



*Processes Were Not Established to Verify
Eligibility for Work Opportunity Tax Credits*

July 1, 2014

Reference Number: 2014-40-041

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 = Risk Circumvention of Agency Regulation or Statute

Phone Number / 202-622-6500

E-mail Address / TIGTACommunications@tigta.treas.gov

Website / <http://www.treasury.gov/tigta>



HIGHLIGHTS

PROCESSES WERE NOT ESTABLISHED TO VERIFY ELIGIBILITY FOR WORK OPPORTUNITY TAX CREDITS

Highlights

Final Report issued on July 1, 2014

Highlights of Reference Number: 2014-40-041 to Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

The Work Opportunity Tax Credit (WOTC) is a Federal tax credit designed to encourage employers to hire individuals from certain targeted groups who have consistently faced significant barriers to employment. For Tax Year 2013, the maximum credit per individual that could be claimed was \$9,600. The credit has been in existence since 1978 but expired on December 31, 2013. On January 28, 2014, members of Congress introduced legislation to renew this tax credit.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether controls were adequate to identify questionable employer claims for the WOTC. Between January 1 and December 30, 2012, more than \$721 million in the WOTC was claimed on 21,278 electronically filed tax returns. The number and amount claimed on paper returns is not available.

WHAT TIGTA FOUND

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on Form 5884, *Work Opportunity Credit*. **2**
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TIGTA also identified 759 WOTC claims totaling approximately \$13 million on 687 electronically

filed tax returns processed in Processing Year 2012 for which the IRS had information at the time the tax returns were processed that could have been used to identify these claims as questionable.

The IRS reviewed 77 of the 759 WOTC claims to determine whether the WOTC was in fact potentially erroneous. The IRS confirmed that 24 of the 77 were erroneous WOTC claims. The remaining 53 WOTC claims involved mistakes on the part of the filer or the pass-through entity.
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WHAT TIGTA RECOMMENDED

TIGTA recommended that if legislation to extend the WOTC is enacted, the IRS should revise Form 5884 *****2*****
*****2***** , and revise associated instructions to advise employers of where to submit certification requests and of certification requirements to claim the WOTC. The IRS should also include the characteristics of the tax returns confirmed as questionable in its overall compliance strategy being developed for General Business Credits and conduct a review of the 24 WOTC claims identified as erroneous to determine the proper tax liability for the tax returns.

In their response to the report, IRS officials agreed with TIGTA's findings and recommendations. They stated that, where feasible, they plan to make suggested revisions to the forms and instructions, and plan to include a compliance strategy to address questionable WOTC claims in the overall compliance strategy being developed for General Business Credits.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 1, 2014

**MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT**

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Processes Were Not Established to Verify
Eligibility for Work Opportunity Tax Credits (Audit # 201340026)

This report presents the results of our review to determine whether controls are adequate to identify questionable employer claims for the Work Opportunity Tax Credit. This audit is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Fraudulent Claims and Improper Payments.

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

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, Acting Assistant Inspector General for Audit (Returns Processing and Account Services).



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Abbreviations

DOL	Department of Labor
e-file(d), e-file	Electronically file(d); electronic file
EIN	Employer Identification Number
IRS	Internal Revenue Service
PY	Processing Year
SESA	State Employment Security Agency
SSN	Social Security Number
WOTC	Work Opportunity Tax Credit



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Background

The Work Opportunity Tax Credit (WOTC) is a Federal tax credit available to employers for hiring individuals from certain targeted groups who have consistently faced significant barriers to employment. The WOTC helps these individuals transition from economic dependency into self-sufficiency as they earn a steady income. The WOTC, originally known as the Targeted Jobs Credit, was created by the Revenue Act of 1978.¹ Since 1978, subsequent legislation has made changes to the types of individuals or targeted groups that are eligible, what constitutes qualified wages, and the amount that employers can claim as a credit. Most recently, the American Taxpayer Relief Act of 2012² retroactively extended the WOTC for taxable employers who hired individuals from targeted groups, in addition to qualified veterans, through December 31, 2013. On January 28, 2014, members of Congress introduced legislation to renew this tax credit for another year; however, at the time of this report, the legislation has not passed.

Target groups that qualify for the WOTC include long-term family assistance recipients, ex-felons, summer youth employees, veterans, etc.

Employer requirements for claiming the WOTC

Before any WOTC can be claimed, the law³ requires employers to obtain a certification from a State Employment Security Agency (SESA)⁴ confirming that the individual is in fact a member of a targeted group. The United States Department of Labor (DOL) is responsible for the certification process including providing guidance and overseeing each SESA that reviews the certification applications and determines if individuals qualify as members of a targeted group. The Internal Revenue Service (IRS) is responsible for processing claims for the WOTC.

To obtain certification, an employer completes IRS Form 8850, *Pre-Screening Notice and Certification Request for the Work Opportunity Credit*,⁵ and either DOL Employment and Training Administration Form 9061, *Individual Characteristics Form*,⁶ or DOL Employment and

¹ Pub. L. No. 95-600, 92 Stat. 2763 (1978).

² Pub. L. No 112-240, 126 Stat 2313 (2013).

³ I.R.C. § 51.

⁴ There is an SESA, each with a coordinator, for all 50 States, Washington D.C., Puerto Rico, and the U.S. Virgin Islands.

⁵ See Appendix V for an example of Form 8850.

⁶ Form 9061 is completed by the employer or the applicant and documents certain characteristics of the applying employee to the help the SESA determine eligibility for the WOTC.



