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**TAX
ADMINISTRATION**

**IRS' Combined Annual
Wage Reporting
Reconciliation Program**





General Government Division

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December 14, 1988

The Honorable Lloyd Bentsen
Chairman, Joint Committee on Taxation

The Honorable Dan Rostenkowski
Vice-Chairman, Joint Committee on Taxation
Congress of the United States

This report responds to your request for information on the Internal Revenue Service's (IRS) Combined Annual Wage Reporting (CAWR) reconciliation program. In discussions with the Committee, we specifically agreed to provide (1) information on IRS' reconciliation program objectives and operations and (2) data on tax amounts assessed, abated (i.e., reduced), and collected as a result of the CAWR program.

Background

IRS established the CAWR reconciliation program in 1980. The primary purpose of the program is to ensure that employers submit correct wage and tax withholding information to both the Social Security Administration (SSA) and IRS so that (1) employees' social security accounts can be properly credited and (2) proper income and employment tax withholdings can be collected from employers. The program attempts to reconcile the total annual wage and tax information submitted by employers to each agency and to determine the reasons for any discrepancies. The IRS reconciliation takes place about 2 years after the tax year ends when all employer wage reporting information is available from both SSA and IRS. For example, the 1980 reconciliation was for tax year 1978 wage reporting information.

SSA is primarily concerned with discrepancies in which employers reported more earnings and tax withholdings to IRS than to SSA; this may indicate that some employees' earnings were not properly credited to their Social Security accounts. IRS, on the other hand, is primarily interested in those discrepancies in which employers reported more earnings and tax withheld to SSA than to IRS; this may indicate that taxes are due on earnings that were not reported to IRS. We previously reported on SSA's and IRS' efforts to resolve discrepancies in which the employer reported more earnings to IRS than to SSA.¹ This report discusses IRS' efforts to resolve discrepancies in which employers reported more earnings to SSA than to IRS, indicating that additional taxes may be owed.

¹Social Security: More Must Be Done to Credit Earnings to Individuals' Accounts (GAO/HRD-87-52, Sept. 17, 1987).

Results in Brief

Our review of the CAWR reconciliation program showed the following:

- Between 1981 and 1984, IRS annually identified about 500,000 discrepancies with potential tax implications. The number of discrepancies identified increased by about 50 percent to 725,000 in 1985 and to 791,000 in 1986. IRS resolved an average of 54 percent of the discrepancies between 1981 and 1986—ranging from a high of 78 percent in 1983 to a low of 22 percent in 1984.
- The CAWR discrepancies identified by IRS accounted for about 0.1 percent of the taxes withheld from 1981 to 1986. Even so, IRS assessed employers additional taxes, interest, and penalties of \$2.7 billion between 1981 and 1984—the most recent information available on assessments. Of the additional taxes, interest, and penalties assessed, IRS abated almost \$1.4 billion and collected almost \$500 million. Some additional amounts may have been collected since our analysis was completed.
- IRS spends about \$7 million a year to resolve half of the CAWR discrepancy cases with tax implications. These resolutions have resulted in an average of almost \$125 million a year in additional taxes, interest, and penalties being collected. IRS recognizes the need to apply more staffing to resolve CAWR discrepancies and, as a result of increased congressional concern, is committed to doubling the staffing applied to CAWR cases with potential tax implications. Beginning in fiscal year 1989 this commitment of additional CAWR staffing should allow IRS to resolve practically all the discrepancy cases with tax implications and help IRS identify patterns of employers who are responsible for the reporting discrepancies—such as those employers who are repeatedly found to have discrepancies.

Objectives, Scope, and Methodology

Our objectives were to provide (1) information on IRS' CAWR reconciliation program objectives and operations and (2) data on the tax amounts assessed, abated, and collected as a result of the CAWR program.

To provide information on the CAWR reconciliation program objectives and operations, we (1) reviewed IRS processing policies and procedures; (2) discussed program operations with responsible IRS National Office and Philadelphia Service Center officials; (3) analyzed pertinent IRS management information, internal audit, and research reports; (4) discussed automated processing procedures with IRS computer services officials; and (5) discussed relevant processing documentation with computer services staff to identify the steps in the reconciliation process.

