



July 2018

FEDERAL TAX WITHHOLDING

Treasury and IRS Should Document the Roles and Responsibilities for Updating Annual Withholding Tables

GAO Highlights

Highlights of [GAO-18-548](#), a report to congressional requesters

Why GAO Did This Study

Withholding helps the federal government collect taxes year-round and prevents some individual taxpayers from owing large amounts when they file their tax returns. Public Law 115-97—referred to by the President and many administrative documents as the Tax Cuts and Jobs Act—made a number of changes that affect individual taxpayers beginning in 2018 and gave Treasury authority to establish new rules governing federal tax withholding. IRS publishes withholding tables for employers to use to determine how much tax to withhold from an employee's pay.

GAO was asked to review the revised federal tax withholding tables for 2018. This report examines (1) Treasury's and IRS's processes for developing federal tax withholding tables; and (2) the outreach Treasury and IRS conducted on withholding and how they assessed the effectiveness of that outreach.

GAO reviewed Treasury and IRS documentation and analysis, interviewed Treasury and IRS officials, and compared federal standards of internal control to Treasury and IRS processes. GAO interviewed a nongeneralizable sample of selected organizations representing audiences IRS identified for outreach on withholding.

What GAO Recommends

GAO is recommending that Treasury and IRS document roles and responsibilities for updating the tax withholding tables. Treasury and IRS agreed with the recommendation.

View [GAO-18-548](#). For more information, contact James R. McTigue, Jr. at (202) 512-9110 or mctiguej@gao.gov.

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Treasury and IRS Should Document the Roles and Responsibilities for Updating Annual Withholding Tables

What GAO Found

Generally, employers are required to withhold income taxes on employee pay, but employees can exclude part of their pay from withholding. Currently, the amount of an employee's pay to be excluded from withholding is determined by multiplying the number of withholding allowances an employee claims by a set dollar value. Internal Revenue Service (IRS) guidance directs employees to claim withholding allowances that match their personal circumstances, such as any tax deductions they plan to take and tax credits they plan to claim when filing their tax returns. Employers then subtract excluded amounts from employees' pay; the rest of the employees' pay is subject to withholding.

Prior to 2018, the withholding allowance value was prescribed by law. Public Law 115-97, enacted in December 2017, gave the Department of the Treasury (Treasury) authority to set the value of a withholding allowance for 2018. According to Treasury officials, Treasury's goals for choosing a withholding allowance value for 2018 included increasing accurate withholding (where taxpayers' withholding matches their tax liability) and not increasing instances of underwithholding or overwithholding (where taxpayers' withholding is less than or greater than their tax liability, respectively). Treasury assessed how alternative values for the 2018 withholding allowance might affect taxpayers' withholding and chose a value of \$4,150, what the allowance value would have been under prior law. According to Treasury, it chose the \$4,150 value because there was no other value it tested that better achieved Treasury's goals.

Treasury and IRS officials described to GAO how the withholding tables were updated, both before 2018 and for 2018. According to the officials, before 2018, IRS adjusted items such as the withholding allowance value and income tax brackets for inflation, as prescribed by law and attained Treasury approval before they were published. Treasury officials stated that for 2018, after choosing the withholding allowance value, the process for updating the withholding tables followed the process for a typical year.

Although Treasury and IRS described to GAO the process for updating the withholding tables, limited documentation of that process exists. For example, there is limited documentation of Treasury's and IRS's roles and responsibilities. According to IRS officials, IRS did not document the process to update the withholding tables because it was routine and straightforward. However, federal internal control standards require agencies to document responsibilities through policies. Documenting the process for updating withholding tables will help Treasury and IRS ensure that it is implemented consistently in the future, for example, if staff with experience in updating the tables were to leave Treasury and IRS.

Treasury and IRS conducted outreach to encourage taxpayers to reassess their withholding and IRS monitored key metrics to assess the effectiveness of that outreach. IRS reported it (1) updated and created pages on its website; (2) used IRS email listservs and social media; and (3) shared withholding materials with partners including tax-related groups, large employers, employer associations, and organizations representing small businesses. To assess the effectiveness of its outreach, IRS monitored key metrics and asked for feedback from partners.

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Abbreviations

Form W-2	Form W-2, Wage and Tax Statement
Form W-4	Form W-4, Employee's Withholding Allowance Certificate
IRS	Internal Revenue Service
RAAS	Office of Research, Applied Analytics, and Statistics
Treasury	Department of the Treasury
TRIO	Tax Reform Implementation Office

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July 31, 2018

The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate

The Honorable Richard E. Neal
Ranking Member
Committee on Ways and Means
House of Representatives

Federal income tax is a “pay-as-you-go” tax, meaning that employers are required to withhold taxes from employee paychecks during the year, rather than employees paying taxes only at the end of the year. Withholding helps the federal government collect taxes year-round, and prevents some individual taxpayers from owing large amounts when they file their tax returns. Each year, employers withhold over \$1 trillion in income tax from employees’ pay, including wages, bonuses, and commissions.

