



*Billions of Dollars in Non-Payroll Tax
Withholding Discrepancies
Are Not Being Addressed*

May 20, 2019

Reference Number: 2019-40-028

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

Redaction Legend:

2 = Law Enforcement Techniques/ Procedures and Guidelines for Law Enforcement Investigations or Prosecutions

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HIGHLIGHTS

BILLIONS OF DOLLARS IN NON-PAYROLL TAX WITHHOLDING DISCREPANCIES ARE NOT BEING ADDRESSED

Highlights

Final Report issued on May 20, 2019

Highlights of Reference Number: 2019-40-028 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

A business entity (payer), such as a bank or financial institution, is often required to withhold backup withholding or Federal income tax when making payments involving non-payroll compensation to recipients. During Tax Year (TY) 2016, payers reported total backup and Federal income tax withholdings of more than \$126 billion.

WHY TIGTA DID THE AUDIT

The payer of these reportable transactions is required to provide income and withholding documents to the IRS and recipients. Payers report total backup and Federal income tax withheld during the tax year on Form 945, *Annual Return of Withheld Federal Income Tax*. This audit was initiated to determine whether the IRS has controls in place to ensure that tax withholding reported on information returns is accurately reflected on Form 945 and paid to the IRS.

WHAT TIGTA FOUND

The IRS *****2*****. TIGTA's analysis identified instances in which payers did not report backup and Federal income tax withholding amounts on Form 945 or reported a lesser amount on Form 945 than reported on the Forms 1099 or W-2G issued to recipients. For example, TIGTA identified 7,265 payers that provided TY 2016 Forms 1099 or W-2G to the

IRS reporting almost \$923 million in withholding, but did not file the required TY 2016 Form 945.

TIGTA also identified 3,163 payers that reported on Form 945 approximately \$760 million less in withholdings than what they reported on associated Forms 1099 and W-2G. In addition, TIGTA identified 773 payers that submitted TY 2016 Forms 1099 or W-2G transmittals, i.e., Forms 1096, *Annual Summary and Transmittal of U.S. Information Returns*, reporting withholding amounts totaling more than \$243 million. These payers did not provide the IRS Forms 1099 or W-2G with Form 1096, did not file a TY 2016 Form 945, and did not have any payments or offsets posted to their tax accounts.

Finally, TIGTA identified 3,527 payers that filed a Form 945 reporting withheld backup and Federal income tax totaling more than \$241 million, but they did not file any Forms 1099 or W-2G with the IRS.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division, develop a process to *****2*****.

IRS management agreed with this recommendation and plans to use data analytics to identify the size and scope of *****2*****. From this analysis, IRS management plans to identify the appropriate compliance activities necessary to address the noncompliance.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 20, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Billions of Dollars in Non-Payroll Tax
Withholding Discrepancies Are Not Being Addressed
(Audit #201740022)

This report presents the results of our review to determine whether the Internal Revenue Service has controls in place to ensure that the withholding reported on information returns is accurately reflected on Form 945, *Annual Return of Withheld Federal Income Tax*, and paid to the Internal Revenue Service. This review is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Improving Tax Reporting and Payment Compliance.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendation. 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

CAWR	Combined Annual Wage Reporting Program
EIN	Employer Identification Number
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year



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Background

A business entity such as a bank or financial institution (hereafter referred to as a payer) is often required to backup¹ withhold or withhold Federal income tax when making payments to recipients. During Tax Year (TY)² 2016, payers reported total backup and Federal income tax withholding associated with non-payroll compensation of more than \$126 billion. Payers must provide details of these non-payroll payments, such as the total payment, the taxable portion, and the amount of tax withheld, if any, to each recipient on the appropriate income and withholding document. Figure 1 summarizes the information returns³ payers use for selected reportable transactions involving non-payroll compensation.