To determine the additional taxes, interest, and penalties assessed, abated, and collected, we obtained and analyzed copies of IRS' monthly report of CAWR Reconciliation Transactions for tax years 1979 through 1985, that is, IRS processing years 1981 to 1987. Since these reports do not provide information on the amount of net tax assessments subsequently collected, we also obtained and analyzed a magnetic tape extract from the IRS Business Master File (BMF) for employers' accounts of the Form 941 series tax modules that had potential CAWR discrepancies. The Form 941 series consists of several tax forms on which businesses with employees report and pay employment taxes, such as federal income taxes withheld from employees' wages. This file reflects CAWR-related data processing adjustments and abatements as well as audit adjustment and abatement transactions made in fiscal years 1978 through 1984. These tax years represent IRS' CAWR processing operations from 1980 through 1986.

We did our work between July 1987 and July 1988 and in accordance with generally accepted government auditing standards. We did not assess the reliability of the IRS system used to record employers' quarterly federal tax returns and the taxes and wages reported on those returns. We relied on IRS' controls to detect errors, omissions, and inconsistencies in the data submitted by employers and SSA. These controls are designed to ensure that accurate and complete data are used in the reconciliation process.

IRS' CAWR Reconciliation Program Operations

CAWR was mandated by Congress in 1976 and became effective with all wages paid after December 31, 1977. Under CAWR, employers report employee earnings and related tax withholdings to SSA on an annual basis and report aggregate income and employment tax withheld on employee earnings to IRS on a quarterly basis. Under an agreement between IRS and SSA, IRS assumed responsibility for matching employers' annual earnings information processed by SSA with the comparable quarterly earnings and income tax withholding reports submitted to IRS. This matching, which was initiated in 1980, identifies apparent discrepancies in earnings reported to the two agencies.

IRS resolves those discrepancies which involve employment taxes owed but not paid, while SSA resolves those discrepancies which involve

employees' accounts that may not reflect the proper amount of earnings.² Figure 1 shows the CAWR reporting program and the reconciliation process IRS uses to identify and resolve discrepancies.

As illustrated, IRS receives annual income and employment tax withholding information from SSA. IRS matches this information by computer to the information from the four quarterly reports it receives from employers. Where an employer has reported more tax withholding, and consequently more earnings, to SSA than to IRS, the case is referred to the appropriate IRS service center for resolution. Staff at the service center may be able to reconcile the discrepancy through research of SSA and IRS records and make appropriate adjustments. If the discrepancy cannot be resolved through research, IRS generally sends a notice to the employer requesting an explanation. If no satisfactory response is received, IRS assesses additional taxes due, including penalties and interest, if appropriate.

Many Discrepancies Identified by IRS Are Not Resolved

From the CAWR reconciliation during the period of 1981 to 1984, IRS identified about 500,000 discrepancies each year in which employers reported more employee earnings to SSA than to IRS. Table 1 shows that the number of discrepancy cases identified increased by about 50 percent since 1984 from 531,000 to 791,000. IRS officials do not know why this increase has occurred.

IRS has resolved an average of 54 percent of these discrepancy cases with potential tax owed but not paid from 1981 to 1986.

²Under a new interagency agreement, IRS will also assist SSA in its attempts to resolve discrepancies which involve employees' accounts when employers do not respond to SSA reconciliation efforts.