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Training Administration Form 9062, *Conditional Certification Form*.⁷ Employers submit the required forms to the applicable SESA, which checks the claims for timeliness⁸ and completeness. The SESA then reviews the application and uses its resources to determine whether the individual qualifies as a member of a targeted group. If the individual qualifies, the SESA sends the employer DOL Employment and Training Administration Form 9063, *Employer Certification Work Opportunity and Welfare-to-Work Tax Credits*. This certification indicates which targeted group the individual belongs to, confirming the employer's ability to claim the WOTC for this individual. Although the SESAs and employers are required to maintain copies of certification records, neither the DOL nor the IRS receives information regarding certification applications and/or determinations. Figure 1 identifies the volume of certification requests for the WOTC processed by the SESAs in Fiscal Years⁹ 2010 through 2012.

Figure 1: Certification Requests for the WOTC

Fiscal Year	Certification Requests	Certifications Approved	Certifications Denied	Certifications Pending Review
2010	3,277,830	940,642	1,230,531	1,106,657
2011	3,750,967	1,160,523	1,227,407	1,363,037
2012	3,572,107	895,005	1,016,411	1,660,691

Source: United States DOL.

Claiming the WOTC

The WOTC is considered a General Business Credit and as such is a nonrefundable credit. To claim the WOTC, employers submit a Form 5884, *Work Opportunity Credit*,¹⁰ with their tax return. The WOTC amount is based on the amount of qualified wages¹¹ paid to that employee, the targeted group to which the employee belongs, and the length of time the employee worked for the business. Figure 2 shows the maximum WOTC amount that an employer can claim for each employee based on the targeted group to which the employee belongs.

⁷ Form 9062 is a precertification form the applying employee can offer the employer to help streamline the application process and is often administered by local or State organizations attempting to help these targeted groups gain employment.

⁸ The application must be made within 28 calendar days of hire.

⁹ A 12-consecutive-month period ending on the last day of any month. The Federal Government's fiscal year begins on October 1 and ends on September 30.

¹⁰ See Appendix VI for an example of Form 5884.

¹¹ The amount of qualified wages for any employee is zero if the employee did not work for the employer for at least 120 hours, the employee worked for the employer previously, the employee is a dependent of the employer, the employee is related to the employer, or 50 percent or less of the wages the employee received were for working in the employer's trade or business.



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Figure 2: Maximum WOTC Amount for Tax Year¹² 2012

Targeted Group – Veterans	Maximum Available WOTC Amount Based on Qualified Wages		
Disabled veterans with a service-connected disability who have been unemployed for at least six months.	40 percent of \$24,000	<i>or</i>	\$9,600
Veterans who have been unemployed for at least six months.	40 percent of \$14,000	<i>or</i>	\$5,600
Disabled veterans with a service-connected disability.	40 percent of \$12,000	<i>or</i>	\$4,800
Veterans receiving Supplemental Nutrition Assistance Program benefits.	40 percent of \$6,000	<i>or</i>	\$2,400
Veterans who have been unemployed for at least four weeks.	40 percent of \$6,000	<i>or</i>	\$2,400
Targeted Group – Nonveterans (other targeted groups)	Maximum Available WOTC Amount Based on Qualified Wages		
Long-term family assistance recipients. ¹³	(40 percent of \$10,000 for first year) + (50 percent of \$10,000 for second year)	<i>or</i>	\$9,000
Qualified ex-felons.	40 percent of \$6,000	<i>or</i>	\$2,400
Designated community residents.			
Vocational rehabilitation referrals.			
Supplemental Nutrition Assistance Program recipients.			
Supplemental Security Income recipients.			
Qualified recipients of Temporary Assistance for Needy Families.			
Summer youth program participants.	40 percent of \$3,000	<i>or</i>	\$1,200

Source: Treasury Inspector General for Tax Administration analysis of IRS Form 5884.

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

¹³ Wages earned by long-term family assistance recipients are eligible for a second year of the WOTC, while all other targeted groups are only eligible for the first year.



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The WOTC amount computed on Form 5884 is reported on Form 3800, *General Business Credit*,¹⁴ which is used to compute the General Business Credit amount. As with all General Business Credits, any amount of the WOTC that goes beyond the taxpayer's tax liability (unused amount) can be used either as a carryback or as a carryforward. A taxpayer can carry back any unused amount of the WOTC to previous liabilities by filing an amended return for the previous year's tax return. For the WOTC, the carryback period is five years for eligible small businesses¹⁵ and one year for all other businesses. The taxpayer can carry forward the amount and save the unused amount of the WOTC to apply to future tax liabilities for up to 20 years.

This review was performed with information obtained from the Large Business and International Division Headquarters in Washington, D.C., and the Small Business/Self-Employed Division Headquarters in Lanham, Maryland, during the period September 2013 through March 2014. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Our scope was limited as a result of the IRS not requiring employers to provide any identifying information as to the individuals for whom the WOTC was being claimed. In addition, the IRS does not receive or maintain certification documentation. We were also unable to identify the specific SESA that the certification was sent to, which would allow us to independently request this information. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

¹⁴ See Appendix VII for an example of Form 3800.

¹⁵ An eligible small business is a corporation whose stock is not publicly traded, a partnership, or a sole proprietorship whose average annual gross receipts for the three tax years preceding the Tax Year 2010 loss year do not exceed \$50 million.



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Results of Review

Businesses Claiming the Work Opportunity Tax Credit Are Not Required to Provide Information That Could Be Used to Identify Questionable Claims

*****2*****
 on Form 5884. For example, *****2*****
 *****2*****
 *****2*****
 *****2*****.
 *****2*****
 *****2*****
 *****2*****
 *****2*****
 *****2*****
 *****2*****.

Figure 3: Requirements of WOTC Claims the IRS Is Unable to Verify

Requirement to Claim Individuals for the WOTC	Can the IRS Verify When the Tax Return Is Processed?
*****2*****	***2**
*****2*****	***2**
*****2*****	***2**
*****2*****	***2**
*****2*****	***2**

Source: Treasury Inspector General for Tax Administration analysis of IRS Form 5884 Instructions (2012).