Figure 1: Reportable Non-Payroll Compensation That May Be Subject to Backup or Federal Income Tax Withholding

Information Return	Reportable Transactions
Form 1099-MISC, <i>Miscellaneous Income</i>	Rents and commissions, non-payroll compensation for services, royalties, reportable gross proceeds paid to attorneys, and other fixed or determinable gains, profits, or income payments.
Form 1099-INT, <i>Interest Income</i>	Interest income, interest on U.S. Savings Bonds and Treasury obligations, and tax-exempt interest.
Form 1099-K, <i>Payment Card and Third Party Network Transactions</i>	Gross amount of payment card/third-party network transactions.
Form 1099-DIV, <i>Dividends and Distributions</i>	Dividends and other distributions.
Form 1099-PATR, <i>Taxable Distributions Received From Cooperatives</i>	Payments patronage dividends and other distributions from a cooperative.
Form 1099-OID, <i>Original Issue Discount⁴</i>	Original issue discount, other periodic interest, and original issue discount on U.S. Treasury obligations but limited to cash paid on these obligations.

¹ Payers generally are required to withhold a portion of the payment if a payee fails to provide the payer a correct Taxpayer Identification Number.

² The 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due.

³ Throughout this report, we refer to the various Form 1099 information returns detailed here as Forms 1099.

⁴ Original Issue Discount is a form of interest. It is the excess of an obligation's stated redemption price at maturity over its issue price.



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Information Return	Reportable Transactions
Form 1099-B, <i>Proceeds From Broker and Barter Exchange Transactions</i>	Gross proceeds from stocks, commodities, regulated futures contracts, foreign currency contracts, forward contracts, debt instruments, options, securities futures contracts, etc., for cash or exchanged property or services through a barter exchange.
Form 1099-G, <i>Certain Government Payments</i>	Payments related to certain taxable grants and agriculture payments.
Form 1099-R, <i>Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.</i>	Payments related to distributions from pensions, annuities, profit-sharing and retirement plans, Individual Retirement Accounts, insurance contracts, etc. (Note: Backup withholding does not apply to Form 1099-R.)
Form W-2G, <i>Certain Gambling Winnings</i>	Gambling winnings. The requirements to report and withhold depend on the type of gambling, the amount of the gambling winnings, and generally the ratio of the winnings to the wager.

Source: Treasury Inspector General for Tax Administration's (TIGTA) analysis of TY 2016 Internal Revenue Service (IRS) tax forms and instructions.

Payers report total tax withheld during the tax year on Form 945, Annual Return of Withheld Federal Income Tax

For TY 2016, payers of the previously mentioned reportable transactions were generally required to submit these income and withholding documents to the IRS by March 31, 2017,⁵ and to recipients by January 31, 2017. Payers submit paper Forms 1099 and W-2G to the IRS on a transmittal Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*. All backup and Federal income tax withholdings reported on Forms 1099 and W-2G must be reported on Form 945. For TY 2016, payers were required to file Form 945 with the IRS by January 31, 2017.⁶

The total withholdings reported on Form 945 is the amount of the tax liability, *i.e.*, amount of tax withheld to be remitted to the IRS, that the IRS records on the payer's tax account. Payers are responsible for periodically paying to the IRS amounts withheld from reportable transactions. In general, a deposit is required during the year when the amount of tax withheld is greater than \$2,500. As the IRS receives payments, it credits the payer's tax account. The payer can also remit any unpaid withholding when filing Form 945. The IRS offsets the total withholdings reported on Form 945 by the amount of total tax payments made during the year, overpayments applied from a prior year, and the amount submitted with Form 945.

This review was performed at the IRS Campus in Covington, Kentucky, and with information obtained from the Small Business/Self-Employed Division Headquarters in Lanham, Maryland,

⁵ If payers submitted Forms 1099 and W-2G on paper, they were due February 28, 2017.

⁶ If payers made their deposits on time, in full payment of the taxes for the year, they could file the return by February 10, 2017.



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during the period September 2017 through December 2018. 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

*******2***** That
Non-Payroll Tax Withholdings Are Reported and Paid As Required**

The IRS has *****2***** the amount of backup and Federal income tax withheld and reported on Form 1099, Form W-2G, and Form 1096 *****2***** . In addition, the IRS has *****2***** , as required. As a result, *****2***** . Payers that withhold taxes and willfully do not remit those funds are defrauding the Federal Government. The IRS’s lack of enforcement in this area can leave substantial amounts of tax uncollected, which contributes to the Tax Gap.⁷

Our analysis identified 11,201 payers that did not report taxes withheld or reported less taxes withheld on Form 945 than the withholding amounts reported to the IRS on Form 1099, Form W-2G, or Form 1096.⁸ The potential non-reporting or underreporting by these payers totals more than \$1.9 billion. The \$1.9 billion discrepancy represents the amount payers reported as being withheld and was not paid to the Federal Government. This includes:

