



*Millions of Dollars in Potentially
Erroneous Excess Social Security
Tax Credit Claims Are Not Addressed*

March 15, 2019

Reference Number: 2019-40-026

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HIGHLIGHTS

MILLIONS OF DOLLARS IN POTENTIALLY ERRONEOUS EXCESS SOCIAL SECURITY TAX CREDIT CLAIMS ARE NOT ADDRESSED

Highlights

Final Report issued on March 15, 2019

Highlights of Reference Number: 2019-40-026 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

The Federal Insurance Contributions Act tax is a U.S. Federal payroll tax imposed on both employees and employers to fund Social Security and Medicare. Most employers withhold the Social Security tax from employees' wages and pay it to the IRS on the employees' behalf. Individuals with more than one employer and whose combined Social Security tax withholding from all employers exceeds the maximum annual withholding amount may claim the excess amount of Social Security tax withheld as a refundable credit. As of December 28, 2017, the IRS received more than 1.5 million Tax Year 2016 tax returns claiming the Excess Social Security Tax Credit. These taxpayers received credits totaling more than \$3.1 billion.

WHY TIGTA DID THE AUDIT

This audit was initiated to follow up on TIGTA's previous audit recommendations and to evaluate the IRS's efforts to detect and prevent erroneous Excess Social Security Tax Credit claims.

WHAT TIGTA FOUND

TIGTA's analysis of more than 2.5 million tax returns e-filed in Processing Years 2017 and 2018 with an Excess Social Security Tax Credit claim found that processes implemented in response to our prior audit have improved the IRS's identification of questionable claims.

However, the IRS paid more than \$74 million in potentially erroneous Excess Social Security Tax Credits as a result of incomplete Social Security tax credit selection criteria, insufficient procedures, and tax examiner processing errors.

In addition, incorrect return selection criteria resulted in the IRS unnecessarily expending approximately \$1.1 million to manually review 737,735 valid Social Security Tax Credit claims filed during Processing Years 2017 and 2018. Finally, the majority of potentially erroneous Excess Social Security Tax Credit claims identified by its post-processing income matching program continue to not be addressed.

WHAT TIGTA RECOMMENDED

TIGTA made eight recommendations to improve the IRS's efforts to detect and prevent erroneous Excess Social Security Tax Credit claims. TIGTA recommended that the IRS update its internal procedures and ensure that employees are following the procedures to accurately determine the correct amount of Excess Social Security Tax Credit. In addition, the IRS should develop processes to ensure that the Social Security tax maximum withholding amounts are annually updated in systemic programs that select claims for review and establish a process to send and measure the success associated with soft notices that alert individuals to potential errors related to Excess Social Security Tax Credit claims.

IRS management agreed with all eight recommendations and plans to take appropriate corrective actions. These actions include implementing a review process for the 2019 filing season to ensure tax examiners correctly address potential errors. The review results will be evaluated to identify the cause of the incorrect actions. The IRS will also ensure that the maximum withholding amounts are updated annually, and agreed to determine the feasibility of sending and measuring the success of soft notices related to the excess Social Security Tax Credit.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 15, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Millions of Dollars in Potentially Erroneous
Excess Social Security Tax Credit Claims Are Not Addressed
(Audit #201840008)

This report presents the results of our review to evaluate the Internal Revenue Service's (IRS) efforts to detect and prevent erroneous Excess Social Security Tax Credit claims during Processing Years 2017 and 2018. This audit was included in our Fiscal Year 2018 Annual Audit Plan and addresses the major management challenge of Improving Tax Compliance.

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



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Abbreviations

AUR	Automated Underreporter
E-File(d)	Electronically Filed
IMF	Individual Master File
IRMF	Information Returns Master File
IRS	Internal Revenue Service
MTRDB	Modernized Tax Return Database
PY	Processing Year
TIGTA	Treasury Inspector General for Tax Administration



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Background

The Federal Insurance Contributions Act¹ tax is a United States Federal payroll tax imposed on both employees and employers to fund Social Security and Medicare. Employers compute the Social Security tax portion of the Federal Insurance Contributions Act tax as a percentage of wages earned. Most employers withhold the Social Security tax from their employee(s) wages and pay it to the Internal Revenue Service (IRS) on the employees' behalf. The Tax Year² 2017 tax rate for the Social Security tax was 12.4 percent, with 6.2 percent paid by the employer and 6.2 percent withheld from the employee. Employers report total Social Security tax withheld to their employee(s) and the IRS in box 4 on Form W-2, *Wage and Tax Statement* (See Figure 1).

Figure 1: Tax Year 2017 Form W-2

22222		a Employee's social security number		OMB No. 1545-0008			
b Employer identification number (EIN)				1 Wages, tips, other compensation		2 Federal income tax withheld	
c Employer's name, address, and ZIP code				3 Social security wages		4 Social security tax withheld	
				5 Medicare wages and tips		6 Medicare tax withheld	
				7 Social security tips		8 Allocated tips	
d Control number				9 Verification code		10 Dependent care benefits	
e Employee's first name and initial Last name Suff.				11 Nonqualified plans		12a	
				13 Statutory employee Retirement plan Third-party sick pay		12b	
				14 Other		12c	
						12d	
f Employee's address and ZIP code							
15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	

Form **W-2** Wage and Tax
Statement

2017

Department of the Treasury—Internal Revenue Service

Source: IRS.gov.

¹ 26 U.S.C. § 3101-3128.

² The 12-month period for which tax is calculated. For most individual taxpayers, the tax year is synonymous with the calendar year.



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Employers can only withhold Social Security tax from an employee until a specific wage amount is reached. The U.S. Social Security Administration sets the maximum taxable wage amount, which can vary from year to year. For example, the maximum wage amount subject to the Social Security tax for Tax Year 2017 is \$127,200, and the maximum Social Security tax employers may withhold is \$7,886.40 (\$127,200 multiplied by 6.2 percent). Individuals are entitled to repayment of Social Security tax withholding that exceeds the maximum withholding amount for a specific year.

Eligibility for the Excess Social Security Tax Credit

Individuals with a single employer who withheld more than the maximum amount of Social Security tax must have the excess withholding refunded by their employer. If an individual's employer will not adjust the excess collection, the individual may request a refund from the IRS using Form 843, *Claim for Refund and Request for Abatement*. Individuals with more than one employer and whose combined Social Security tax withholding from all employers exceeds the maximum annual withholding amount (*i.e.*, \$7,886.40) may claim the excess amount of Social Security tax withheld as a refundable credit (hereinafter referred to as the Excess Social Security Tax Credit or the credit)³ on Form 1040, *U.S. Individual Income Tax Return*. For example:⁴

Taxpayer A has one employer who withheld \$8,000 in Social Security tax from his or her wages for Tax Year 2017. To obtain the excess withholding, Taxpayer A is required to contact his or her employer to recover the \$113.60 (\$8,000 less the \$7,886.40 limit for Tax Year 2017) in excess Social Security tax withheld from his or her wages.