Furthermore, we found that the IRS is inconsistent in its requesting of information for employee-based credits. For example, the IRS requires employers to provide identifying information relating to individuals being claimed for the *****2*****. To claim this credit, the



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Figure 5: WOTC Claims on E-Filed Forms 3800 for PY 2012

Tax Return Type	Tax Returns With WOTC Claims on Forms 3800 ¹⁸	WOTC Amount Claimed ¹⁹
Individual Tax Return	19,338	\$132,583,380
Business Tax Return	1,940	\$588,906,839
Total	21,278	\$721,490,219

Source: This table includes Forms 3800 processed through the Modernized e-File system²⁰ between January 1 and December 30, 2012, and does not include amounts for the WOTC claimed as a carryforward or a carryback.

*****2*****

*****2*****
*****2*****
*****2*****. The term “tiered pass-through entity” describes a situation in which a pass-through entity owns an interest in another pass-through entity. A “pass-through entity” is an entity that passes income, credits, deductions, etc., through to individuals or businesses that are partners, shareholders, or beneficiaries.

*****2*****
*****2*****
*****2*****. Our review of 15,999 e-filed business tax returns with a WOTC claim on Form 5884 processed in PY 2012 identified 1,416 tax returns²¹ with WOTC claims of approximately \$40.5 million that involve a tiered pass-through entity arrangement. *****2*****

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

¹⁸ A tax return may have a WOTC claim on more than one Part III of Form 3800.
¹⁹ This only shows the amount of the WOTC claimed on e-filed tax returns. Similar information is not available from the IRS for WOTC claims on paper-filed tax returns. *****2*****
*****2*****. As such, the IRS cannot identify and quantify all claims for the WOTC.
²⁰ The Modernized e-File system is a web-based system that allows e-filing of tax returns over the Internet.
²¹ *****2*****



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*****2*****.

We are not making a recommendation to address the above concern. We plan to include this issue in our upcoming evaluation of the IRS’s processes and controls to ensure that Schedule K-1, Partner’s Share of Income, Deductions, Credits, etc., income and credits accurately reflect information reported on business tax returns.

Recommendation

If legislation to extend the WOTC is enacted, the Commissioners, Large Business and International Division and Small Business/Self-Employed Division, should:

Recommendation 1: Revise Form *****2*****
*****2*****. Requesting this type of information may also help deter erroneous claims for the WOTC. *****2*****
*****2*****.

Management’s Response: The IRS agreed with the recommendation. If legislation is passed extending the WOTC, the IRS will assess whether changes to Form 5884 to *****2*****to ensure that businesses do not erroneously claim the WOTC are feasible. In deciding which potential form changes to pursue, the IRS will consider the findings from Recommendations 3 and 4 as well as the additional costs to taxpayers and the IRS.

Potentially Erroneous Work Opportunity Tax Credits Were Allowed Even Though Data Exists to Identify Claims As Questionable

We identified 759 WOTC claims totaling approximately \$13 million on 687 e-filed tax returns22 processed in PY 2012 for which the IRS had information at the time the tax returns were processed that could have been used to identify these claims as questionable. These include 713 WOTC claims totaling approximately \$9 million on 641 e-filed tax returns *****2*****
*****2*****
*****2*****. This means that the *****2*****

22 These include both Tax Year 2011 and Tax Year 2012 tax returns. *****2*****
*****2*****.



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****2***. Therefore, the 641 filers may not be entitled to claim the WOTC. In addition, we identified 46 WOTC claims totaling approximately \$4 million on 46 e-filed tax returns **2*****.

The IRS reviewed 77 of the 759 WOTC claims to determine whether the WOTC was in fact potentially erroneous. The IRS confirmed that 24 of the 77 were erroneous WOTC claims.²³ The remaining 53 WOTC claims involved mistakes on the part of the filer or the pass-through entity. These included instances in which the filer erroneously recorded the New Hire Retention Credit on the WOTC credit line, the pass-through entity misclassified the credit on the filer’s Schedule K-1 selecting a code associated with the WOTC when they should have selected a code for another credit, the filer listed the wrong EIN on the Form 3800, and a number of other types of errors. Figure 6 shows the breakdown of WOTC claims that the IRS agreed were potentially erroneous.

Figure 6: Breakdown of Erroneous WOTC Claims in PY 2012

Questionable Characteristics of WOTC Claim	WOTC Claims	Amount of the WOTC Allowed
*****2*****	20	\$1,828,844
*****2*****		
*****2*****	4	\$1,348,699
*****2****		
Total	24	\$3,177,543

Source: Analysis of Modernized Tax Return Database downloads of Forms 3800 and Forms 5884. This table represents only those forms processed through the Modernized e-File system between January 1 and December 30, 2012. These tax returns do not include the WOTC claimed on Form 3800 for carryforwards or carrybacks.

IRS guidelines require that:

- Pass-through entities that claim the WOTC include the Form 5884 with their tax return.
- Taxpayers that report a credit from a pass-through entity enter the pass-through entity’s EIN on Form 3800.

*****2*****
2.²⁴ In response to that report, IRS management agreed that procedures should be reviewed to identify improvements in the detection of questionable General Business Credits. IRS

²³ See Appendix IV.

²⁴ Treasury Inspector General for Tax Administration, Ref. No. 2013-40-093, *Unsupported and Potentially Erroneous Claims for General Business Credits Are Not Always Identified When Tax Returns Are Processed* p. 4 (Sept. 2013).



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management noted that success in correcting any deficiencies would be dependent upon developing a compliance strategy. *****2*****

Recommendations

The Deputy Commissioner for Services and Enforcement should:

Recommendation 2: Include the characteristics of the tax returns confirmed as questionable in which filers claimed the WOTC *****2***** in its overall compliance strategy being developed for General Business Credits in response to a prior Treasury Inspector General for Tax Administration audit recommendation.25

Management's Response: The IRS agreed with the recommendation. A compliance strategy to address questionable WOTC claims will be included in the overall compliance strategy being developed for General Business Credits in response to a prior Treasury Inspector General for Tax Administration audit recommendation. *****2*****

Recommendation 3: Conduct a review of the 24 WOTC claims identified as erroneous to determine the proper tax liability for the tax returns.

