing due date and the elimination of automatic extensions could have on the payor community, the IRS also engaged stakeholders with educational outreach and communications. This ensured employers were aware well ahead of the end of the tax year that their information returns would be due by January 31, 2017. These actions led to the IRS, by February 15, 2017, receiving data from the SSA for more than 214 million Form W-2 filings. That represents a more than two-fold increase over the number received at the same point in time the previous year.

As stated in the report:

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3 80 FR 48433, August 13, 2015
Additionally, when the temporary Treasury Regulation § 1.6081-8T became effective, the IRS also issued Proposed Treasury Regulation § 1.6081-8, which proposes to eliminate the automatic extension for the Form 1099 series, including Form 1099-MISC. The IRS intends to work with the Treasury Department to publish a final regulation that will eliminate the automatic extension for Form 1099-MISC reporting non-employee compensation.

Attached are our comments and proposed actions to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Michael Beebe, Director, Return Integrity and Compliance Services, Wage and Investment Division, at (470) 639-3250.
Recommendations

RECOMMENDATION 1
The Commissioner, W&I Division, should ensure that recommendation.

CORRECTIVE ACTION
We disagree with the recommendation.

IMPLEMENTATION DATE
Implemented.

RESPONSIBLE OFFICIAL
Director, Return Integrity Office, Return Integrity and Compliance Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 2
The Commissioner, W&I Division and the IRS Office of Chief Counsel, should work with the Department of the Treasury Office of Tax Policy to determine the feasibility of eliminating automatic extensions to file Form 1099-MISC. If the automatic extension is eliminated, the Commissioner, W&I Division, should ensure that a UWR is created to implement the necessary programming modifications.

CORRECTIVE ACTION
We agree with the recommendation to eliminate automatic extensions for Forms 1099-MISC that report non-employee compensation. Chief Counsel is working with the Treasury Department's Office of Tax Policy to finalize the regulation to achieve this. A Unified Work Request will not be necessary for our systems to process Forms 1099-MISC after the ability to obtain an automatic extension is eliminated. The new regulation is expected to be in effect for the 2019 filing season; however, it is dependent on agreement by the Treasury Department. Therefore, we cannot commit to an implementation date.
IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
Director, Return Integrity Office, Return Integrity and Compliance Services, Wage and Investment Division

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