In comparison, Taxpayer B has one full-time employer and one part-time employer. The full-time employer withheld \$7,886.40 and the part-time employer withheld \$113.60 in Social Security tax for Tax Year 2017. To obtain the excess withholding, Taxpayer B can claim a refundable credit on his or her Tax Year 2017 Form 1040 for the \$113.60 in excess Social Security tax withheld by the part-time employer.

Claiming the Excess Social Security Tax Credit

The majority of filers claim their Excess Social Security Tax Credit on Form 1040, Line 71 – *Excess social security and tier 1 RRTA⁵ tax withheld*. For Tax Year 2017 and prior, individuals

³ A refundable credit is not limited to the amount of an individual's tax liability and can result in a Federal tax refund that is larger than the amount of a person's Federal income tax withholding for that year.

⁴ These examples are hypothetical examples not drawn from any actual taxpayer's case.

⁵ Railroad Retirement Tax Act (RRTA) (26 U.S.C. §§ 3201–3241) taxes fund railroad worker retirement benefits. Railroad employers are subject to a separate and distinct system of employment taxes from the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (26 U.S.C. §§ 3301–3311) systems covering most other employers. The IRS is responsible for collecting these taxes. Chapter 22 of the Internal Revenue Code imposes these taxes.



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can also claim the credit on Form 1040A, *U.S. Individual Income Tax Return*;⁶ Form 1040NR, *U.S. Nonresident Alien Income Tax Return*; or the Form 1040-SS, *U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)*.⁷ Figure 2 shows where individuals claim the credit on their Tax Year 2017 Form 1040. For Tax Year 2018, the IRS redesigned Form 1040 and eliminated Form 1040A. For Tax Year 2018, the Excess Social Security Tax Credit will be claimed on Line 72 of Schedule 5, *Other Payments and Refundable Credits*, which carries forward to Line 17 of Form 1040.

Figure 2: Payments Section of Form 1040

If you have a qualifying child, attach Schedule EIC.	Payments	64	Federal income tax withheld from Forms W-2 and 1099 . . .	64		
	65	2017 estimated tax payments and amount applied from 2016 return	65			
	66a	Earned income credit (EIC)	66a			
	b	Nontaxable combat pay election 66b	66b			
	67	Additional child tax credit. Attach Schedule 8812 . . .	67			
	68	American opportunity credit from Form 8863, line 8 . . .	68			
	69	Net premium tax credit. Attach Form 8962 . . .	69			
	70	Amount paid with request for extension to file . . .	70			
	71	Excess social security and tier 1 RRTA tax withheld . . .	71			
	72	Credit for federal tax on fuels. Attach Form 4136 . . .	72			
	73	Credits from Form: a <input type="checkbox"/> 2439 b <input type="checkbox"/> Reserved c <input type="checkbox"/> 8885 d <input type="checkbox"/>	73			
	74	Add lines 64, 65, 66a, and 67 through 73. These are your total payments . . .	74			

Source: Form 1040 for Tax Year 2017.

As of December 28, 2017, the IRS received more than 1.5 million Tax Year 2016 tax returns claiming the credit. These taxpayers received credits totaling more than \$3.1 billion. Of the 1.5 million claims, 112,153 were paper-filed and 1,440,841 were electronically filed (e-filed). Figure 3 shows the number of returns and amounts paid for Tax Years 2014 through 2017.⁸

⁶ Beginning with tax returns filed for Tax Year 2018, Form 1040A will be obsolete as a result of changes to the Form 1040 resulting from the Tax Cuts and Jobs Act of 2017 (Pub L. 115-97, 131 Stat. 2054).

⁷ Puerto Rico residents who wish to file in Spanish may use Form 1040-PR, *Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)*, in lieu of Form 1040-SS.

⁸ Appendix V provides an additional breakdown by filing method.



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**Figure 3: Returns Claiming the Excess Social Security
Tax Credit for Tax Years 2014 Through 2017**

Tax Year	Return Type	Total Claims	Number of Claims Paid	Amount Paid ⁹
2014	E-Filed	1,268,720	1,263,608	\$2,480,707,820
	Paper	134,746	118,928	\$247,460,859
	Total	1,403,466	1,382,536	\$2,728,168,679
2015	E-Filed	1,416,426	1,411,017	\$2,803,180,847
	Paper	127,625	119,669	\$248,461,458
	Total	1,544,051	1,530,686	\$3,051,642,305
2016	E-Filed	1,440,841	1,435,334	\$2,887,525,530
	Paper	112,153	105,677	\$218,704,984
	Total	1,552,994	1,541,011	\$3,106,230,514
2017 ¹⁰	E-Filed	1,130,842	1,127,375	\$2,289,423,439
	Paper	39,026	36,821	\$69,156,693
	Total	1,169,868	1,164,196	\$2,358,580,132

Source: Treasury Inspector General for Tax Administration's (TIGTA) analysis of the Modernized Tax Return Database (MTRDB),¹¹ the Individual Return Transaction File,¹² and the Individual Master File (IMF).¹³

**A prior TIGTA review found that processes to detect and prevent erroneous
Excess Social Security Tax Credit claims were not effective**

In September 2014, we reported that the IRS did not have effective processes to address potentially erroneous Excess Social Security Tax Credit claims at the time tax returns are processed.¹⁴ Our review of Tax Year 2011 tax returns identified 87,319 returns for which the total amount of Social Security tax withholding reported to the IRS by employers on Forms W-2 did not support the amount claimed as a credit by taxpayers on their tax returns. Based on our review of a statistically valid sample of 322 of the 87,319 returns, we estimate that the IRS may

⁹ This does not include any amounts subsequently received or adjusted during post-processing. For example, amended returns, Automated Underreporter Program, etc.

¹⁰ Tax Year 2017 data are through May 24, 2018.

¹¹ The legal repository for original e-filed returns received by the IRS through the Modernized e-File system.

¹² A database the IRS maintains that contains information on the individual tax returns it receives.

¹³ The IRS database that stores various types of individual taxpayer account information.

¹⁴ TIGTA, Ref. No. 2014-40-058, *Processes Are Needed to More Effectively Address Potentially Erroneous Excess Social Security Tax Credit Claims* (Sept. 2014).



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have paid more than \$12.9 million in potentially erroneous Excess Social Security Tax Credits on 25,728 Tax Year 2011 returns as a result of weaknesses in its verification processes. We forecasted that the IRS could pay more than \$64 million in potentially erroneous claims over five years (Tax Years 2011 through 2015). Figure 4 presents the recommendations we made to the IRS along with IRS management's response to those recommendations.