Management's Response: The IRS agreed with the recommendation. The IRS will conduct an analysis of the 24 WOTC claims identified as erroneous, based on the available data, to assess compliance risks. The results of this analysis will be used to determine any necessary changes to compliance work streams, forms, or instructions.

Office of Audit Comment: Although the IRS agreed with our findings, the IRS disagreed with our outcome measure of approximately \$3.2 million in potential revenue protected. As stated in our report, management reviewed these claims and agreed they were erroneous *****2***** We agree, but as our report points out, the IRS has the data to identify these potentially erroneous claims at the time tax returns are processed but has not established processes and procedures. Our outcome measure reflects the fact that the IRS allows these erroneous claims to be processed without identifying the return and corresponding with the taxpayer to ensure the validity of the WOTC claim.

25 Treasury Inspector General for Tax Administration, Ref. No. 2013-40-093, Unsupported and Potentially Erroneous Claims for General Business Credits Are Not Always Identified When Tax Returns Are Processed p. 9 (Sept. 2013).



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Work Opportunity Tax Credit Guidance Lacks Clarity on Key Requirements

IRS guidance does not inform employers of the need to send the required certification Form 8850 to the State where their business is located. For example, review of the instructions for the Form 8850 informs employers not to file the Form 8850 with the IRS. Instead, instructions for the Form 8850 and the Form 5884 direct employers to file certifications with their State Workforce Agency no later than the 28th day after the job applicant begins work. Both instructions fail to inform the employer that the certification is required to be sent to the State in which their business is located rather than the State in which the individual resides. This can result in inaccurate submissions by the employer to SESA locations. This is likely to occur with multi-State businesses and employees who live in one State and work in another State.

The DOL recommends sending applications to the SESA where the business is located (and employee works); however, there is no specific guidance from either the DOL or the IRS on this matter. Further, the law states that employers are not entitled to claim the WOTC until certification that the individual(s) is a member of a targeted group is received back from a SESA.²⁶ However, review of IRS instructions for claiming the WOTC found that guidance does not clearly state when an employer is eligible to claim the WOTC. For example, Form 5884 instructions state:

You must request and be issued certification for each employee from the state employment security agency (SESA). The certification proves that the employee is a member of a targeted group. You must receive the certification by the day the individual begins work or complete Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity Credit, on or before the day you offer the individual a job.²⁷

The guidance above inaccurately informs employers that completing and submitting the Form 8850 qualifies them to claim an individual being hired for the WOTC. Submission of a Form 8850 does not qualify an employer to claim an individual being hired for the WOTC; only the receipt of an approved certification qualifies an employer to claim an individual for the WOTC.

²⁶ I.R.C. § 51.

²⁷ Excerpt from Form 5884 Instructions (2012).



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Recommendation

If legislation to extend the WOTC is enacted, the Commissioners, Large Business and International Division and Small Business/Self-Employed Division, should:

Recommendation 4: Revise instructions for Form 5884 and Form 8850 to clearly and accurately advise employers of where to submit Form 8850 and that an approved certification must be received to be eligible to claim an individual for the WOTC.

Management's Response: The IRS agreed with the recommendation. If legislation is passed extending the WOTC, the IRS will review the instructions for Forms 5884 and 8850 to identify potential changes to clarify when taxpayers qualify for these credits. In deciding what changes to implement, the IRS will consider feasibility factors from the DOL as well as the potential costs and benefits to taxpayers and tax administration.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether controls are adequate to identify questionable employer claims for the WOTC. There was a significant impairment to the scope of our audit work. Because there was no clear guidance regarding which SESA location employers should send requests for certification, we could not determine which SESA location would have received and processed certification requests from employers claiming the WOTC. As a result, we could not complete testing to evaluate if the IRS had effective processes to ensure that employers claimed an appropriate WOTC amount and reversed the WOTC after an employer's certification was denied. To accomplish our objective, we:

- I. Assessed the effectiveness of the IRS's ability to ensure that employees claimed for the WOTC are qualified members of a targeted group.
 - A. Reviewed the Internal Revenue Manual and met with the IRS to obtain an understanding of existing controls.
 - B. Obtained extracts of all PY¹ 2012 e-filed tax returns that have claimed the WOTC on Form 3800, *General Business Credit*, or Form 5884, *Work Opportunity Credit*, from the Modernized e-File system.² We performed a data reliability assessment for these extracts. We validated both data files by comparing 20 cases to the Integrated Data Retrieval System³ and Employee User Portal.⁴ Based on this validation, we determined the data were reliable.
- II. Determined if the IRS is effectively screening taxpayers claiming the WOTC from pass-through entities.
 - A. Identified 9,968 PY 2012 e-filed tax returns claiming \$148,846,347 in the WOTC for which an EIN was reported on Form 3800, Part III, line 4b, column b.
 1. Performed data analysis to determine if the EIN reported on the Form 3800 matches an EIN of a pass-through entity that claimed the WOTC on Form 5884.

¹ The calendar year in which the tax return or document is processed by the IRS.

² The Modernized e-File system is a web-based system that allows e-filing of tax returns over the Internet.

³ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

⁴ IRS computer system used to review tax return information transmitted through the Modernized e-File system.



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2. Identified 641 PY 2012 e-filed tax returns claiming \$9,001,518 *****2*****
*****2*****
*****2*****.
- B. Identified 34,630 PY 2012 e-filed business tax returns with claims for the WOTC on Form 5884.
 1. Determined if pass-through entity WOTC claims were made without reporting a pass-through entity EIN.
 2. Identified 1,416 PY 2012 e-filed *****2*****tax returns claiming \$40,482,328 in *****2*****WOTC claims on Form 5884 *****2*****
*****2*****
*****2*****.
 3. Identified 46 PY 2012 **2** tax returns claiming \$4,004,211 *****2*****
*****2*****
*****2*****.