While employers are required to withhold taxes on employees’ pay, taxpayers can adjust their withholding based on their individual tax circumstances, such as for any deductions they take and credits they claim.¹ The Internal Revenue Service (IRS) publishes withholding tables each year for employers to determine how much tax to withhold from employees’ pay. Public Law 115-97, referred to by the President and many administrative documents as the Tax Cuts and Jobs Act, made a number of changes that affect the tax liability of individual taxpayers in 2018, which in turn affected the amount employers were to withhold from employees’ pay in 2018.² The law also gave the Department of the Treasury (Treasury) authority to establish new rules governing federal tax withholding.

¹26 U.S.C. § 3402.

²Pub. L. No. 115-97, 131 Stat. 2054 “To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018” (2017). See, e.g., Proclamation No. 9702, 83 Fed. Reg. 9409 (Feb. 28, 2018); Statutory Pay-As-You-Go Act Annual Report, 83 Fed. Reg. 3774 (Jan. 26, 2018).

You asked us to review the revised federal tax withholding tables for 2018. For this report, we examined (1) Treasury's and IRS's processes, including controls and analysis, for developing federal tax withholding tables; and (2) the outreach Treasury and IRS conducted to help taxpayers determine their tax withholding and how they assessed the effectiveness of that outreach.

To identify the controls in place over the withholding table development process and assess the extent to which they were followed in 2018, we reviewed available documentation of Treasury and IRS procedures for annually updating and reviewing the withholding tables, reviewed documentation of approvals of the tables, and interviewed Treasury and IRS officials. We also reviewed federal standards on internal control and compared those standards to the Treasury and IRS processes.³

To assess the extent to which Treasury and IRS assessed how the tables would affect taxpayer withholding, we reviewed Treasury's analysis and related documentation and interviewed Treasury officials and compared Treasury's analysis to its stated goals for the amount of the withholding allowance for 2018. We reviewed documentation and interviewed Treasury officials concerning the data they used for their analysis—which we discuss in this report—and determined that the data were sufficiently reliable for the purposes of our reporting objectives.

To describe Treasury and IRS outreach efforts to taxpayers and the extent to which the agencies assessed the effectiveness of that outreach, we reviewed IRS outreach plans and documentation and interviewed Treasury and IRS officials. We also reviewed IRS documentation on its efforts to track key web and social media metrics related to its outreach and the data reliability of those metrics. We determined that those data are sufficiently reliable for the purposes of our reporting objectives. We also reviewed federal standards on internal control and compared those standards to IRS evaluation of its outreach efforts.

For both objectives, we interviewed representatives of three organizations that IRS worked with for their views on Treasury's and IRS's decisions and outreach efforts for 2018. We selected these three organizations—the Council for Electronic Revenue Communication Advancement, the

³GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

American Payroll Association, and the American Institute of Certified Public Accountants—based on their representation of certain key populations IRS identified, such as payroll providers and paid tax return preparers. These organizations’ views are not generalizable to all the organizations that IRS contacted as part of its outreach.

We conducted this performance audit from February 2018 to July 2018 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

What is withholding and how does it work?

Generally, employers are required to withhold income taxes on employee pay each time they pay their employees—that is, for each payroll period.⁴ Part of employees’ pay—known as the withholding allowance—can be excluded from income subject to tax withholding to account for employees’ personal circumstances, such as for tax deductions they plan to take or tax credits they plan to claim when filing their tax returns. If withholding were calculated using the full amount of an employee’s pay without accounting for deductions and credits, most employees would have more tax withheld from their paychecks than they actually owe.

Taxpayers for whom withholding is accurate—in which withholding matches their tax liability—will not receive a tax refund or have a balance due when they file their tax returns.⁵ Taxpayers whose withholding is less than their tax liability—or do not pay sufficient estimated taxes during the year—will have a balance due when they file their tax returns and

⁴26 U.S.C. § 3402; 26 C.F.R. §§ 31.3402(a)-1, 31.3401(b)-1.

⁵The tax refund or balance due is the result of taxation of income including deductions, offsets, and credits.

potentially could be subject to a penalty.⁶ Taxpayers for whom withholding is greater than their tax liability will receive a tax refund when they file their tax returns.

Explanation of Accurate Withholding, Overwithholding, and Underwithholding

Accurate withholding: An employee's total withholding allowance matches the total of the employee's tax deductions and credits. As a result, the employee's taxable income matches the amount of the employee's pay subject to withholding. The employee does not have a balance due or receive a refund when filing a tax return.

Overwithholding: An employee's total withholding allowance is less than the total of the employee's tax deductions and credits. The employee will receive a refund when filing a tax return.

Underwithholding: An employee's total withholding allowance is greater than the total of the employee's tax deductions and credits. The employee will have a balance due when filing a tax return.

Source: GAO analysis of Internal Revenue Service documents. | GAO-18-548

Note: Explanation is for an employee who has no other income and who does not pay estimated tax.

What are employee responsibilities for withholding?