- 7,265 payers that reported withheld taxes totaling almost \$923 million to the IRS on Forms 1099 or W-2G but did not file a TY 2016 Form 945 as required. The total amount of withheld tax reported on Form 945 is what the IRS records on the payer’s tax account as the tax year’s tax liability and is the amount of tax the IRS expects the payer to remit. As such, these payers would not have a tax liability recorded on their tax accounts as no Form 945 was filed. Furthermore, our review of the associated payer’s tax accounts identified that these payers also did not remit the reported tax withheld as there were no payments or offsets credited to their associated tax accounts.
- 3,163 payers that reported more than \$760 million less in tax withheld on Form 945 than what they reported on associated Forms 1099 or W-2G.⁹ For these 3,163 payers, the amount of withheld tax recorded on the associated tax accounts for the payers to remit is

⁷ 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.

⁸ Our results are based on our analysis of data captured on the information returns submitted by the payers to the IRS. As such, the calculation of backup and Federal income tax withholding is dependent upon receiving accurate data on the information returns submitted by the payers.

⁹ We classified a payer as underreporting the withheld amount on Form 945 if the aggregate amount withheld on the information returns the payer filed *****2***** amount reported on Form 945.



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\$760 million less than the amount these payers reported on the associated Forms 1099 or W-2G.

- 773 payers that reported on Form 1096 withholding amounts totaling more than \$243 million. These payers did not file Form 1099, Form W-2G, or Form 945 with the IRS. These payers also did not remit any payments to the IRS.

Payers are required to file Forms 1099 and W-2G to report the income and withholdings of recipients. Payers are also required to report on Form 945 all backup and Federal income tax withholdings reported on Forms 1099 and W-2G. The amount of Federal income tax withheld and reported on Form 945 is generally equal to the total withholdings reported on Forms 1099 and W-2G. Once the IRS receives a Form 945 from a payer, the total amount of withheld taxes reported on the Form 945 is added to the associated tax account of the payer as the payer's tax liability, *i.e.*, amount of tax to be paid to the IRS. Payments of tax withheld, remitted to the IRS, and posted to the payer's tax account then offset the payer's tax liability amount.

During the course of our audit, we provided IRS management with the discrepancy cases we identified. IRS management noted that:

- Their review of a judgmental sample¹⁰ of these discrepancy cases identified questionable information returns from seven payers totaling almost \$396 million.¹¹ For example, the IRS noted these could be the result of payers submitting information returns with unreliable data. However, the IRS can confirm the accuracy of the data submitted by payers by identifying and addressing discrepancies.
- Transmittal documents, *i.e.*, Form 1096, for the information return packages cannot be used to determine or enforce a filing requirement, or tax liability, without the associated information returns. IRS procedures require tax examiners to request missing information returns when payers do not attach Forms 1099 and W-2G to a transmittal Form 1096 showing a dollar amount. Requesting and obtaining the information returns would provide the IRS with information necessary to consider and ensure that payers are reporting all backup and Federal income tax withholdings for an IRS reconciliation with Forms 945. In a separate TIGTA audit (Audit Number 201840020, *Authentication and Verification of Information Return Transmitters*), we identified that tax examiners were not consistently contacting payers to request information returns not attached to the Forms 1096 and will recommend that the IRS address this concern. As such, we are not including a recommendation in this report to address this deficiency.

¹⁰ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

¹¹ We removed the seven payers and the associated Federal income tax withholding from our outcome measure.



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- Some of the discrepancies we identified could be the result of payers *****2*****
 *****2*****¹² *****2*****
 *****2*****. Management could not provide specific examples of this occurrence related to the discrepancies our analysis identified. In fact, the IRS does *****2*****
 *****2*****. However, to address management’s concern, we performed additional analysis to identify and remove instances from our discrepancy population in which *****2*****
 *****2*****.¹³ As a result, we identified and removed from our discrepancy cases 913 payers that *****2*****
 *****2*****
 *****2*****.