Figure 4: Prior TIGTA Recommendations

Recommendation	Actions Taken to Address the Recommendation
Ensure that IRS employees follow established procedures when verifying taxpayers' claims for the Excess Social Security Tax Credit at the time tax returns are processed.	The IRS agreed with this recommendation. The IRS conducts annual training focusing on how to use the Forms W-2 attached to an e-filed return to calculate and resolve questionable claims for Excess Social Security Tax Credit and issued alerts regarding revised research instructions and exceptions via the Servicewide Electronic Research Program.
Develop a process to verify e-filed tax returns at the time of filing when the taxpayer claims the Excess Social Security Tax Credit and the Social Security tax withholding amount reported on the tax return equals or exceeds the amount of taxable Social Security wages.	The IRS agreed with this recommendation and implemented programming on December 2, 2015, to identify Excess Social Security Tax Credit claims for which the Social Security tax withholding amount reported equals or exceeds the amount of taxable Social Security wages.
Develop a process to verify e-filed tax returns at the time of filing when the taxpayer claims the Excess Social Security Tax Credit and the taxpayer provides information related to only one employer.	The IRS agreed with this recommendation and implemented programming on May 29, 2015, to identify e-filed tax returns for which the taxpayer only provides information related to one employer, <i>i.e.</i> , two or more Forms W-2 from the same Employer Identification Number.
Develop a strategy that adequately addresses tax returns identified with a discrepancy between the Social Security tax withholding reported by taxpayers and the withholding reported by employers, including determining the net benefit of using soft notices.	The IRS disagreed with this recommendation. No subsequent actions have been taken to address this recommendation due to a continuing decline in resources.

Source: TIGTA, Ref. No. 2014-40-058, Processes Are Needed to More Effectively Address Potentially Erroneous Excess Social Security Tax Credit Claims (Sept. 2014).

Both e-filed and paper tax returns identified by the additional programming the IRS implemented in response to our recommendations are sent to tax examiners for verification. Once received, tax examiners verify the accuracy of the Excess Social Security Tax Credit claim using the Form W-2 information attached to the tax return or by researching wage information received from employers. If the taxpayer's claim is supported, the claim is processed. If the claim is not



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supported, the IRS adjusts the credit and sends a notice to the taxpayer explaining the reason for the adjustment.

This review was performed with information obtained from the Wage and Investment Division Submission Processing office in Covington, Kentucky, and the IRS Tax Processing Centers in Fresno, California, and Kansas City, Missouri, during the period January through August 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

Tax Examiner Processing Errors and Incomplete Social Security Tax Credit Return Selection Criteria Result in the Payment of Potentially Erroneous Claims

Our analysis of more than 2.5 million e-filed tax returns filed in Processing Years (PY) 2017 and 2018¹⁵ with an Excess Social Security Tax Credit claim found that processes implemented in response to our prior audit have improved the IRS's identification of questionable claims. These processes identify tax returns claiming the Excess Social Security Tax Credit for further review when:

- There is only one Form W-2 attached to the tax return.
- The total amount of Social Security wages reported on all the Forms W-2 attached to the tax return were less than the maximum Social Security withheld amount.
- The Social Security taxes withheld are the same or more than the reported Social Security wages.
- The Social Security tax amount on any one Form W-2 attached to the tax return is greater than the withholding limits. For example, for Tax Year 2017, the maximum wage amount subject to the Social Security tax is \$127,200, and the maximum Social Security tax employers may withhold is \$7,886.40 (\$127,200 multiplied by 6.2 percent).

The above processes identified 783,125 tax returns¹⁶ for additional review in PYs 2017 and 2018 and prevented the issuance of Excess Social Security Tax Credit claims totaling more than \$6.4 million. However, our review also found that the IRS paid more than \$74 million in potentially erroneous Excess Social Security Tax Credits for claims associated with 32,620 tax returns resulting from incomplete detection criteria, insufficient procedures, and tax examiner error. These include:

- 29,253 (89.7 percent) tax returns with potentially erroneous claims totaling more than \$68 million that include claims for which tax examiners did not follow internal verification guidelines or verification guidelines were incomplete. For example, tax examiners did not disallow claims when the Social Security withholding from a *single*

¹⁵ Our analysis of tax returns was limited to Tax Year 2016 tax returns filed in PY 2017 and Tax Years 2016 and 2017 tax returns received through May 24, 2018.

¹⁶ The number of tax returns identified for review in PY 2018 included 700,660 tax returns that were unnecessarily selected for review due to a programming error detailed in the next section of this report.



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employer on multiple Forms W-2 submitted with the tax return exceeded the maximum Social Security withholding amount for that tax year. These individuals are required to seek reimbursement from their employer or file a Form 843. Some other potentially erroneous claims resulted from incomplete internal guidelines which do not require tax examiners to research employer Forms W-2 when a paid preparer filed the tax return. Internal guidelines only require tax examiners to review employer Form W-2 information for **self-prepared** tax returns to identify taxpayers that do not input Form W-2 information correctly. We notified IRS management of our concerns on January 9, 2018. IRS management agreed with our assessment and indicated that internal guidelines will be updated.

- 3,358 (10.3 percent) tax returns with potentially erroneous claims totaling more than \$6 million that were not identified because the selection criteria does not identify claims for screening that are filed using a filing status other than Single or Married Filing Jointly. IRS management agreed with our assessment and stated that return selection criteria will be updated for PY 2019.
- 9 (0.03 percent) tax returns with potentially erroneous claims totaling \$14,744 that Excess Social Security Tax Credit return selection criteria did not identify for screening because the claim was filed on Form 1040NR. IRS management agreed with our assessment and stated that return selection criteria will be updated for PY 2019.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Develop processes and procedures to ensure that tax examiners accurately review Excess Social Security Tax Credit claims.

Management's Response: The IRS agreed with this recommendation and plans to implement a review process for the 2019 Filing Season. IRS management also plans to evaluate review results to identify the causes for the incorrect actions and address them appropriately.

Recommendation 2: Update internal guidelines to require tax examiners to research employer Forms W-2 when a paid preparer filed the tax return.

Management's Response: The IRS agreed with this recommendation and updated its internal guidelines on February 6, 2019, to provide uniform procedures for researching wage information on all electronic returns.

Recommendation 3: Expand Excess Social Security Tax Credit return selection criteria to identify for screening claims filed using filing status Married Filing Separately, Head of Household, or Qualified Widow(er).



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Management's Response: The IRS agreed with this recommendation and has placed required programming changes to screen claims filed using filing status Married Filing Separately, Head of Household, or Qualified Widow(er) into production in January 2019.

Recommendation 4: Expand Excess Social Security Tax Credit return selection criteria to identify for screening claims filed on Form 1040NR for additional review.

Management's Response: The IRS agreed with this recommendation and has placed required programming changes to screen claims filed on Form 1040NR for additional review into production in January 2019.