Employees are required to indicate the number of withholding allowances they claim directly to their employers, using the IRS's Employee's Withholding Allowance Certificate (Form W-4).⁷ Each withholding allowance on Form W-4 represents a set dollar amount that employers will use to determine an employee's total withholding allowance amount—the amount that will be excluded from income subject to tax withholding—as described later. Form W-4 and its instructions guide employees to claim withholding allowances that match their personal circumstances, such as their filing status (e.g. single versus married filing jointly), whether

⁶Taxpayers who receive income from sources generally not subject to withholding, such as interest, dividends, alimony, self-employment income, capital gains, and prizes and awards, may have to increase their withholding on wages or make estimated tax payments during the year. Taxpayers who do not pay enough tax throughout the year, either through withholding or by making estimated tax payments, may have to pay a penalty for underpayment of tax. Generally, most taxpayers will avoid this penalty if they either owe less than \$1,000 in tax after subtracting their withholding and estimated tax payments, or the amount paid is at least 90 percent of their tax liability for the current year or 100 percent of their tax liability shown on their tax return for the prior year, whichever is smaller. 26 U.S.C. § 6651.

⁷26 C.F.R. § 31.3402(f)(5)-1. Employees can also request additional withholding.

they have a working spouse, the tax deductions they plan to take, and any tax credits they plan to claim. Employees are to fill out Form W-4 when they start a new job and can also update their claims of withholding allowances as their personal circumstances change, such as a marriage, the birth of a child, or beginning a second job. Employees must update Form W-4 if changes in their personal circumstances allow them to claim fewer withholding allowances. IRS also publishes an online withholding calculator for employees to use to determine the number of allowances to claim on Form W-4.

What are employer responsibilities for withholding?

The amount of income tax that an employer withholds each time the employee is paid depends on (1) the amount the employee is paid in each payroll period, (2) the filing status and number of withholding allowances the employees claim on their Form W-4 and any additional amount they ask to be withheld, and (3) the value of the withholding allowance. IRS publishes withholding tables on IRS.gov for employers to determine how much tax to withhold from employee paychecks. For an example of the withholding tables, see figure 1.⁸ The full withholding process is illustrated in figure 2.

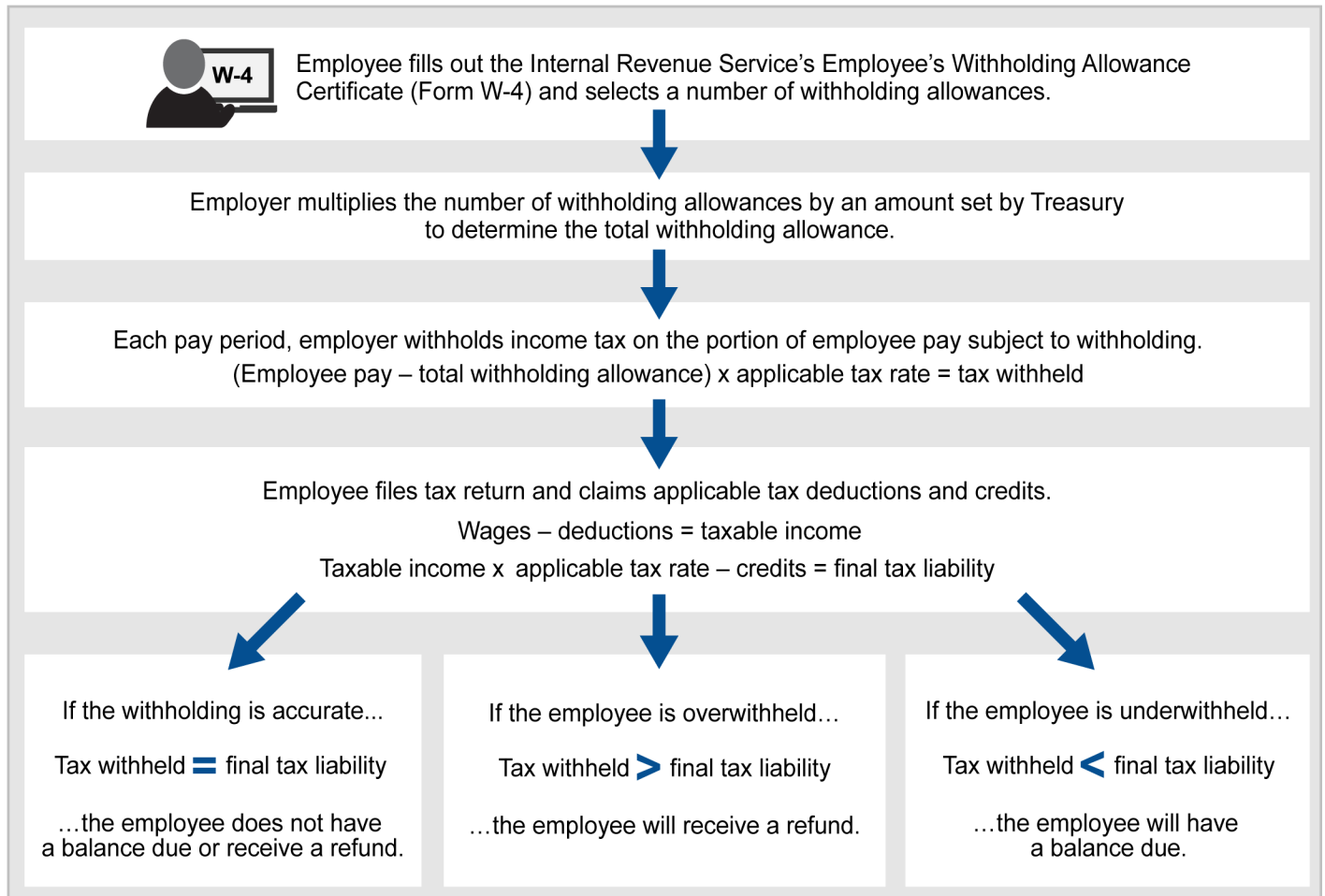
Figure 1: Example of Payroll Period Withholding Tables for Wages Paid in 2018