Internal controls methodology

Internal controls relate to management’s plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: processes and procedures to identify questionable employer claims for the WOTC. We evaluated the controls by reviewing the IRS’s Internal Revenue Manuals and interviewing IRS management.



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Appendix II

Major Contributors to This Report

Russell P. Martin, Acting Assistant Inspector General for Audit (Returns Processing and Account Services)
Diana M. Tengesdal, Acting Director
Kathleen Hughes, Audit Manager
Levi J. Dickson, Lead Auditor
Johnathan D. Elder, Auditor
J. Edmund Carr III, Audit Evaluator
Jack Laney, Audit Evaluator
Joseph Butler, Information Technology Specialist



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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Commissioner, Large Business and International Division SE:LB
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Wage and Investment Division SE:W
Deputy Commissioner (Domestic), Large Business and International Division SE:LB
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Operations, Wage and Investment Division SE:W
Deputy Commissioner, Support, Wage and Investment Division SE:W
Director, Shared Support, Large Business and International Division SE:LB:SS
Director, Office of Legislative Affairs CL:LA
Chief Counsel CC
National Taxpayer Advocate TA
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Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Revenue Protection – Potential; \$1,828,844 for 20 erroneous WOTC claims on 16 tax returns processed in PY 2012.

Methodology Used to Measure the Reported Benefit:

We conducted an analysis of PY 2012 e-filed tax returns with WOTC claims on Form 3800, Part III, line 4b. A tax return may have a WOTC claim on more than one Part III of Form 3800. We identified WOTC claims that *****2***** EIN, indicating the WOTC was from a*****2*****. We identified 899 WOTC claims *****2*****. The IRS selected a sample of 79 of the 899 WOTC claims and identified nine WOTC claims*****2*****. Through data analysis, we identified an additional 177 WOTC claims that were *****2***** *****2*****. We removed these 186 WOTC claims from the population of questionable claims. As a result, our review of PY 2012 WOTC claims found that the *****2*****for 713 WOTC claims totaling \$9,001,518 filed on 641 tax returns*****2*****. Of the 713 WOTC claims, the IRS reviewed 70 claims on 66 tax returns and agreed that 20 WOTC claims totaling \$1,828,844 filed on 16 tax returns*****2*****.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; \$1,348,699 for four unsupported WOTC claims on four tax returns processed in PY 2012. *****2***** (see page 8).

Methodology Used to Measure the Reported Benefit:

We conducted an analysis of PY 2012 **2** tax returns with WOTC claims on Form 3800, Part III, line 4b. A tax return may have a WOTC claim on more than one Part III of Form 3800. We identified 47 WOTC claims*****2*****. The IRS selected a sample of eight of the 47 WOTC claims *****2*****.



*Processes Were Not Established to
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*****2*****. We removed this claim from the population of questionable claims. As a result, our review of PY 2012 WOTC claims found 46 claims totaling \$4,004,211 filed on 46 tax returns*****2*****. The IRS reviewed seven of the 46 WOTC claims on seven tax returns and agreed that four WOTC claims totaling \$1,348,699 *****2*****. *****2*****.



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Appendix V

*Form 8850, Pre-Screening Notice and Certification
Request for the Work Opportunity Credit*

Form 8850 (Rev. January 2013) Department of the Treasury Internal Revenue Service	Pre-Screening Notice and Certification Request for the Work Opportunity Credit	OMB No. 1545-1500
Information about Form 8850 and its separate instructions is at www.irs.gov/form8850.		
Job applicant: Fill in the lines below and check any boxes that apply. Complete only this side.		
Your name _____ Social security number ► _____		
Street address where you live _____		
City or town, state, and ZIP code _____		
County _____ Telephone number _____		
If you are under age 40, enter your date of birth (month, day, year) _____		
1 <input type="checkbox"/> Check here if you received a conditional certification from the state workforce agency (SWA) or a participating local agency for the work opportunity credit.		
2 <input type="checkbox"/> Check here if any of the following statements apply to you. <ul style="list-style-type: none">• I am a member of a family that has received assistance from Temporary Assistance for Needy Families (TANF) for any 9 months during the past 18 months.• I am a veteran and a member of a family that received Supplemental Nutrition Assistance Program (SNAP) benefits (food stamps) for at least a 3-month period during the past 15 months.• I was referred here by a rehabilitation agency approved by the state, an employment network under the Ticket to Work program, or the Department of Veterans Affairs.• I am at least age 18 but not age 40 or older and I am a member of a family that:<ul style="list-style-type: none">a Received SNAP benefits (food stamps) for the past 6 months, orb Received SNAP benefits (food stamps) for at least 3 of the past 5 months, but is no longer eligible to receive them.• During the past year, I was convicted of a felony or released from prison for a felony.• I received supplemental security income (SSI) benefits for any month ending during the past 60 days.• I am a veteran and I was unemployed for a period or periods totaling at least 4 weeks but less than 6 months during the past year.		
3 <input type="checkbox"/> Check here if you are a veteran and you were unemployed for a period or periods totaling at least 6 months during the past year.		
4 <input type="checkbox"/> Check here if you are a veteran entitled to compensation for a service-connected disability and you were discharged or released from active duty in the U.S. Armed Forces during the past year.		
5 <input type="checkbox"/> Check here if you are a veteran entitled to compensation for a service-connected disability and you were unemployed for a period or periods totaling at least 6 months during the past year.		
6 <input type="checkbox"/> Check here if you are a member of a family that: <ul style="list-style-type: none">• Received TANF payments for at least the past 18 months, or• Received TANF payments for any 18 months beginning after August 5, 1997, and the earliest 18-month period beginning after August 5, 1997, ended during the past 2 years, or• Stopped being eligible for TANF payments during the past 2 years because federal or state law limited the maximum time those payments could be made.		
Signature— All Applicants Must Sign		
Under penalties of perjury, I declare that I gave the above information to the employer on or before the day I was offered a job, and it is, to the best of my knowledge, true, correct, and complete.		
Job applicant's signature ► _____		Date _____
For Privacy Act and Paperwork Reduction Act Notice, see page 2.		Cat. No. 22651L Form 8850 (Rev. 1-2013)