Figure 1: The CAWR Reconciliation Process

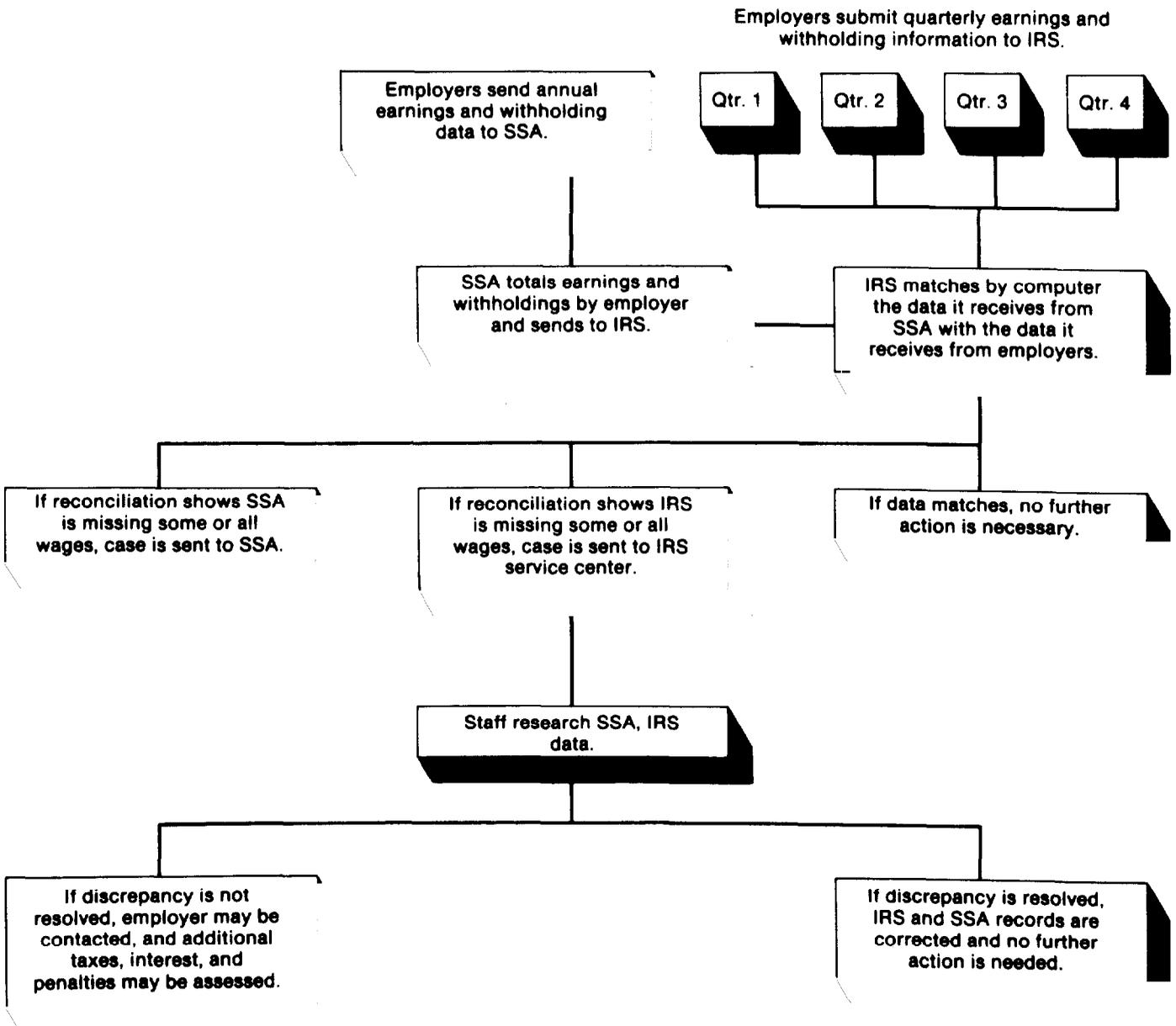


Table 1: Discrepancy Cases Identified and Resolved by IRS for 1981 Through 1986

Cases in thousands			
Year	Discrepancy cases identified	Discrepancy cases resolved	Percent of cases resolved
1981 ^a	516	286	55.4
1982	486	369	75.9
1983	451	352	78.0
1984	531	114	21.5
1985	725	395	54.5
1986	791	357	45.1
Total	3,500	1,873	53.5^b

^aSince 1981 case data were not readily available, we estimated the number of discrepancies identified and resolved on the basis of 1980 discrepancy case data.

^bThis figure is an average percent for the years shown.

Source: IRS CAWR Reconciliation Analysis Reports and Program Start-Up Letters.

IRS officials told us they do not pursue all discrepancies identified with potential tax implications primarily because of budgetary constraints. The CAWR program is not separately funded through the IRS budget; rather, CAWR gets its operating funds from other IRS service center processing programs. IRS officials decide how many discrepancies they can pursue each year on the basis of the staffing available from other service center returns processing programs.

IRS officials also said they pursue discrepancy cases on the basis of the projected tax yield or the amount of tax due but not paid, and those with the greatest projected tax yield are assigned a higher priority and are to be resolved first. Consequently, cases not resolved have less potential tax yield than those IRS resolved.

CAWR Discrepancies That IRS Resolved Resulted in Millions of Tax Dollars Collected

The CAWR discrepancies identified by IRS from 1981 to 1986 accounted for about 0.1 percent of the taxes withheld. On the basis of the 54 percent of CAWR discrepancies IRS identified and resolved between 1981 and 1984, the period for which the most complete information about assessments was available, IRS assessed \$2.7 billion in taxes, interest, and penalties, i.e., IRS billed employers for taxes, interest, and penalties owed and not paid. Table 2 shows more detailed information on the assessments, abatements, and collections for this period.