IRS management raised similar concerns as to the use of *****2***** in response to a July 2017 report¹⁴ in which we identified large-dollar Combined Annual Wage Reporting (CAWR)¹⁵ discrepancies. Management noted that some of the discrepancy cases identified could be the result of employers using *****2*****
 *****2*****
 *****2*****. IRS management submitted a programming change in December 2015 to add *****2***** to help tax examiners more efficiently resolve these discrepancy cases. A similar process would assist the IRS in resolving the types of discrepancies we identified as part of this review. However, to date, this programming change has not been implemented.

IRS management also noted that they submitted information technology programming requests, including the latest request in January 2018, to expand the CAWR process to create a separate module to *****2*****. This module would *****2*****
 *****2*****¹², such as those we have identified, that warrant further research and possible examination. However, the IRS did not implement the programming request due to conflicting priorities for the Information Technology function. For example, the IRS cancelled the most recent request because Information Technology function resources were needed for the implementation of the Tax Cuts

¹² *****2*****
 *****2*****.

¹³ *****2*****
 *****2*****.

¹⁴ TIGTA, Ref. No. 2017-40-038, *Case Selection Processes Result in Billions of Dollars in Potential Employer Underreported Tax Not Being Addressed* (July 2017).

¹⁵ The IRS-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 Social Security Administration on Forms W-3, *Transmittal of Wage and Tax Statements*; W-2, *Wage and Tax Statement*; W-3c, *Transmittal of Corrected Wage and Tax Statements*; and W-2c, *Corrected Wage and Tax Statement*, and to the IRS on Forms 1099-R and W-2G.



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and Jobs Act of 2017.¹⁶ The IRS resubmitted the programming requests to *****2***** on December 14, 2018.

Taxes withheld were not always reported on Forms 1099 or W-2G as required

Our analysis also identified *****2***** that file a Form 945 but have not filed Forms 1099 or W-2G (or Form 1096). We identified 3,527¹⁷ payers that filed a Form 945 reporting withheld backup and Federal income tax totaling more than \$241 million, but did not submit any Forms 1099 or W-2G to the IRS. Without Forms 1099 and W-2G (or Form 1096), the IRS cannot determine if the payer reported all Federal income tax withholding on Form 945. In addition, the IRS cannot determine if the recipients of these reportable transactions accurately reported the income and taxes withheld on the recipients' tax return, e.g., Form 1040, U.S. Individual Income Tax Return.

Recommendation

Recommendation 1: The Commissioner, Small Business/Self-Employed Division, should develop a process to *****2*****

Management's Response: The IRS agreed with this recommendation and plans to use data analytics to identify the size and scope *****2***** From this analysis, IRS management plans to identify the appropriate compliance activities necessary to address the noncompliance.

Office of Audit Comment: Although the IRS agreed with our recommendation, management disagreed with our outcome measure. In management's view, the dollar value of noncompliance is not determinable through data analysis alone, given that entities can *****2***** and some file questionable information returns. As our report notes, we performed analysis to identify entities *****2***** and removed these from our exception cases. We also removed payers identified as submitting questionable information returns. *****2*****, as we recommended and management agreed to implement, would address these concerns.

16 Pub. L. No. 115-97, 131 Stat. 2054 (2017), officially known as "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for Fiscal Year 2018."

17 We performed additional matches to address the IRS's concerns that payers *****2***** Our additional matches identified 1,193 instances in which payers that **2** *****2***** The 1,193 payers are not included in the 3,527.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the IRS has controls in place to ensure that the withholding reported on information returns is accurately reflected on Form 945, *Annual Return of Withheld Federal Income Tax*, and paid to the IRS. To accomplish this objective, we:

- I. Assessed the effectiveness of *****2*****.
*****2*****
*****2*****.
- A. Identified 56,469,305 TY 2016 Forms 1099 or W-2G that report withholding to determine if the withholding was included on Form 945.
- B. *****2*****¹ the 72,687 payers that filed the 56,469,305 Forms 1099 or W-2G to 60,758 Forms 945 to identify instances *****2*****
*****2*****.
- C. For instances in which withholding was not reported on a Form 945, determined if the payments were actually made to the IRS.
- D. For discrepancies identified, determined why the IRS did not identify the discrepancies and determined what it could have done differently to identify them.
- II. Assessed the effectiveness *****2*****
*****2*****.
- A. *****2***** reported on Forms 1099 or W-2G *****2*****
*****2*****.
- B. *****2***** the population table of 72,687 Forms 1099 or W-2G payer *****2*****
*****2*****
*****2*****.
- C. Identified all instances in which the withholding amounts on Forms 945 were less than the amounts reported on Forms 1099 or W-2G.
- III. Evaluated the effectiveness of *****2*****
*****2*****.