TABLE 2—BIWEEKLY Payroll Period							
(a) SINGLE person (including head of household)—				(b) MARRIED person—			
If the amount of wages (after subtracting withholding allowances) is:		The amount of income tax to withhold is:		If the amount of wages (after subtracting withholding allowances) is:		The amount of income tax to withhold is:	
Not over \$142		\$0		Not over \$444		\$0	
Over—	But not over—		of excess over—	Over—	But not over—		of excess over—
\$142	—\$509 . . .	\$0.00 plus 10%	—\$142	\$444	—\$1,177 . . .	\$0.00 plus 10%	—\$444
\$509	—\$1,631 . . .	\$36.70 plus 12%	—\$509	\$1,177	—\$3,421 . . .	\$73.30 plus 12%	—\$1,177
\$1,631	—\$3,315 . . .	\$171.34 plus 22%	—\$1,631	\$3,421	—\$6,790 . . .	\$342.58 plus 22%	—\$3,421
\$3,315	—\$6,200 . . .	\$541.82 plus 24%	—\$3,315	\$6,790	—\$12,560 . . .	\$1,083.76 plus 24%	—\$6,790
\$6,200	—\$7,835 . . .	\$1,234.22 plus 32%	—\$6,200	\$12,560	—\$15,829 . . .	\$2,468.56 plus 32%	—\$12,560
\$7,835	—\$19,373 . . .	\$1,757.42 plus 35%	—\$7,835	\$15,829	—\$23,521 . . .	\$3,514.64 plus 35%	—\$15,829
\$19,373		\$5,795.72 plus 37%	—\$19,373	\$23,521		\$6,206.84 plus 37%	—\$23,521

Source: Internal Revenue Service Notice 1036, revised January 2018. | GAO-18-548

⁸IRS publishes withholding tables for daily, weekly, biweekly, semimonthly, monthly, quarterly, semiannual, and annual pay periods.

Figure 2: Illustration of the Withholding Process



Source: GAO analysis of Internal Revenue Service documents. | GAO-18-548

What is the relationship between withholding and compliance?

Accurate and overwithholding fosters tax compliance, and underwithholding tends to be detrimental to compliance. IRS urges taxpayers to try to have withholding match their anticipated tax liability. When withholding cannot match tax liability, the current withholding system is biased slightly towards overwithholding. For example, according to IRS officials, the number of allowances is rounded down to the next lower integer and the instructions on how many allowances to claim for tax credits are biased toward overwithholding. Overwithholding fosters tax compliance: if an employee's withholding is less than tax liability, the employee may owe additional taxes, which could become

delinquent if not paid on time.⁹ However, Treasury officials noted that while overwithholding fosters tax compliance, it also has costs for taxpayers, particularly for low-income workers who may be liquidity-constrained and could benefit more from larger regular paychecks than from larger annual tax refunds.

What are taxpayer preferences for withholding?

Generally, about three-quarters of wage-earning taxpayers are overwithheld. For example, from January 29, 2018 to May 11, 2018, IRS processed more than 135 million individual tax returns for tax year 2017. IRS issued refunds for over 102 million (about 75 percent) of these returns. The refunds totaled to \$284.9 billion; the average refund was \$2,778.

How did Public Law 115-97 change withholding?

Public Law 115-97—enacted in December 2017 and which we refer to in this report as the Tax Cuts and Jobs Act—made a number of changes that affect individual taxpayers beginning in 2018. For example, the Tax Cuts and Jobs Act made changes to deductions and credits, such as the state and local tax deduction and the Child Tax Credit, which may affect tax liability and withholding for a large number of taxpayers.¹⁰

Prior to the Tax Cuts and Jobs Act, the portion of any employees' pay that was excluded from withholding—that is, the employee's total withholding allowance—was determined by multiplying the number of withholding allowances an employee claimed on Form W-4 by the amount of the personal exemption for that year. The personal exemption amount increased over time because it was statutorily indexed to inflation. The Tax Cuts and Jobs Act set the personal exemption to zero for tax years

⁹Generally, tax compliance for income subject to withholding is high. Based on data from 2008-2010, IRS estimated that 99 percent of income was accurately reported for income types for which taxes were withheld and income amounts were reported to IRS, such as wages and salaries. See GAO, *Tax Gap: IRS Needs Specific Goals and Strategies for Improving Compliance*, [GAO-18-39](#) (Washington, D.C.: Oct. 31, 2017).