Table 2: CAWR Tax Assessments, Abatements, and Collections for 1981 to 1984^{a, b}

Dollars in millions

Year	CAWR tax assessments	CAWR tax abatements	CAWR net assessments	Amount of net assessments collected
1981	\$657	\$344	\$313	\$172
1982	566	244	322	143
1983	1,122	612	509	119
1984	401	185	216	53
Total	\$2,746	\$1,385	\$1,360	\$487

^aInformation on net assessments and collections was not available for fiscal years 1985 and 1986 as of September 1987. Assessments, abatements, and collections include taxes, interest, and penalties owed.

^bCAWR tax assessments minus CAWR tax abatements may not equal CAWR net assessments due to rounding.

Source: IRS Business Master File for employers' accounts.

IRS officials were unable to explain the increase in assessments from \$566 million in 1982 to \$1,122 million in 1983. They did, however, attribute the decrease in assessments to \$401 million in 1984 to the program staffing being constrained to the point that only 22 percent of the discrepancies identified with tax implications were resolved.

IRS officials said that many of the assessments for this period resulted because service center staff were unable to contact the employers. When this occurs, service center staff assess the tax on the basis of available information and bill the employer. According to IRS officials, most affected employers do not respond to IRS until after it has assessed the tax and sent a bill. At that time the employer provides IRS information about the employees' earnings and tax withholdings which enables IRS to abate some or all of the amount assessed. Almost \$1.4 billion, or about 52 percent of the \$2.7 billion in CAWR assessments, was abated. After abatements, there remained over \$1.3 billion of net assessments, of which IRS collected almost \$500 million. The remaining \$800 million had not been collected as of the end of September 1987; however, additional collections may have been made.

IRS Plans to Resolve More CAWR Discrepancies

IRS program officials have recognized the need to increase staffing to resolve CAWR discrepancies being identified. IRS officials said that budgetary constraints have been the only major factor adversely affecting the CAWR reconciliation program, and in fiscal year 1989 they plan to increase the staffing applied to the program.

From our analysis of CAWR discrepancy cases identified during 1981 to 1984, we believe that it would be cost-beneficial for IRS to add staff to the CAWR reconciliation program. IRS currently spends about \$7 million a year to resolve half of the CAWR discrepancy cases with tax implications, and these cases have resulted in an average of almost \$125 million a year from 1981 to 1984 in additional taxes, interest, and penalties collected. Since IRS resolves the CAWR discrepancies on the basis of their potential for tax yield, doubling the resources applied to resolving discrepancies will not likely double the resultant tax yield.

The additional staffing should also help IRS to analyze CAWR program results over several years to identify patterns of employers who are responsible for the reporting discrepancies. For example, IRS does not currently identify employers who repeatedly have discrepancies in their reporting of wages and withholding information even though IRS' Internal Audit Division reported such repeat discrepancies as being a problem in 1984. In our analysis of 1981 to 1984 discrepancy cases, we found that about 15 percent of the employers filing different employee earnings and tax withholding data to SSA and IRS did so in at least 2 of the 4 years we reviewed. These employers accounted for 58 percent of the CAWR tax assessments during this period. While IRS does not have plans to change the criteria for selecting discrepancy cases for resolution, IRS program officials plan to add an indicator to CAWR discrepancy cases for flagging employers previously identified so that IRS employees attempting to resolve those discrepancies know that the employer is a repeated offender.

In response to increasing congressional concern about the CAWR reconciliation program, IRS recently advised the House Committee on Ways and Means that, beginning in fiscal year 1989, it will double the staffing of the CAWR program so as to resolve all discrepancy cases with potential tax implications. The IRS Deputy Commissioner (Operations) advised the Chairmen of both the House Oversight and Social Security Subcommittees that IRS intends to apply an additional 225 positions and \$7.4 million to resolve another 405,000 CAWR cases with potential tax yield. The Deputy Commissioner assured the Chairmen that the additional staffing would be made available from other IRS programs even if requested budgetary increases were not approved.

On the basis of our analysis of CAWR cases in 1981 to 1986, additional staffing should allow IRS to resolve practically all of the discrepancy cases with a potential tax yield. From 1981 to 1986 IRS resolved about 54 percent of these cases. IRS' commitment to doubling the staff assigned

to resolve these cases should enable it to resolve almost all of the CAWR cases with potential tax implications. We also believe that such a commitment to CAWR could ultimately reduce the staffing needed to resolve these cases by reducing the number of employers who repeatedly submit discrepant reports as well as by identifying other patterns in discrepant filing.

IRS program officials reviewed a draft of this report and suggested some clarifying changes that we considered in preparing the final version. We are sending copies of this report to IRS and other interested parties and copies will be made available to others upon request. The major contributors to this report are listed in the appendix.

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