¹ *****2*****.



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- A. Identified amounts reported as withheld on Form 945 for TY 2016.
B. *****2***** withheld amounts reported on Form 945 for TY 2016 *****2*****
C. For the withholding amounts on Form 945 that *****2*****

Data validation methodology

During this review, we relied on the IRS’s Business Master File,2 Business Returns Transaction File,3 and Information Returns Master File4 data for TY 2016 stored on TIGTA’s Data Center Warehouse.5 To assess the reliability of computer-processed data, TIGTA programmers validated the data files we extracted, and we ensured that each data extract contained the specific data elements we requested, and that the data elements were accurate. In addition, we performed validation by reviewing random samples of each file and verified that the data in the files were the same as the data captured in the IRS’s Integrated Data Retrieval System.6 As a result of our testing, we determined that the data were sufficiently reliable for the purposes of this report.

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: *****2***** discrepancies that may result in withholding not being paid or reported to the IRS and the processing of Form 1096, Annual Summary and Transmittal of U.S. Information Returns, in which Forms 1099 or W-2G were not attached.

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

3 A computer file of transcribed line items on all business returns and their accompanying forms and schedules.

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

5 A TIGTA repository of IRS data.

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



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Appendix II

Major Contributors to This Report

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

Diana M. Tengesdal, Director

Darryl J. Roth, Audit Manager

Kenneth L. Carlson, Lead Auditor



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Appendix III

Report Distribution List

Deputy Commissioner for Operations Support
Deputy Commissioner for Services and Enforcement
Commissioner, Small Business/Self-Employed Division
Chief Technology Officer
Director, Examination Field and Campus Policy, Small Business/Self-Employed Division
Deputy, ACIO for Applications Development, Information Technology
Director, Office of Audit Coordination



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Appendix IV

Outcome Measure

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

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$1.5 billion from 11,194 payers that either did not report or reported less backup or Federal income tax withholding on Forms 945, Annual Return of Withheld Federal Income Tax, than they reported on information returns or Forms 1096, Annual Summary and Transmittal of U.S. Information Returns, provided to the IRS (see page 4).

Methodology Used to Measure the Reported Benefit:

We conducted an analysis of TY 2016 Forms 945 by *****2*****. This identified:

- 20,631 payers that provided TY 2016 Forms 1099 or W-2G to the IRS reporting total withholdings of almost \$5.1 billion, but did not file a TY 2016 Form 945 *****2*****. While 1,906 of the 20,631 payers did not appear to have filed a Form 945, we identified payments and offsets to the payers’ accounts totaling almost \$167 million. We removed these payers to identify 18,725 payers. Lastly, we eliminated 11,460 instances in which either: the total amount of withholding for the payer was *****2***** on a Form 945 filed *****2*****,¹ or the payer did not have an account on the IRS Master File.² This left 7,265 payers that provided TY 2016 Forms 1099 or W-2G reporting total withholdings of almost \$923 million and did not file a TY 2016 Form 945.
- 3,163 payers reported more than \$13.5 billion in taxes withheld on Form 945 while reporting almost \$14.3 billion on Forms 1099 or W-2G *****2*****

¹ *****2*****.

² The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations information.



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*****2*****.³ This is an understatement of total withholding of more than \$760 million.

- 918 payers submitted TY 2016 Forms 1096 reporting total withholdings of almost \$244 million, but did not file a TY 2016 Form 945 *****2***** or provide the IRS Forms 1099 or W-2G. While 60 of the 918 payers did not file a Form 945 *****2*****, we identified payments and offsets to the payers' accounts. We removed those payers, along with 85 payers whose total withholding amounted to *****2*****, to identify 773 payers that provided the IRS with TY 2016 Forms 1096 reporting total withholdings of more than \$243 million⁴ that did not file a TY 2016 Form 945 *****2***** *****2*****.