¹⁰The Tax Cuts and Jobs Act limited the amount of state and local taxes an individual taxpayer can deduct in a calendar year to \$10,000. Pub. L. No. 115-97, § 11042, 131 Stat. 2054, 2085–2086 (2017), *codified at* 26 U.S.C. § 164(b)(6). The Tax Cuts and Jobs Act increased the value of the Child Tax Credit from as much as \$1,000 per child to \$2,000 per child and raised the income limit for eligible taxpayers. Pub. L. No. 115-97, § 11022, 131 Stat. 2054, 2073–2074 (2017), *codified at* 26 U.S.C. § 24(h). These changes apply to tax years beginning after December 31, 2017 and before January 1, 2026.

beginning after December 31, 2017, and before January 1, 2026.¹¹ The Tax Cuts and Jobs Act gives Treasury the authority to determine a new withholding allowance structure based on certain statutory factors.¹²

Treasury and IRS Process for Updating Annual Withholding Tables is Not Fully Documented

Officials Described the Annual Process for Updating Withholding Tables as Routine, but Documentation is Limited

According to Treasury and IRS officials, updating the withholding tables in a typical year had been a routine matter of updating for inflation, as prescribed by law. Before 2018, IRS updated withholding tables based on the income tax brackets, standard deduction, and withholding allowance value—previously tied to the personal exemption amount—for a given year.¹³ Provisions in the Tax Cuts and Jobs Act required additional analyses and decisions to develop the withholding tables for 2018, as described later in this report. However, Treasury officials stated that after key decisions for 2018 were made, the process for updating and publishing the withholding tables followed the process for a typical year. While Treasury officials told us they may change how the withholding allowance works in the future, they stated that the internal process for the development of the tables will remain the same.

According to Treasury and IRS officials, several offices within Treasury and IRS participate in the annual process to update and publish the tables in a typical year:

¹¹Pub. L. No. 115-97, § 11041(a), 131 Stat. 2054, 2082 (2017), *codified at* 26 U.S.C. § 151(d)(5).

¹²Pub. L. No. 115-97, § 11041(c), 131 Stat. 2054, 2070 (2017), *codified at* 26 U.S.C. § 3402(f). These statutory factors are similar to the withholding exemptions that existed prior to the enactment of Public Law 115-97 and include, among other things, whether the employee is married and the number of child tax credits the employee may reasonably be expected to be allowed.

¹³These amounts were adjusted each year based on the Consumer Price Index, a measure of inflation, as prescribed by law. 26 U.S.C. §§ 1(f)(3), 151(d)(4).

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- IRS's Office of Research, Applied Analytics, and Statistics (RAAS) uses spreadsheets to calculate the values for the new withholding tables. RAAS enters inflation adjustment factors in one sheet, and the updated withholding tables for different filing statuses and different pay periods are automatically calculated in linked sheets.
 - Treasury's Office of Tax Analysis checks the inputs and outputs of the spreadsheets, and provides any other review IRS requests.
 - IRS's Office of Chief Counsel reviews and approves publications containing the updated withholding tables, but does not generally review the calculations.
 - After the withholding spreadsheets are converted for publication, IRS's Tax Forms and Publications proofreads the withholding tables by comparing them to the RAAS spreadsheets. They then incorporate them into multiple IRS products and coordinate the standard IRS publication review process for all publications containing the withholding tables. The standard IRS publication review process includes circulation to multiple offices for approval, including IRS's Office of Chief Counsel and Treasury's Office of Tax Analysis. Tax Forms and Publications then releases the products for posting on IRS.gov.

Although Treasury and IRS described to us the process for annually updating the withholding tables, there is limited documentation of that process. Federal internal control standards require agencies to document responsibilities through policies and periodically review their control activities.¹⁴ According to IRS officials, IRS did not document the process to update the withholding tables because it was routine and straightforward. In response to our inquiries about the process, IRS added notes and directions to the withholding update spreadsheet for 2018, but these notes do not document the roles of the Treasury and IRS offices responsible for updating, approving, and publishing the withholding tables. Likewise, while a 2016 Treasury memo outlined proposed revisions to responsibilities for the annual Treasury and IRS process for updating the withholding tables, the final responsibilities for the process were never documented.¹⁵ Officially documenting roles and

¹⁴[GAO-14-704G](#).

¹⁵The changes in the 2016 memo gave IRS responsibility for performing all of the update calculations; previously Treasury had a role in performing the update calculations. The motivation for the change was to reduce duplicated effort and to reduce the number of times the calculations were transmitted between Treasury and IRS.

responsibilities for the process, such as in the Internal Revenue Manual, will help Treasury and IRS ensure that the process is implemented consistently in the future, for example if staff with experience in updating the tables were to leave Treasury and IRS.¹⁶

Updating the Withholding Tables for 2018 Required Determining a Withholding Allowance Value

Treasury Had Discretion to Choose a Withholding Allowance Value for 2018

Under the Tax Cuts and Jobs Act, Treasury had new discretion for 2018 to adopt rules under which the total withholding allowance is determined based on certain factors, rather than to tie the withholding allowance to the personal exemption. Treasury officials told us that, because of time constraints, they considered the value of the withholding allowance to be the only parameter Treasury could change to affect withholding for 2018. Treasury decided that the withholding tables for 2018 should be compatible with the existing Forms W-4 employees had already filed because there would not have been enough time for employers and payroll providers to accommodate larger changes in 2018 that may have required employees to file new Forms W-4. Representatives of an association representing payroll providers corroborated that payroll providers would need 6 to 8 months to incorporate major structural changes into their software, input new information, and ensure that employees updated their Forms W-4.