*Processes Were Not Established to
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Form 8850 (Rev. 1-2013)

Page **2**

For Employer's Use Only

Employer's name _____ Telephone no. _____ EIN ▶ _____

Street address _____

City or town, state, and ZIP code _____

Person to contact, if different from above _____ Telephone no. _____

Street address _____

City or town, state, and ZIP code _____

If, based on the individual's age and home address, he or she is a member of group 4 or 6 (as described under Members of Targeted Groups in the separate instructions), enter that group number (4 or 6) ▶ _____

Date applicant:

Gave information _____ Was offered job _____ Was hired _____ Started job _____

Under penalties of perjury, I declare that the applicant provided the information on this form on or before the day a job was offered to the applicant and that the information I have furnished is, to the best of my knowledge, true, correct, and complete. Based on the information the job applicant furnished on page 1, I believe the individual is a member of a targeted group. I hereby request a certification that the individual is a member of a targeted group.

Employer's signature ▶ _____ Title _____ Date _____



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Appendix VI

Form 5884, Work Opportunity Credit

Form 5884 Department of the Treasury Internal Revenue Service	Work Opportunity Credit ▶ Attach to your tax return. ▶ Information about Form 5884 and its instructions is at www.irs.gov/form5884 .	OMB No. 1545-0219 2013 Attachment Sequence No. 77
Name(s) shown on return		Identifying number
1 Enter on the applicable line below the total qualified first- or second-year wages paid or incurred during the tax year, and multiply by the percentage shown, for services of employees who are certified as members of a targeted group.		
a Qualified first-year wages of employees who worked for you at least 120 hours but fewer than 400 hours \$ _____ x 25% (.25)		1a
b Qualified first-year wages of employees who worked for you at least 400 hours \$ _____ x 40% (.40)		1b
c Qualified second-year wages of employees certified as long-term family assistance recipients \$ _____ x 50% (.50)		1c
2 Add lines 1a, 1b, and 1c. See instructions for the adjustment you must make to salaries and wages		2
3 Work opportunity credit from partnerships, S corporations, cooperatives, estates, and trusts		3
4 Add lines 2 and 3. Cooperatives, estates, and trusts, go to line 5. Partnerships and S corporations, stop here and report this amount on Schedule K. All others, stop here and report this amount on Form 3800, line 4b		4
5 Amount allocated to patrons of the cooperative or beneficiaries of the estate or trust (see instructions)		5
6 Cooperatives, estates, and trusts, subtract line 5 from line 4. Report this amount on Form 3800, line 4b		6



*Processes Were Not Established to
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Appendix VII

Form 3800, General Business Credit

Form 3800 Department of the Treasury Internal Revenue Service (99)	General Business Credit ► Information about Form 3800 and its separate instructions is at www.irs.gov/form3800 . ► You must attach all pages of Form 3800, pages 1, 2, and 3, to your tax return.	OMB No. 1545-0895 <div style="font-size: 24pt; font-weight: bold;">2013</div> Attachment Sequence No. 22	
Name(s) shown on return		Identifying number	
Part I Current Year Credit for Credits Not Allowed Against Tentative Minimum Tax (TMT) (See instructions and complete Part(s) III before Parts I and II)			
1	General business credit from line 2 of all Parts III with box A checked	1	
2	Passive activity credits from line 2 of all Parts III with box B checked 2	2	
3	Enter the applicable passive activity credits allowed for 2013 (see instructions)	3	
4	Carryforward of general business credit to 2013. Enter the amount from line 2 of Part III with box C checked. See instructions for statement to attach	4	
5	Carryback of general business credit from 2014. Enter the amount from line 2 of Part III with box D checked (see instructions)	5	
6	Add lines 1, 3, 4, and 5	6	
Part II Allowable Credit			
7	Regular tax before credits: • Individuals. Enter the amount from Form 1040, line 44, or Form 1040NR, line 42 • Corporations. Enter the amount from Form 1120, Schedule J, Part I, line 2; or the applicable line of your return • Estates and trusts. Enter the sum of the amounts from Form 1041, Schedule G, lines 1a and 1b; or the amount from the applicable line of your return	7	
8	Alternative minimum tax: • Individuals. Enter the amount from Form 6251, line 35 • Corporations. Enter the amount from Form 4626, line 14 • Estates and trusts. Enter the amount from Schedule I (Form 1041), line 56	8	
9	Add lines 7 and 8	9	
10a	Foreign tax credit 10a	10a	
b	Certain allowable credits (see instructions) 10b	10b	
c	Add lines 10a and 10b 10c	10c	
11	Net income tax. Subtract line 10c from line 9. If zero, skip lines 12 through 15 and enter -0- on line 16	11	
12	Net regular tax. Subtract line 10c from line 7. If zero or less, enter -0- 12	12	
13	Enter 25% (.25) of the excess, if any, of line 12 over \$25,000 (see instructions) 13	13	
14	Tentative minimum tax: • Individuals. Enter the amount from Form 6251, line 33 • Corporations. Enter the amount from Form 4626, line 12 • Estates and trusts. Enter the amount from Schedule I (Form 1041), line 54	14	
15	Enter the greater of line 13 or line 14	15	
16	Subtract line 15 from line 11. If zero or less, enter -0-	16	
17	Enter the smaller of line 6 or line 16	17	
C corporations: See the line 17 instructions if there has been an ownership change, acquisition, or reorganization.			
For Paperwork Reduction Act Notice, see separate instructions.			Cat. No. 12392F Form 3800 (2013)



*Processes Were Not Established to
Verify Eligibility for Work Opportunity Tax Credits*

Form 3800 (2013)

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Part II Allowable Credit (Continued)

Note. If you are not required to report any amounts on lines 22 or 24 below, skip lines 18 through 25 and enter -0- on line 26.