To identify the total potential revenue increase for *****2*****, we summed the amounts previously mentioned. This includes:

- 7,265 payers that provided TY 2016 Forms 1099 or W-2G reporting total withholdings of almost \$923 million that did not file a TY 2016 Form 945.
- 3,163 payers that reported more than \$760 million less on Form 945 than on Forms 1099 or W-2G filed under the same EIN or a cross-referenced EIN.
- 773 payers that provided the IRS TY 2016 Forms 1096 reporting total withholdings of more than \$243 million that did not file a TY 2016 Form 945 under the same EIN or a cross-referenced EIN.

This resulted in 11,201 payers that either did not report or reported less backup and Federal income tax withholding than they reported on information returns or Form 1096 totaling more than \$1.9 billion.

The IRS reviewed a judgmental sample⁵ of exception cases and identified seven payers with questionable information returns totaling almost \$396 million. We removed the seven payers and the associated backup and Federal income tax withholding from our outcome measure. This resulted in 11,194 payers that either did not report or reported less backup and/or Federal income tax withholding on Forms 945 totaling more than \$1.5 billion than they reported to the IRS on Form 1099, Form W-2G, or Form 1096.

³ We classified a payer as underreporting the withheld amount on Form 945 if the aggregate amount withheld on the information returns filed *****2***** amount reported on the Form 945.

⁴ In a separate TIGTA audit (Audit Number 201840020, *Authentication and Verification of Information Return Transmitters*), we identified that tax examiners were not consistently contacting payers to request information returns not attached to the Forms 1096 and will recommend that the IRS address this concern.

⁵ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



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Appendix V

Management's Response to the Draft Report

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

**COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION**

April 15, 2019

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mary Beth Murphy /s/ Mary Beth Murphy
Commissioner, Small Business/Self-Employed Division

SUBJECT: Billions of Dollars in Non-Payroll Tax Withholding Discrepancies
Are Not Being Addressed (Audit# 201740022)

Thank you for the opportunity to review and comment on the above subject draft audit report. Non-payroll tax withholding helps to ensure that the government can collect taxes on all appropriate income, particularly income that is not usually subject to withholding. Payers of certain income types must deduct and withhold tax if certain criteria are not met, such as the payee failing to furnish a correct taxpayer identification number to the payer.

Non-payroll tax withholding, which includes both backup and income tax withholding, has been an area of significant focus for us in recent years. In 2016, we convened a team to review the backup withholding process from beginning to end. The team mapped and validated existing processes to identify and evaluate potential compliance gaps and proposed several recommendations to address backup withholding non-compliance. We have already completed several education and outreach activities to increase the awareness of the backup withholding requirements and we are in the process of establishing a campus backup withholding compliance unit.

Your report also acknowledges that we identified several opportunities for programming enhancements to our systems are they relate to backup and income tax withholding. For example, in December 2015, we requested to add *****2*****
*****2*****
*****2*****. However, we have been unable to make these changes because of our limited resources and competing demands. In January 2018, we requested the creation of *****2*****
*****2*****. This module would *****2***** such as those you identified in this report.

While we await systemic enhancements, we plan to use data analytics to identify ***2***
*****2*****.



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We will then identify the appropriate compliance activities necessary to address those
*****2*****.

We disagree with the outcome measure and believe it is overstated. The dollar value of
this non-compliance is not determinable through data analysis alone. *****2*****
*****2*****.
*****2*****. Also, while seven payers filing questionable
information returns that were identified from a judgmental sample were removed, the
entire population was not checked for the same Internal Revenue Manual indicators of
being false, fictitious or potentially fraudulent which would also contribute to the
overstatement.

Attached is our response outlining our corrective actions to address your
recommendation. If you have any questions, please contact me or Brenda Dial,
Director, Examination Operations, SB/SE Division.

Attachment



*Billions of Dollars in Non-Payroll Tax Withholding
Discrepancies Are Not Being Addressed*

Attachment

RECOMMENDATION 1:

The Commissioner, Small Business/Self-Employed Division, should develop a process
*****2*****
*****2*****
*****2*****
*****2*****
*****2*****

CORRECTIVE ACTION:

We agree with the recommendation. We will use data analytics to identify the size and
scope *****2*****. From this
analysis, we will identify the appropriate compliance activities necessary to address the
apparent non-compliance.

IMPLEMENTATION DATE:

October 15, 2020

RESPONSIBLE OFFICIAL:

Director, Headquarters Exam, Exam Case Selection, Small Business/Self-Employed
Division (SB/SE)

CORRECTIVE ACTION MONITORING PLAN:

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