Treasury had several objectives in deciding the withholding allowance value for 2018, according to Treasury officials and a Treasury memo regarding the decision. These included:

- **Provide for accurate withholding:** Treasury sought to provide for accurate withholding under the new tax structure. Treasury and IRS officials told us that their main goal was to increase accurate withholding where possible and to revise the withholding tables to reflect Tax Cuts and Jobs Act changes to the standard deduction, the personal exemption, and the tax rates. As a result, taxpayers with

¹⁶The Internal Revenue Manual is IRS's primary, official compilation of instructions to staff that relate to the administration and operations of the IRS. IRM § 1.11.2, *Internal Revenue Manual Process* (Nov. 14, 2016).

Treasury Assessed How
Alternative Withholding
Allowance Values Might Affect
Taxpayers' Withholding, but
Faced Data Limitations

simple situations—that is, taxpayers with one job, who claim the standard deduction, and who do not have children or claim other credits—would have their taxes accurately withheld based on previously filed Forms W-4.

- **Avoid increasing both overwithholding or underwithholding:** Where accurate withholding was not possible, Treasury officials told us they wanted to avoid increasing both underwithholding or overwithholding, both in the aggregate and for individual taxpayers, compared to prior law. Treasury also aimed to minimize underwithholding among certain groups of taxpayers, such as low-income taxpayers and taxpayers who itemize deductions.
- **Avoid increasing overwithholding for taxpayers whose tax liability decreased:** Treasury aimed to avoid increasing overwithholding for taxpayers whose tax liability is expected to decrease, given provisions in the Tax Cuts and Jobs Act. Treasury officials stated that withholding more from paychecks than in past years for taxpayers whose tax liability is expected to decrease would be inconsistent with the intent of the law as they understood it.

Treasury used simulations of 2018 withholding and tax liability to analyze the effects that alternative withholding allowance values would have on taxpayers' withholding and evaluated those options based on its established goals, as discussed above. The analysis included five potential values for the withholding allowance, ranging from \$3,000 to \$5,000, including \$4,150—the value of what the personal exemption would have been for 2018 had it not been set to zero under the Tax Cuts and Jobs Act. Treasury assessed how each of the alternative values would affect withholding overall, and for certain measures, such as the percentage of taxpayers overwithheld and underwithheld. Treasury also assessed how withholding for various hypothetical taxpayer examples would be affected by the different allowance values. The hypothetical taxpayer examples reflected diversity in filing status, number of jobs, number of children, income levels, and whether taxpayers would take the standard deduction or itemize deductions.

To create the simulations, Treasury officials told us that Treasury used its individual tax model, which is based on Statistics of Income data, and wage information from Forms W-2 Wage and Tax Statement (Form W-2), on which employers report employee pay and taxes withheld for the

Treasury Kept Withholding Allowance Value from Prior Law for 2018

year.¹⁷ Because by law employees file Form W-4 with employers and not IRS, Treasury was not able to use Form W-4 data in its analysis. Instead, Treasury relied on assumptions to estimate the number of allowances taxpayers typically claim. For example, Treasury assumed that married workers would request the married withholding rate, rather than choose to be withheld at the higher single rate. Treasury stated that its assumptions probably underestimated the number of allowances taxpayers would actually claim.

Treasury officials told us that taxpayers for whom IRS receives multiple Forms W-2 present a challenge in simulating wage data because it is not clear whether these individuals held multiple jobs simultaneously or consecutively.¹⁸ Holding multiple jobs simultaneously can change the appropriate number of withholding allowances to claim for each job. Treasury officials stated that its lack of data on taxpayer-claimed withholding allowances meant its withholding estimates were subject to considerable uncertainty. Treasury officials stated that further or expanded analysis in the future would face the same data limitations.

Treasury also tested its analysis of withholding based on Form W-4 data from federal employees. The analysis used data from 2016 Forms W-4 from about 1.4 million federal employees across eight federal departments. Treasury's analysis found that, when weighted to reflect the overall tax filing population, the results using these data were similar to the results using simulated withholding data for all taxpayers.

In late December 2017, Treasury officials submitted the results of their analysis and their recommendation for the withholding allowance value for 2018 to the Assistant Secretary for Tax Policy through a memo. The memo described their reasoning, assumptions, and analysis for recommending a 2018 withholding allowance value of \$4,150, the same value as the 2018 personal exemption would have had under prior law. The Assistant Secretary of Tax Policy agreed to the recommended amount without changes. IRS then used the \$4,150 withholding allowance value to update the withholding tables and the withholding calculator.

¹⁷IRS's Statistics of Income program data are generally based on a statistical sample of tax returns. At the time of its analysis, Treasury's model was based on Statistics of Income data for tax year 2014.

¹⁸Form W-2 does not include the individual's period of employment.