Incorrect Excess Social Security Tax Credit Return Selection Criteria Results in the Needless Use of Resources to Review Valid Claims

Our review identified that the IRS's Excess Social Security Tax Credit return selection criteria unnecessarily identified 737,735 tax returns filed in PYs 2017 and 2018 for tax examiner verification. As a result, processing of these tax returns was delayed, and we estimate that the IRS needlessly expended approximately \$1.1 million reviewing these valid Excess Social Security Tax Credit claims. The 737,735 returns include:

- 700,660 (95 percent) tax returns unnecessarily selected for verification in PY 2018 because of a programming error. The selection criteria was not updated to reflect the correct maximum amount of Tax Year 2017 Social Security tax withholding. For example, programming had the maximum Social Security tax withholding set as \$7,347, when in fact the amount should have been \$7,886. IRS management confirmed that the programming criteria was not updated to reflect the increased dollar amount.
- 37,075 (5 percent) tax returns unnecessarily selected for verification in PYs 2017 and 2018 because the selection criteria is inconsistent with processes followed by tax examiners manually reviewing Excess Social Security Tax Credit claims. For example, the systemic selection criteria does not:
 - Include scanning the return for the phrase "agent for" in the employer name line on the Form W-2. Per manual internal guidelines, Forms W-2 with the same Employer Identification Number are allowed if they are prepared by different pay agents. Different pay agents are identified in the employer name line by the phrase "agent for."
 - Evaluate whether the Social Security tax withholding is below the maximum withholding amount for each taxpayer when multiple Forms W-2 are present from the same employer. In comparison, manual review procedures apply the annual withholding thresholds by taxpayer and employer.
 - Use the same lower dollar tolerance used to select paper returns for manual review. As a result, the IRS systemically identifies tax returns for manual review that are



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released with no action by tax examiners because they do not meet manual review criteria.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 5: Develop processes and procedures to ensure that the Social Security tax maximum withholding amounts are updated in systemic programs that select Excess Social Security Tax Credit claims for review.

Management's Response: The IRS agreed with this recommendation and plans to implement procedures to align the annual updates for processing instructions with the business rule development process for the Modernized e-File system. Changes will be synchronized between the two processes. Primary and backup staff assignments have already been made to ensure that peer reviews are completed with originators when requesting programming changes to processing systems for tax forms.

Recommendation 6: Update systemic processes to ensure that the IRS does not unnecessarily select tax returns for manual review that report "agent for" in the employer name line, report Social Security tax withholding below the maximum withholding amount for each taxpayer, and/or are below the dollar tolerance used to select paper tax returns for manual review.

Management's Response: The IRS agreed with this recommendation and plans to update procedures to refine selection criteria to ensure that the IRS does not unnecessarily select tax returns for manual review.

The Majority of Potentially Erroneous Claims Identified by the Post-Processing Matching Program Are Not Addressed

Although the IRS performs a match three times a year subsequent to tax return processing to identify potentially erroneous Excess Social Security Tax Credit claims, no actions are being taken to address the majority of discrepancies identified. The IRS identifies those tax returns with a discrepancy between the Social Security tax withholding reported by taxpayers and the withholding reported by employers. For example, the IRS identified 83,706 Tax Year 2016 tax returns with a discrepancy between the Social Security tax withholding reported by taxpayers and employers. However, the IRS only selected 36,617 (44 percent) of the 83,706 tax returns for review.¹⁷ It should be noted that the 36,617 tax returns which were selected had the highest average potential estimated assessments of the cases identified, totaling more than \$108 million.

¹⁷ According to the IRS, the selection rate is higher than the selection percentage for other discrepancies worked as part of its post-processing matching program.



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Further analysis of the IRS's estimated potential assessments related to the remaining 47,089 tax returns not selected found that:

- 37,912 (80.5 percent) tax returns had the potential for more than \$77.2 million in additional tax assessments. The IRS uses a computer-based scoring tool that gives each case an estimated dollar value based on the behavior and characteristics of historical cases.¹⁸ The IRS uses the tool to assist with selecting cases to be worked that will yield the highest tax assessments.
- 5,768 (12.3 percent) tax returns had a refund potential. The IRS's scoring tool determined that more than \$6.9 million in potential refunds were available to the taxpayer. However, the IRS did not notify the taxpayers of the discrepancy identified because it is outside of the program's scope to notify taxpayers of additional refunds.
- 3,409 (7.2 percent) tax returns did not have assessment or refund potential. For these tax returns, the IRS's scoring tool estimated that the taxpayers would neither owe the IRS nor be due a refund from the IRS. As such, the IRS would not expend resources to pursue these cases.

IRS management attributes the inability to address all discrepancies identified to their lack of resources. IRS management stated that resources required to work additional Excess Social Security Tax Credit discrepancies would limit their ability to work other types of discrepancies identified.

The IRS still has not evaluated the use of soft notices to increase the volume of discrepancy cases addressed

In September 2014, we recommended that the IRS develop a strategy to address tax returns identified with a discrepancy between the Social Security tax withholding reported by taxpayers and the withholding reported by employers, including assessing the net benefit of using soft notices.¹⁹ The IRS disagreed with our recommendation. While IRS management agreed that the use of soft notices would increase the IRS's ability to address identified discrepancies, they stated that soft notices would also strain limited resources.

Management's position in response to our September 2014 report, as well as their lack of testing of soft notices to address Excess Social Security Claims, is not consistent with its use of soft notices to address other discrepancy cases resulting from its income matching program. As of May 24, 2018, taxpayers took additional action for 38 percent of the 31,729 Tax Year 2016 soft notices sent by the IRS. The IRS sent soft notices to taxpayers alerting them of discrepancies

¹⁸ The IRS's estimated potential assessment is a weighted assessment rate based on behavior and characteristics of historical cases. The estimated potential assessment is not the actual assessment amount.

¹⁹ TIGTA, Ref. No. 2014-40-058, *Processes Are Needed to More Effectively Address Potentially Erroneous Excess Social Security Tax Credit Claims* (Sept. 2014).



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with interest, dividends, gambling winnings, Social Security, and Railroad Retirement income. These notices alerted these individuals to potential errors on their tax returns. Taxpayers could then file an amended tax return to address the income discrepancy identified or provide additional information to explain their discrepancy. According to the IRS, it costs the IRS \$63.85 to work an amended tax return.

Using the IRS's income matching program results, we estimate that the use of soft notices to address Excess Social Security Tax Credit discrepancy cases could potentially result in more than \$29.3 million in additional assessments of erroneous Credits paid on 14,407 tax returns that the IRS is currently not working. Assuming all 14,407 taxpayers filed an amended tax return in response to the soft notice, we estimate that it would cost the IRS \$919,887 to process the amended tax returns. In addition, we estimate it would cost the IRS \$113,736 to print and mail the notices for all returns with potential assessments. As a result, the IRS could potentially realize an estimated \$28.3 million in additional net assessments if it began using soft notices to address Excess Social Security Tax Credit cases identified by the post-processing matching process.²⁰ Further, we estimate that 2,192 taxpayers were entitled to more than \$2.6 million in credits than they received.²¹

Resources are being used to issue soft notices to address discrepancy cases with minimal assessment potential while more productive returns go unaddressed

In response to our concerns with the IRS's lack of use of soft notices to address potentially erroneous Excess Social Security Tax Credit claims, IRS management stated that without adequate resources to follow up on those cases for which taxpayers do not respond, the soft notices lose effectiveness. However, the IRS has not provided us with data to support its claim that using soft notices would result in an ineffective use of its limited resources. In fact, the IRS provided information from a study that it conducted that showed soft notices change the taxpayer's behavior in subsequent years approximately 78 percent of the time even if the taxpayer did not correct the return in question.²² In addition, our analysis shows that the Social Security Tax Credit discrepancy cases not addressed have an average potential tax assessment of \$2,038 per tax return, whereas the tax returns for which the IRS sent soft notices as part of its post-processing income matching program had an average potential tax assessment of only \$249. This is contrary to the IRS's Strategic Plan to emphasize the use of data analytics, in conjunction

²⁰ The estimated additional net assessments includes any tax the IRS might collect when there is an Excess Social Security Tax Credit discrepancy. This could include tax resulting from other discrepancies identified on the tax return.

