GAO Highlights

Highlights of GAO-17-371, a report to the Committee on Finance, U.S. Senate.

Why GAO Did This Study

Employers report employment taxes for Social Security, Medicare, unemployment insurance, and income taxes to IRS. In fiscal year 2016, these totaled almost $2.28 trillion. Each year, IRS examines a small percentage of employment tax returns to check employer compliance (known as operational examinations).

GAO was asked to review how practices from NRP examinations could improve operational examinations. This report (1) evaluates how IRS plans to analyze the NRP results, (2) describes GAO’s review of available NRP data, and (3) describes NRP practices IRS applied to operational examinations and assesses whether additional improvements could be made to operational examinations. GAO reviewed documentation, interviewed officials, and reviewed the NRP results. GAO also surveyed all IRS examiners who completed both NRP and operational examinations on ideas for improving operational examinations.

What GAO Found

The Internal Revenue Service (IRS) uses its National Research Program (NRP) to study tax compliance issues. These NRP studies generally rely on detailed examinations of a random sample of tax returns and use different practices (including tools and procedures) than IRS’s routine operational examinations. IRS recently completed the examinations for an NRP study on employment tax returns filed from tax years 2008 to 2010. This study was the first IRS had done on employment taxes in over 30 years. Based on IRS guidance, NRP results are intended to factor into IRS decisions about compliance areas and to be used to estimate the tax gap—the difference between taxes owed and those voluntarily paid on time. Although the examinations for the study are done, IRS has not developed formal plans to analyze the results to (1) identify areas of noncompliance, (2) address such noncompliance, or (3) update its employment tax gap estimate. IRS officials said they have not developed such formal plans due to competing research priorities and limited resources, and because the NRP results have not yet been finalized. Without completed analysis of the NRP employment tax results, IRS risks using outdated data to make decisions about compliance and areas of the tax gap to pursue.

GAO reviewed the available NRP study results on noncompliance and found that taxable wages for worker classification and fringe benefits were among the most frequently misreported and led to the highest wage adjustment amounts on average. Worker classification issues arise when employers misclassify employees as independent contractors or other nonemployees. If employees are misclassified, the employer’s obligation to withhold and pay employment taxes is not established and goes unpaid. Fringe benefits issues involve property, a service, or cash received that should be treated as taxable wages but are not.

IRS carried over certain NRP practices to operational employment tax examinations, including tools to help plan, document, and report the results of examinations and operational examinations on ideas for improving operational examinations.

What GAO Recommends

GAO recommends that IRS develop plans to analyze the NRP results in 2017 to address areas of noncompliance identified, and update its employment tax gap estimates; determine whether and when to provide certain data upfront before an examination starts; and periodically remind IRS examiners how they can access certain tools. IRS agreed with GAO’s recommendations.

View GAO-17-371. For more information, contact Jessica Lucas-Judy at (202) 512-9110 or Lucas.JudyJ@gao.gov.

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EMPLOYMENT TAXES

Timely Use of National Research Program Results Would Help IRS Improve Compliance and Tax Gap Estimates

• More than 90 percent of examiners said that they would like to have a certain tool—electronic data on the information returns of employers—when operational examinations start instead of on request, which they said would help identify issues to examine sooner and put fewer burdens on taxpayers. Although IRS officials said that providing the tool when all examinations start would not be a good use of IRS resources, they did not have data to evaluate whether and when providing this tool would improve examinations.

• Half of IRS examiners who were asked about two specific NRP tools in GAO’s survey were not aware of how to request them for use during operational examinations. According to IRS officials, these tools may only be used infrequently during employment tax examinations. However, ensuring IRS examiners are aware of how to access them would be in line with IRS’s strategic goal of empowering employees with tools and training. Without examiners being aware of these tools and able to utilize them when needed, they may be limited in their ability to effectively examine employment tax returns.

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