Treasury recommended the \$4,150 value because there was “no higher or lower value that was clearly better” for achieving the goals it outlined. Treasury’s simulation showed that any of the withholding allowance values it analyzed would decrease the proportion of overwithheld taxpayers and increase the proportion of underwithheld taxpayers compared to prior law. As shown in table 1, Treasury’s simulation found that for 2018, using the \$4,150 withholding allowance value would result in a slightly lower proportion of overwithheld taxpayers and a slightly higher proportion of underwithheld taxpayers under the Tax Cuts and Jobs Act than would have been the case under prior law.

Table 1: Treasury Simulation of Changes in Overwithholding and Underwithholding for 2018 for Individual Taxpayers with Wage Income

	Simulation of \$4,150 withholding allowance value for 2018 if tax laws had not changed	Simulation of \$4,150 withholding allowance value for 2018 given tax law changes under Public Law 115-97
Percentage of taxpayers with wages with overwithheld tax	76%	73%
Percentage of taxpayers with wages with underwithheld tax	18%	21%
Percentage of taxpayers with wages with accurately withheld tax	6%	6%

Source: Department of the Treasury (Treasury) analysis | GAO-18-548

Notes: Public Law 115-97 is referred to by the President and many administrative documents as the Tax Cuts and Jobs Act.

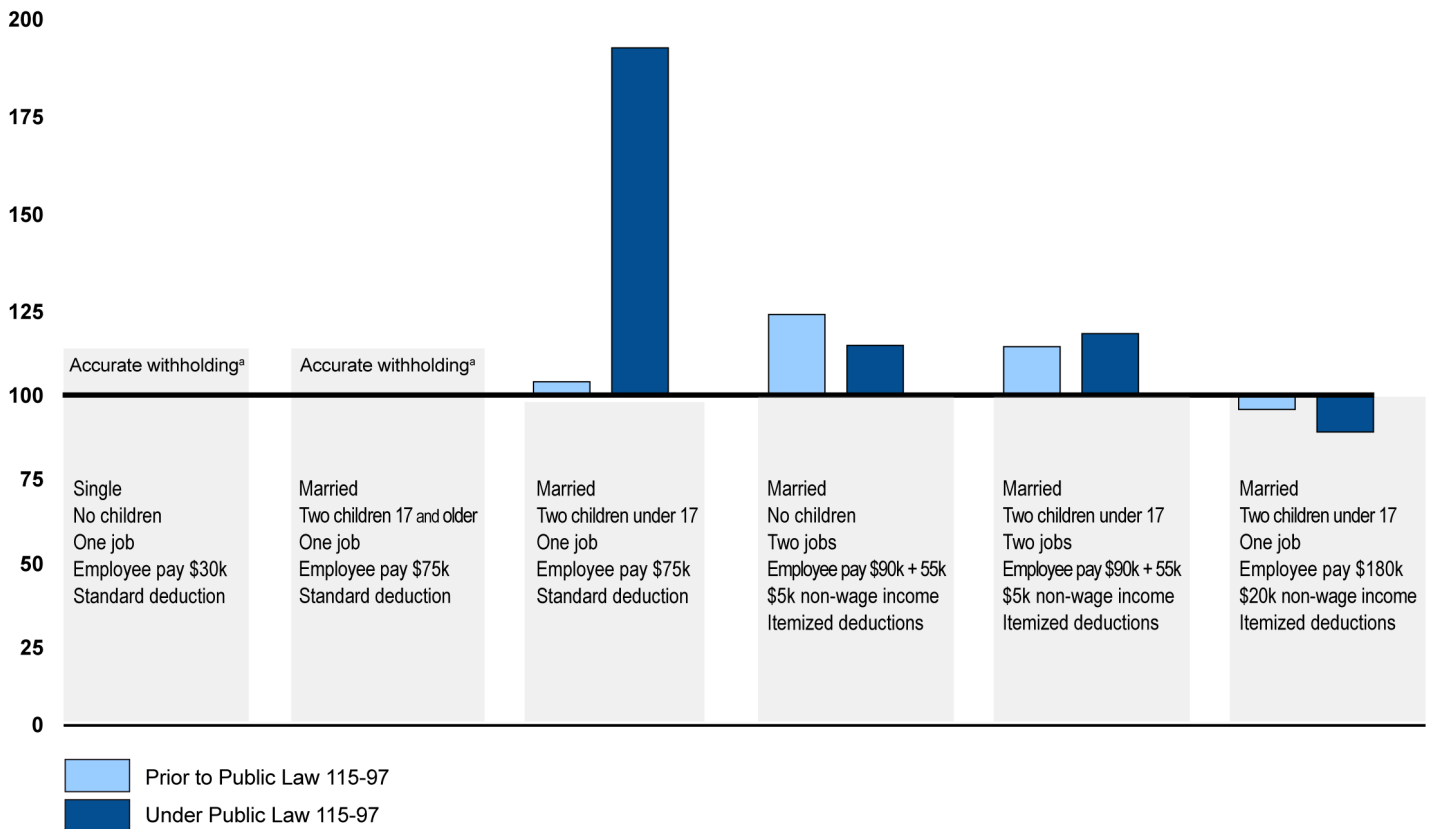
For the purposes of its analysis, Treasury considered withholding within \$100 of tax liability to be accurate withholding. Therefore, for Treasury’s analysis, overwithholding is withholding that exceeds a taxpayer’s tax liability by over \$100, and underwithholding is withholding that is over \$100 less than a taxpayer’s tax liability.