²¹ The actual amount of net additional assessments the IRS may realize or additional refunds issued is dependent on the individual characteristics of each return for which the IRS sends a soft notice.

²² The IRS soft notice study was conducted for Tax Years 2003–2004 on a limited population with limited issues, not including Excess Social Security Tax Credit claims. However, the IRS has not conducted any other studies since that time.



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with qualitative information, to select high-priority work and make the most effective use of the IRS's resources.

Recommendations

The Commissioner, Small Business/Self-Employed Division, in conjunction with the Commissioner, Wage and Investment Division, should:

Recommendation 7: Establish a process to send and measure the success associated with soft notices that alert individuals to potential errors on their tax return related to Excess Social Security Tax Credit claims.

Management's Response: The IRS agreed with the recommendation and plans to evaluate the existing process and selection criteria for sending soft notices to determine the feasibility of incorporating Excess Social Security Tax credit. If it is feasible and funding is available, IRS management plans to establish a process to measure the success of sending soft notices relating to claiming the Excess Social Security Tax Credit.

Office of Audit Comment: The IRS disagreed with our outcome measure of \$28.3 million in potential additional revenue that could be assessed if soft notices were sent to taxpayers identified as having an Excess Social Security Tax discrepancy. The IRS noted that resources would not afford the ability to send notices to all of the taxpayers we identified. Our outcome represents the amount of additional revenue at risk resulting from IRS identification of taxpayers with an Excess Social Security Tax discrepancy. As stated in the report, the actual assessments the IRS may realize is dependent on the individual characteristics of each return for which the IRS sends a soft notice.

Recommendation 8: Evaluate current resources expended on the issuance of soft notices to ensure that notices are sent to those taxpayers with the highest tax assessment potential to maximize the use of limited resources.

Management's Response: The IRS agreed with the recommendation. IRS management plans to evaluate IRS resources expended on and the selection criteria for sending soft notices to determine if notices are sent to those taxpayers with the highest estimated potential assessment.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the IRS's effort to detect and prevent erroneous Excess Social Security Tax Credit claims during PYs 2017 and 2018. To accomplish our objective, we:

- I. Evaluated the IRS's actions to address our prior audit recommendations¹ and assessed current control weaknesses.
 - A. Determined if the IRS's corrective actions effectively addressed TIGTA's prior recommendations to ensure that IRS employees followed established procedures when verifying taxpayers' claims for the Excess Social Security Tax Credit at the time tax returns were processed.
 - B. Determined whether the IRS implemented TIGTA's prior recommendations to verify e-filed tax returns at the time of filing when the taxpayer claimed the Excess Social Security Tax Credit and the Social Security tax withholding amount reported on the tax return equaled or exceeded the amount of taxable Social Security wages.
 1. Met with IRS management to identify the controls the IRS developed to verify e-filed tax returns at the time of filing.
 2. Evaluated whether the business rules the IRS implemented were effective and were verifying the accuracy of e-filed claims for Excess Social Security Tax Credit at the time of filing for PYs 2017 and 2018.
- II. Evaluated the IRS's efforts to detect and prevent erroneous Excess Social Security Tax Credit claims during PY 2017.
 - A. Determined the number and dollars of tax returns claiming and receiving the Excess Social Security Tax Credit for Tax Years 2014 through 2017.
 - B. Evaluated the accuracy of the IRS's processing of Tax Year 2016 Excess Social Security Tax Credit claims and determined whether the e-filed tax returns were supported by Form W-2, *Wage and Tax Statement*, data received by the IRS.

¹ TIGTA, Ref. No. 2014-40-058, *Processes Are Needed to More Effectively Address Potentially Erroneous Excess Social Security Tax Credit Claims* (Sept. 2014).



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- III. Evaluated the criteria used to select discrepancy cases as part of the IRS's Automated Underreporter (AUR) Program² and which cases the IRS selected to work.
- A. Using the Tax Year 2016 Excess Social Security Tax Credit claims that were not supported by Form W-2 data received by the IRS, determined the number of tax returns that the IRS identified as part of the AUR Program.
 - B. Determined whether the IRS took any actions to address our prior recommendation that the IRS develop a strategy to address tax returns identified with a discrepancy between the Social Security tax withholding reported by taxpayers and the withholding reported by employers, including assessing the net benefit of using soft notices.
 - C. Determined whether the IRS's use of soft notices for other types of discrepancy cases addressed tax returns with a higher average potential tax assessment than Excess Social Security Tax Credit discrepancy case that were not selected by the IRS.

Data validation methodology

During this review, we relied on data stored at TIGTA's Data Center Warehouse and performed analysis of data extracted from the IRS's AUR Program. To assess the reliability of computer-processed data, programmers within the Data Center Warehouse 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. For example, we reviewed judgmental samples of the data extracts and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System³ or other systems, if possible. As a result of our testing, we determined that the data used in our review were reliable.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the Internal Revenue Manual, other policies and procedures followed when processing Excess Social Security Tax Credit claims, and the systems/programming used to process the tax returns. We evaluated the controls by reviewing the Internal Revenue Manual, interviewing IRS management, and evaluating applicable documentation and reports.

² The AUR Program matches taxpayer income and deductions submitted on information returns by third parties, e.g., employers, banks, or brokerage firms, against amounts reported by taxpayers on their individual income tax returns to identify discrepancies.

³ 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)

Deann L. Baiza, Director

Linna K. Hung, Audit Manager

Jeffrey D. Cullum, Lead Auditor

Nathan J. Cabello, Auditor



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Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Commissioner, Small Business/Self-Employed Division
Commissioner, Wage and Investment Division
Director, Accounts Management, Wage and Investment Division
Director, E-File Services, Wage and Investment Division
Director, Exam Case Selection, Small Business/Self-Employed Division
Director, Exam Planning Performance and Analysis, Small Business/Self-Employed Division
Director, Examination, Small Business/Self-Employed Division
Director, Headquarters Exam, Small Business/Self-Employed Division
Director, Refundable Credits Policy and Program Management, Wage and Investment Division
Director, Submission Processing, Wage and Investment 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:

- Cost Savings (Funds Put to Better Use) – Potential; \$74,027,960 in Excess Social Security Tax Credit that was erroneously paid on 32,620 tax returns as a result of incomplete detection criteria, insufficient procedures, and human error (see page 7).

Methodology Used to Measure the Reported Benefit:

We analyzed 783,125 Tax Years 2016 and 2017 e-filed tax returns from PYs 2017 and 2018 that were identified by at least one of the Excess Social Security Tax Credit code and edit rules from the MTRDB CED_GMF table.