18 Multiply line 14 by 75% (.75) (see instructions)	18		
19 Enter the greater of line 13 or line 18	19		
20 Subtract line 19 from line 11. If zero or less, enter -0-	20		
21 Subtract line 17 from line 20. If zero or less, enter -0-	21		
22 Combine the amounts from line 3 of all Parts III with box A, C, or D checked	22		
23 Passive activity credit from line 3 of all Parts III with box B checked	23		
24 Enter the applicable passive activity credit allowed for 2013 (see instructions)	24		
25 Add lines 22 and 24	25		
26 Empowerment zone and renewal community employment credit allowed. Enter the smaller of line 21 or line 25	26		
27 Subtract line 13 from line 11. If zero or less, enter -0-	27		
28 Add lines 17 and 26	28		
29 Subtract line 28 from line 27. If zero or less, enter -0-	29		
30 Enter the general business credit from line 5 of all Parts III with box A checked	30		
31 Reserved	31		
32 Passive activity credits from line 5 of all Parts III with box B checked	32		
33 Enter the applicable passive activity credits allowed for 2013 (see instructions)	33		
34 Carryforward of business credit to 2013. Enter the amount from line 5 of Part III with box C checked and line 6 of Part III with box G checked. See instructions for statement to attach	34		
35 Carryback of business credit from 2014. Enter the amount from line 5 of Part III with box D checked (see instructions)	35		
36 Add lines 30, 33, 34, and 35	36		
37 Enter the smaller of line 29 or line 36	37		
38 Credit allowed for the current year. Add lines 28 and 37. Report the amount from line 38 (if smaller than the sum of Part I, line 6, and Part II, lines 25 and 36, see instructions) as indicated below or on the applicable line of your return: <ul style="list-style-type: none"> • Individuals. Form 1040, line 53, or Form 1040NR, line 50 • Corporations. Form 1120, Schedule J, Part I, line 5c • Estates and trusts. Form 1041, Schedule G, line 2b 	38		

Form **3800** (2013)



*Processes Were Not Established to
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Form 3800 (2013)

Page **3**

Name(s) shown on return

Identifying number

Part III General Business Credits or Eligible Small Business Credits (see instructions)

Complete a separate Part III for each box checked below. (see instructions)

- | | |
|--|---|
| <p>A <input type="checkbox"/> General Business Credit From a Non-Passive Activity</p> <p>B <input type="checkbox"/> General Business Credit From a Passive Activity</p> <p>C <input type="checkbox"/> General Business Credit Carryforwards</p> <p>D <input type="checkbox"/> General Business Credit Carrybacks</p> | <p>E <input type="checkbox"/> Reserved</p> <p>F <input type="checkbox"/> Reserved</p> <p>G <input type="checkbox"/> Eligible Small Business Credit Carryforwards</p> <p>H <input type="checkbox"/> Reserved</p> |
|--|---|

I If you are filing more than one Part III with box A or B checked, complete and attach first an additional Part III combining amounts from all Parts III with box A or B checked. Check here if this is the consolidated Part III

	(b) If claiming the credit from a pass-through entity, enter the EIN	(c) Enter the appropriate amount
1a Investment (Form 3468, Part II only) (attach Form 3468)	1a	
b Reserved	1b	
c Increasing research activities (Form 6765)	1c	
d Low-income housing (Form 8586, Part I only)	1d	
e Disabled access (Form 8826) (see instructions for limitation)	1e	
f Renewable electricity, refined coal, and Indian coal production (Form 8835)	1f	
g Indian employment (Form 8845)	1g	
h Orphan drug (Form 8820)	1h	
i New markets (Form 8874)	1i	
j Small employer pension plan startup costs (Form 8881) (see instructions for limitation)	1j	
k Employer-provided child care facilities and services (Form 8882) (see instructions for limitation)	1k	
l Biodiesel and renewable diesel fuels (attach Form 8864)	1l	
m Low sulfur diesel fuel production (Form 8896)	1m	
n Distilled spirits (Form 8906)	1n	
o Nonconventional source fuel (Form 8907)	1o	
p Energy efficient home (Form 8908)	1p	
q Energy efficient appliance (Form 8909)	1q	
r Alternative motor vehicle (Form 8910)	1r	
s Alternative fuel vehicle refueling property (Form 8911)	1s	
t Reserved	1t	
u Mine rescue team training (Form 8923)	1u	
v Agricultural chemicals security (Form 8931) (see instructions for limitation)	1v	
w Employer differential wage payments (Form 8932)	1w	
x Carbon dioxide sequestration (Form 8933)	1x	
y Qualified plug-in electric drive motor vehicle (Form 8936)	1y	
z Qualified plug-in electric vehicle (carryforward only)	1z	
aa New hire retention (carryforward only)	1aa	
bb General credits from an electing large partnership (Schedule K-1 (Form 1065-B))	1bb	
zz Other	1zz	
2 Add lines 1a through 1zz and enter here and on the applicable line of Part I	2	
3 Enter the amount from Form 8844 here and on the applicable line of Part II	3	
4a Investment (Form 3468, Part III) (attach Form 3468)	4a	
b Work opportunity (Form 5884)	4b	
c Biofuel producer (Form 6478)	4c	
d Low-income housing (Form 8586, Part II)	4d	
e Renewable electricity, refined coal, and Indian coal production (Form 8835)	4e	
f Employer social security and Medicare taxes paid on certain employee tips (Form 8846)	4f	
g Qualified railroad track maintenance (Form 8900)	4g	
h Small employer health insurance premiums (Form 8941)	4h	
i Reserved	4i	
j Reserved	4j	
z Other	4z	
5 Add lines 4a through 4z and enter here and on the applicable line of Part II	5	
6 Add lines 2, 3, and 5 and enter here and on the applicable line of Part II	6	