We compared the 783,125 tax returns to the IMF data and found that the IRS did not adjust 766,993 (98 percent) of the 783,125 tax returns at filing. During our review, we found that the IRS did not update its programming thresholds to reflect the Tax Year 2017 amounts. We analyzed the Tax Years 2016 and 2017 tax returns with the correct threshold amounts for Tax Year 2017 and found that 700,660 tax returns should not have had a code and edit rule set during PY 2018. For the remaining 66,333 (766,993 – 700,660) tax returns, we found that 29,253 tax returns claiming and receiving \$68,006,288 in Excess Social Security Tax Credit were not supported by the Information Returns Master File (IRMF)¹ Forms W-2, *Wage and Tax Statement*, available to the IRS at the time the tax return was filed.

We also analyzed 1,440,841 TY 2016 e-filed tax returns filed during PY 2017 from the MTRDB and obtained the Forms W-2 that were reported by taxpayers with those tax returns. Using the data, we applied the logic outlined in the IRS's code and edit programming and identified the following tax returns that the IRS did not set a code and edit rule for and should have:

- 3,358 tax returns receiving \$6,006,928 found by not limiting the filing status to Single for individual tax return filers. For example, in our analysis, we also included Married Filing Separately and Head of Household filing statuses.

¹ Part of the IRS taxpayer Master File that contains all taxpayer data extracted from various sources.



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- 9 tax returns receiving \$14,744 found by not limiting to just Form 1040, *U.S. Individual Income Tax Return*, and Form 1040A, *U.S. Individual Income Tax Return*. We included Form 1040NR, *U.S. Nonresident Alien Income Tax Return*.

32,620 tax returns = 29,253 + 3,358 + 9.

\$74,027,960 = \$68,006,288 + \$6,006,928 + \$14,744.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 662,550 tax returns that were unnecessarily delayed as a result of the IRS's detection criteria not being updated and the IRS selection criteria being too broad (see page 9).

Methodology Used to Measure the Reported Benefit:

We analyzed 783,125 Tax Years 2016 and 2017 e-filed tax returns from PYs 2017 and 2018 that were identified by at least one of the Excess Social Security Tax Credit code and edit rules from the MTRDB CED_GMF table.

We compared the 783,125 tax returns to the IMF data and found that the IRS did not adjust 766,993 (98 percent) of the 783,125 tax returns at filing. During our review, we found that the IRS did not update its programming thresholds to reflect the Tax Year 2017 amounts. We analyzed the Tax Years 2016 and 2017 tax returns with the correct threshold amounts for Tax Year 2017 and found that 700,660 tax returns should not have had a code and edit rule set during PY 2018. For the remaining 66,333 (766,993 – 700,660) tax returns, we found that 37,075 tax returns were supported by IRMF Forms W-2, and the IRS was unnecessarily selecting tax returns for manual review as a result of the systemic selection criteria being too broad.

However, we did find that 75,172 of the 700,660 tax returns would have been identified by the Error Code 121 at filing and sent to the Error Resolution function for manual review regardless. We also identified seven Form 1040A tax returns that would have been sent to the Error Resolution function for manual review regardless. In addition, we found that there were six records that were also part of the 32,620 tax returns we are already claiming an outcome for. Therefore, we are reducing our outcome for this.

662,550 tax returns = (700,660 – 75,172 – 7 - 6) + 37,075.

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Potential; \$1,099,833 in unnecessary expenses incurred as a result of the IRS unnecessarily selecting tax returns for manual review (see page 9).



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Methodology Used to Measure the Reported Benefit:

We analyzed 783,125 Tax Years 2016 and 2017 e-filed tax returns from PYs 2017 and 2018 that were identified by at least one of the Excess Social Security Tax Credit code and edit rules from the MTRDB CED_GMF table.

We compared the 783,125 tax returns to the IMF data and found that the IRS did not adjust 766,993 (98 percent) of the 783,125 tax returns at filing. During our review, we found that the IRS did not update its programming thresholds to reflect the Tax Year 2017 amounts. We analyzed the Tax Years 2016 and 2017 tax returns with the correct threshold amounts for Tax Year 2017 and found that 700,660 tax returns should not have had a code and edit rule set during PY 2018. For the remaining 66,333 (766,993 – 700,660) tax returns, we found that 37,075 tax returns were supported by IRMF Forms W-2, and the IRS was unnecessarily selecting tax returns for manual review as a result of the systemic selection criteria being too broad.

However, we did find that 75,172 of the 700,660 tax returns would have been identified by the Error Code 121 at filing and sent to the Error Resolution function for manual review regardless. We also identified seven Form 1040A tax returns that would have been sent to the Error Resolution function for manual review regardless. In addition, we found that there were six records that were also part of the 32,620 tax returns we are already claiming an outcome for. Therefore, we are reducing our outcome for this.

662,550 tax returns = (700,660 – 75,172 – 7 - 6) + 37,075.

According to the IRS, it costs \$1.66 to manually review a tax return in the Error Resolution function. As a result, we estimate that the IRS incurred \$1,099,833 (662,550 x \$1.66) in unnecessary expenses as a result of the IRS unnecessarily selecting these 662,550 tax returns for manual review.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$28,327,843 in additional revenue the IRS could assess if the IRS were to send soft notices for Excess Social Security Tax Credit discrepancies it identifies in its post-processing matching program (see page 10).

Methodology Used to Measure the Reported Benefit:

We analyzed 1,440,841 Tax Year 2016 e-filed tax returns filed during PY 2017 from the MTRDB and obtained the Forms W-2 that were reported by taxpayers with those tax returns. We matched the Taxpayer Identification Number and the Employer Identification Number reported by the taxpayer to the employer-provided Forms W-2 on the IRMF and determined that



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302,445 tax returns were not supported by IRMF Forms W-2 available at the time the tax return was filed.

We compared the 302,445 tax returns to the AUR Program cases the IRS identified for Tax Year 2016. We found that 141,979 tax returns were identified by the AUR Program. We found that 160,466 tax returns were not identified by the AUR Program as a result of Forms W-2 available during the AUR Program matching that were unavailable at the time the tax returns were processed or because the discrepancy was below the AUR Program tolerance. We also found that the AUR Program identified and selected 36,617 of the 141,979 tax returns to be worked, and 105,362 tax returns were not selected. Our analysis of the 105,362 tax returns not selected by the AUR Program found that 6,839 tax returns were included in the outcome for 32,620 tax returns above. We also found that 51,434 of the 105,362 tax returns were simply timing differences (*i.e.*, there was no Forms W-2 at-filing but there were Forms W-2 when the AUR Program checked and as a result there was no discrepancy identified). As a result, we removed these tax returns from this outcome. From the remaining 47,089 tax returns, we found that the IRS estimated that 37,912 tax returns would result in additional tax assessments totaling \$77,246,743, and 9,177 tax returns would result in no assessment or refunds totaling \$6,949,875. Therefore, the average additional assessment for Excess Social Security Tax Credit cases not selected by the IRS is \$2,038 ($\$77,246,743 / 37,912$ tax returns).

We also reviewed the AUR Program cases identified for Tax Year 2016 and found that the IRS did not send any soft notices to the Excess Social Security Tax Credit cases but did send 31,729 soft notices for other discrepancies identified by the AUR Program. Using the IMF data, we found that 38 percent of the tax returns had a transaction code that indicated an additional action had been taken after the soft notice had been issued.

As a result, we estimate that if the IRS sent soft notices to the 37,912 Excess Social Security Tax Credit discrepancies that it identified but did not select to work, this would result in additional actions on 14,407 ($37,912 \text{ tax returns} \times 38 \text{ percent}$) tax returns. Using the average additional assessment of Excess Social Security Tax Credit cases of \$2,038 (computed previously), we estimate that the IRS would increase revenue by \$29,361,466 ($\$2,038 \times 14,407$) by sending soft notices on the 37,912 tax returns.

Assuming all 14,407 taxpayers filed an amended tax return in response to the soft notice and a cost of \$63.85 per amended return filed, we estimate that it would cost the IRS \$919,887 to process the amended tax returns. In addition, at a cost of \$3.00 to print and mail notices for all 37,912 tax returns, we estimate that it would cost the IRS \$113,736 to mail notices. As a result, the IRS could potentially realize an estimated \$28,327,843 in additional net assessments if it began using soft notices to address Excess Social Security Tax Credit cases identified by the post-processing matching process.



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Type and Value of Outcome Measure:

- Taxpayers Rights and Entitlements – Potential; \$2,641,360 in credits 2,192 taxpayers could receive if the IRS were to send soft notices for Excess Social Security Tax Credit discrepancies it identifies in the taxpayer's favor in its post-processing matching program (see page 10).

Methodology Used to Measure the Reported Benefit:

We analyzed 1,440,841 TY 2016 e-filed tax returns filed during PY 2017 from the MTRDB and obtained the Forms W-2 that were reported by taxpayers with those tax returns. We matched the Taxpayer Identification Number and the Employer Identification Number reported by the taxpayer to the employer-provided Forms W-2 on the IRMF and determined that 302,445 tax returns were not supported by IRMF Forms W-2 available at the time the tax return was filed.

We compared the 302,445 tax returns to the AUR Program cases identified by the IRS for Tax Year 2016. We found that the AUR Program identified 141,979 tax returns. The AUR Program did not identify 160,466 tax returns because the Forms W-2 available during AUR Program matching were not available at the time the tax returns were processed or because the discrepancy was below the AUR Program tolerance. We also found that the AUR Program identified and selected 36,617 of the 141,979 tax returns to be worked, and 105,362 tax returns were not selected. Our analysis of the 105,362 tax returns not selected by the AUR Program found that 6,839 tax returns were included in the outcome for 32,620 tax returns above. We also found that 51,434 of the 105,362 tax returns were simply timing differences (*i.e.*, there was no Forms W-2 at-filing but there were Forms W-2 when the AUR Program checked and as a result there was no discrepancy identified). As a result, we removed these tax returns from this outcome. From the remaining 47,089 tax returns, we found that the IRS identified that 37,912 tax returns would result in additional tax assessments, 3,409 tax returns would result in no refund or tax assessment, and 5,768 tax returns would result in refunds totaling \$6,949,875. Therefore, the average potential refund for Excess Social Security Tax Credit cases the IRS did not select is \$1,205(\$6,949,875/5,768 tax returns).

IRS management indicated that they do not send notices to taxpayers with a refund potential. As such, the IRS has no data on the number of taxpayers who would respond to a notice when they were entitled to an additional refund. We used the percentage of additional actions taken on AUR Program cases for which the IRS did send a soft notice to estimate the response rate for cases with a refund potential. As a result, we estimate that if the IRS sent soft notices to the 5,768 Excess Social Security Tax Credit discrepancies with a refund potential, this would result in a response for 2,192 (5,768 x 38 percent) tax returns. Using the average refund amount (computed previously), we estimate that 2,192 taxpayers would receive \$2,641,360 (2,192 x \$1,205) in refunds if the IRS were to send soft notices to these taxpayers.



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Social Security Tax Credit Claims Are Not Addressed*

Appendix V

*Tax Returns Claiming the Excess Social Security Tax
Credit During Tax Years 2014 Through 2017
by Tax Form*

Tax Year	Filing Type	Type of Form 1040	Total Claims	Claims %¹	Total Claims Paid	Amount Paid²
2014	E-filed	Form 1040, U.S. Individual Income Tax Return	1,268,077	90.35%	1,263,127	\$2,480,494,644
		Form 1040A, U.S. Individual Income Tax Return	643	0.05%	481	\$213,176
	Paper	Form 1040, U.S. Individual Income Tax Return	133,088	9.48%	117,482	\$244,224,008
		1040-PR, Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)	668	0.05%	589	\$1,337,436
		Form 1040-SS, U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)	523	0.04%	486	\$1,003,424
		Form 1040NR, U.S. Nonresident Alien Income Tax Return	394	0.03%	339	\$884,102
		Form 1040A, U.S. Individual Income Tax Return	65	0.00%	30	\$11,678
		Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents	8	0.00%	2	\$211
		Total	1,403,466	100%	1,382,536	\$2,728,168,679

¹ Percentages shown may not total 100 percent due to rounding.

² This does not include any amounts subsequently received or adjusted during post-processing. For example, amended returns, AUR Program, etc.



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Social Security Tax Credit Claims Are Not Addressed*

Tax Year	Filing Type	Type of Form 1040	Total Claims	Claims % ¹	Total Claims Paid	Amount Paid ²
2015	E-filed	Form 1040, U.S. Individual Income Tax Return	1,415,262	91.66%	1,410,133	\$2,802,801,014
		Form 1040A, U.S. Individual Income Tax Return	1,164	0.08%	884	\$379,833
	Paper	Form 1040, U.S. Individual Income Tax Return	126,122	8.17%	118,282	\$245,390,302
		1040-PR, Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)	682	0.04%	664	\$1,342,978
		Form 1040NR, U.S. Nonresident Alien Income Tax Return	476	0.03%	410	\$1,017,720
		Form 1040-SS, U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)	274	0.02%	269	\$689,515
		Form 1040A, U.S. Individual Income Tax Return	67	0.00%	44	\$20,943
		Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents	4	0.00%	0	\$0
	Total		1,544,051	100%	1,530,686	\$3,051,642,305
2016	E-filed	Form 1040, U.S. Individual Income Tax Return	1,439,632	92.70%	1,434,388	\$2,886,892,510
		Form 1040A, U.S. Individual Income Tax Return	1,061	0.07%	799	\$284,044
		Form 1040NR, U.S. Nonresident Alien Income Tax Return	148	0.01%	147	\$348,976
	Paper	Form 1040, U.S. Individual Income Tax Return	110,945	7.14%	104,578	\$216,369,658
		1040-PR, Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)	583	0.04%	565	\$1,098,188
		Form 1040NR, U.S. Nonresident Alien Income Tax Return	330	0.02%	289	\$715,190