Form **3800** (2013)



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Appendix VIII

Management's Response to the Draft Report

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

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

JUNE 5, 2014

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *for* Karen Schiller /s/ Mary Beth Murphy
Commissioner, Small Business/Self-Employee Division

SUBJECT: Draft Audit Report - Processes Were Not Established to Verify Eligibility for Work
Opportunity Tax Credits (Audit #201340026)

Thank you for the opportunity to review the draft report titled "Processes Were Not Established to Verify Eligibility for Work Opportunity Tax Credits." We agree with your findings and will consider the recommendations provided in the report. Where feasible, we will make suggested revisions to the forms and instructions in our continued efforts to reduce inadvertent errors and missing information that make it difficult to verify the accuracy of the Work Opportunity Tax Credit (WOTC).

Our examination program is based on our comprehensive analysis of compliance and filing data. However, it is important to note that from Fiscal year 2010 to Fiscal year 2014, the IRS has seen the number of key enforcement personnel drop by 3,000 positions. Our examination program aims to ensure that our limited resources are allocated to focus on areas with the highest levels of noncompliance. This allows us to maximize audit coverage in the most egregious tax filing issues while achieving balanced overall coverage. This approach has enabled us to achieve program balance while addressing challenges resulting from declining staffing levels.

The WOTC is a Federal tax credit available to employers for hiring individuals from certain targeted groups who have consistently faced significant barriers to employment. Internal Revenue Code § 51 sets forth the requirements that an employer must meet before they can claim WOTC. Employers who claim this non-refundable General Business Credit must submit Form 5884, *Work Opportunity Credit* with their tax return. While the IRS processes WOTC claims, the IRS

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

***** It is important to note that the IRS does request and review the certification information during an examination where the validity of the WOTC claim is in question.



*Processes Were Not Established to
Verify Eligibility for Work Opportunity Tax Credits*

2

Your report includes monetary benefits of \$1.8 million in revenue protection from 16 returns filed *****2*****
*****2*****, and \$1.3 million in revenue protection from 4 returns*****2*****
*****2*****. While we agree that these returns *****2*****
*****2*****. We are, therefore, unable to agree with your stated monetary benefits.

Attached is a detailed response outlining our corrective actions.

If you have any questions, please contact me, or a member of your staff may contact Shenita Hicks, Director,
Examination, Small Business/Self Employed at 240-613-2849.

Attachment



Processes Were Not Established to Verify Eligibility for Work Opportunity Tax Credits

Attachment

RECOMMENDATION 1:

If legislation to extend the WOTC is enacted, the Commissioners, Large Business and International Division and Small Business/Self-Employed Division, should revise Form 5884, Work Opportunity Credit, *****2*****. Requesting this type of information may also help deter erroneous claims for WOTC. *****2*****

CORRECTIVE ACTION:

If legislation is passed extending the WOTC, we will assess whether changes to Form 5884, Work Opportunity Credit, *****2***** to ensure businesses do not erroneously claim the WOTC are feasible. In deciding which potential form changes to pursue, we will consider the findings from Recommendations 3 and 4 as well as the additional costs to taxpayers and the IRS.

IMPLEMENTATION DATE:

October 15, 2017

RESPONSIBLE OFFICIAL(S):

Director, Examination Policy, Small Business/Self Employed Division

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 2:

The Deputy Commissioner for Services and Enforcement should include the characteristics of the tax returns confirmed as questionable in which filers claimed the WOTC *****2*****.

CORRECTIVE ACTION:

A compliance strategy to address questionable WOTC claims will be included in the overall compliance strategy being developed for General Business Credits in response to a prior Treasury Inspector General for Tax Administration audit recommendation. *****2*****.

IMPLEMENTATION DATE:

October 15, 2015



*Processes Were Not Established to
Verify Eligibility for Work Opportunity Tax Credits*

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RESPONSIBLE OFFICIAL(S):

Director, Examination Policy, Small Business/Self Employed Division
Director, Reporting Compliance, Small Business/Self Employed Division

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 3:

The Deputy Commissioner for Services and Enforcement should conduct a review of the 24 WOTC claims identified as erroneous to determine the proper tax liability for the tax returns.

CORRECTIVE ACTION:

The IRS will conduct an analysis of the 24 WOTC claims identified as erroneous, based on the available data, to assess compliance risks. The results of this analysis will be used to determine any necessary changes to compliance work streams, forms, or instructions.

IMPLEMENTATION DATE:

October 15, 2015

RESPONSIBLE OFFICIAL(S):

Director, Examination Planning and Delivery, Small Business/Self Employed Division
Director, Pre-Filing and Technical Guidance, Large Business and International Division

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 4:

If legislation to extend the WOTC is enacted, the Commissioners, Large Business and International Division and Small Business/Self-Employed Division, should revise instructions for Form 5884 and Form 8850 to clearly and accurately advise employers of where to submit Form 8850 and that an approved certification must be received to be eligible to claim an individual for the WOTC.

CORRECTIVE ACTION:

If legislation is passed extending the WOTC, we will review the instructions for Forms 5884 and 8850 to identify potential changes to clarify when taxpayers qualify for these credits. In deciding what changes to implement, we will consider feasibility factors from the Department of Labor as well as the potential costs and benefits to taxpayers and tax administration.



*Processes Were Not Established to
Verify Eligibility for Work Opportunity Tax Credits*

3

IMPLEMENTATION DATE:

October 15, 2016

RESPONSIBLE OFFICIAL(S):

Director, Examination Policy, Small Business/Self Employed Division
Director, Pre-Filing and Technical Guidance, Large Business and International Division

CORRECTIVE ACTION MONITORING PLAN:

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