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Tax Year	Filing Type	Type of Form 1040	Total Claims	Claims % ¹	Total Claims Paid	Amount Paid ²
		Form 1040-SS, U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)	207	0.01%	202	\$496,996
		Form 1040A, U.S. Individual Income Tax Return	69	0.00%	36	\$19,065
		Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents	19	0.00%	7	\$5,887
	Total		1,552,994	100%	1,541,011	\$3,106,230,514
2017³	E-filed	Form 1040, U.S. Individual Income Tax Return	1,130,381	96.62%	1,127,021	\$2,289,033,762
		Form 1040A, U.S. Individual Income Tax Return	349	0.03%	242	\$99,393
		Form 1040NR, U.S. Nonresident Alien Income Tax Return	112	0.01%	112	\$290,284
	Paper	Form 1040, U.S. Individual Income Tax Return	38,546	3.29%	36,390	\$68,259,476
		1040-PR, Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)	234	0.02%	230	\$435,464
		Form 1040NR, U.S. Nonresident Alien Income Tax Return	110	0.01%	85	\$166,001
		Form 1040-SS, U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)	110	0.01%	108	\$293,305
		Form 1040A, U.S. Individual Income Tax Return	14	0.00%	5	\$1,919
		Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents	12	0.00%	3	\$528
	Total		1,169,868	100%	1,164,196	\$2,358,580,132

³ Tax Year 2017 data are through May 24, 2018.



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Social Security Tax Credit Claims Are Not Addressed*

Appendix VI

Management's Response to the Draft Report




COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

FEB 25 2019

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Millions of Dollars in Potentially Erroneous
Excess Social Security Tax Credit Claims Are Not Addressed
(Audit #201840008)

Thank you for the opportunity to review the subject draft report and provide comments. As noted, the Excess Social Security Tax Credit is available to individuals who had multiple employers during the tax year and whose collective wages from those employers exceeded the maximum amount of wages taxable under the Federal Insurance Contributions Act (FICA). The excess FICA tax above the maximum annual amount, paid through employer withholding, is allowable as a refundable credit against the individuals' income tax liabilities.

We appreciate the acknowledgement that processes we implemented to address conditions observed in your prior review improved our ability to detect questionable claims. Those improvements prevented the payment of more than \$64 million in incorrect claims during 2017 and 2018. We also appreciate the opportunities identified for improvement during this review and are acting on them. We are addressing all recommendations and three have been completed.

We are committed to exploring the expansion of our soft notice program to include excess social security tax discrepancy cases and incorporating those with the highest estimated potential assessment. We disagree that sending soft notices to taxpayers with excess social security tax discrepancies could generate a potential revenue of \$28,327,843. We do not agree with the methodology used to project this potential revenue. Our resources would not afford us the ability to send notices to all the taxpayers you identified with excess social security tax credit claimed. Additionally, if this work is pursued versus another type of work there will be an opportunity cost for that business decision.



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Social Security Tax Credit Claims Are Not Addressed*

2

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 James P. Clifford, Director, Customer Account Services, Wage and Investment Division, at 470-639-3504.

Attachment



*Millions of Dollars in Potentially Erroneous Excess
Social Security Tax Credit Claims Are Not Addressed*

Attachment

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1

Develop processes and procedures to ensure that tax examiners accurately review Excess Social Security Tax Credit claims.

CORRECTIVE ACTION

We agree with this recommendation. A review process will be implemented for the 2019 filing season to ensure tax examiners are correctly addressing potential errors involving claims for the Excess Social Security Tax Credit. We will evaluate review results to identify the causes for incorrect actions and address them appropriately.

IMPLEMENTATION DATE

February 15, 2020

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2

Update internal guidelines to require tax examiners to research employer Forms W-2 when a paid preparer filed the tax return.

CORRECTIVE ACTION

We agree with this recommendation. Internal Revenue Manual 3.12.3.13.3.3, Individual Income Tax Returns, was updated on February 6, 2019 to provide uniform procedures for researching wage information on all electronic returns.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

N/A



*Millions of Dollars in Potentially Erroneous Excess
Social Security Tax Credit Claims Are Not Addressed*

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RECOMMENDATION 3

Expand Excess Social Security Tax Credit return selection criteria to identify for screening claims filed using filing status Married Filing Separate, Head of Household, or Qualified Widow(er).

CORRECTIVE ACTION

We agree with this recommendation. The requisite programming changes were documented on Unified Work Request (UWR) 213983. The programming changes were implemented and placed into production in January 2019.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 4

Expand Excess Social Security Tax Credit return selection criteria to identify for screening claims filed on Form 1040NR for additional review.

CORRECTIVE ACTION

We agree with this recommendation. The requisite programming changes were documented on UWR 214090 and were placed into production in January 2019.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 5

Develop processes and procedures to ensure annually that Social Security tax maximum withholding amounts are updated in systemic programs that select Excess Social Security Tax Credit claims for review.



*Millions of Dollars in Potentially Erroneous Excess
Social Security Tax Credit Claims Are Not Addressed*

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CORRECTIVE ACTION

We agree with this recommendation. Procedures will be implemented to align the annual updates for the Code and Edit processing instructions with the business rule development process for the Modernized e-File system. Changes will be synchronized between the two processes. Primary and backup staff assignments have already been made to ensure peer reviews are completed with originators when UWRs requesting programming changes to processing systems for Form 1040, U.S. Individual Income Tax Return, and other like forms are submitted.

IMPLEMENTATION DATE

March 15, 2020

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 6

Update systemic processes to ensure that the IRS does not unnecessarily select tax returns for manual review which: report "agent for" in the employer name line; report Social Security tax withholding below the maximum withholding amount for each taxpayer; and/or are below the dollar tolerance used to select paper tax returns for manual review.

CORRECTIVE ACTION

We agree with this recommendation. Procedures are being updated to refine selection criteria for returns affected by the listed conditions.

IMPLEMENTATION DATE

February 15, 2020

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.



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Recommendations

The Commissioner, Small Business/Self-Employed Division, in conjunction with the Commissioner, Wage and Investment Division, should:

RECOMMENDATION 7

Establish a process to send and measure the success associated with soft notices that alert individuals to potential errors on their tax return related to Excess Social Security Tax Credit claims.

CORRECTIVE ACTION

We will evaluate the existing process and selection criteria for sending soft notices to determine the feasibility of incorporating excess Social Security Tax credit. If it is feasible and funding is available, a process will be established to measure the success of sending soft notices related to claiming the Excess Social Security Tax Credit.

IMPLEMENTATION DATE

October 15, 2020

RESPONSIBLE OFFICIAL

Director, Exam Case Selection, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 8

Evaluate current resources expended on the issuance of soft notices to ensure that notices are sent to those taxpayers with the highest tax assessment potential to maximize the use of limited resources.

CORRECTIVE ACTION

We will evaluate our resources expended on the issuance of soft notices and will evaluate the selection criteria to determine if soft notices are sent to those taxpayers with the highest Estimated Potential Assessment while considering our limited resources.

IMPLEMENTATION DATE

October 15, 2020

RESPONSIBLE OFFICIAL

Director, Exam Case Selection, Small Business/Self-Employed Division



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Social Security Tax Credit Claims Are Not Addressed*

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CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.