In assessing how withholding for hypothetical taxpayer examples would change based on the Tax Cuts and Jobs Act, Treasury found that the \$4,150 withholding allowance value would have varying effects on taxpayers depending on their unique circumstances, as shown in figure 3. For example, there could be substantial differences in withholding for families with children who are eligible for the Child Tax Credit. A hypothetical family with two children under 17 and one job paying \$75,000 (the third example in figure 3) would be substantially more overwithheld than under prior law given the increased value of the Child Tax Credit. A similar family with children 17 or older that did not qualify for the Child Tax Credit (the second example in figure 3) would be accurately

withheld. In its analysis, Treasury assumed that the hypothetical taxpayers did not update their Forms W-4 for 2018 following the enactment of the Tax Cuts and Jobs Act.

Figure 3: Treasury Analysis of Withholding as a Percentage of Tax Liability for Hypothetical Taxpayers Assuming a Withholding Allowance Value of \$4,150 under Current and Prior Law

Tax withheld as a percentage of tax liability



Source: Department of the Treasury analysis of effects of chosen withholding allowance on various types of taxpayers. | GAO-18-548

Notes: Public Law 115-97 is referred to by the President and many administrative documents as the Tax Cuts and Jobs Act.

The examples are based on the total withholding allowance each hypothetical taxpayer would be expected to claim if they follow the instructions on Form W-4 and do not account for any changes to withholding that a taxpayer would make by filing an updated Form W-4 for 2018 following the change in the law. For the analysis of those taking itemized deductions, Treasury officials stated that Treasury used published data on the value of itemized deductions by income level and adjusted for changes in the Tax Cuts and Jobs Act for state and local taxes. Treasury officials said Treasury's analysis found that the hypothetical taxpayers shown above who itemized deductions under prior law would take the standard deduction under Public Law 115-97.

According to 2015 IRS Statistics of Income data, in 2015, 52 percent of individual income tax returns listed Adjusted Gross Income between \$30,000 and \$200,000. Thirty percent of returns included

Treasury and IRS Implemented the New Withholding Tables in Early 2018 and May Make Changes to the Withholding Structure for 2019

itemized deductions, while 69 percent of returns claimed the standard deduction and 1 percent of returns were not categorized. (The Joint Committee on Taxation estimates that for 2018, 88 percent of taxpayers will take the standard deduction while 12 percent will itemize deductions.) Thirty-six percent of returns were filed with married filing jointly status, while 47 percent of returns were filed with single status. (The remaining 17 percent of returns were married filing separately or head of household filing status.)

^aAccurate withholding means that 100 percent of tax liability was withheld.

After Treasury chose the \$4,150 withholding allowance value, IRS updated the withholding table spreadsheets with the withholding allowance value, standard deduction, and tax tables. IRS then followed its usual practice, described earlier in this report, to create the withholding tables for 2018. IRS publicly released the 2018 tables for income tax withholding in Notice 1036 on January 11, 2018, and asked that employers and payroll providers implement the new tables by February 15, 2018. Representatives of an association representing payroll providers we spoke with stated that IRS's release of the tables in early January gave payroll providers enough time to implement the new tables by the February 15, 2018 deadline.

IRS officials told us that they created the Tax Reform Implementation Office (TRIO) to coordinate the implementation of the Tax Cuts and Jobs Act, and TRIO communicated with Treasury during the process of updating the 2018 withholding table publications and the withholding calculator to reflect changed law and the new withholding allowance value. Treasury and IRS coordinated to add new functions—such as an Earned Income Tax Credit calculator—and new language—such as an explanation of the new limit on deductions for state and local tax—to the withholding calculator and ensured that the calculator would be able to accommodate a large volume of users.¹⁹ In Notice 2018-14, released on January 29, 2018, IRS allowed employees to continue to use the 2017 Form W-4 until March 30, 2018. (Typically, the Form W-4 would be updated at the beginning of the year.) IRS publicly released the new withholding calculator and the 2018 Form W-4 on February 28, 2018.

¹⁹The Treasury Inspector General for Tax Administration found that in certain situations, the amount of withholding suggested by the calculator results in a taxpayer unknowingly having more tax withheld from their pay than is necessary. For example, a taxpayer that is paid biweekly will generally have 26 pay periods during Calendar Year 2018, but IRS's withholding calculator uses 25 pay periods to determine the withholding amount. IRS responded that this assumption has been in the withholding calculator's logic since the calculator was first developed 17 years ago but that it may change this assumption in the future. Treasury Inspector General for Tax Administration, *Tax Cuts and Jobs Act: Assessment of Implementation Planning Efforts*, 2018-44-027 (Washington, D.C., Apr. 11, 2018).

Treasury officials told us that Treasury may make more significant changes to withholding in 2019 given its new discretion over the withholding structure provided in the Tax Cuts and Jobs Act. On June 6, 2018, IRS released an early draft of the 2019 Form W-4. The draft moves away from having employees claim withholding allowances. Rather, the draft form allows employees to specify the amount of deductions they plan to take or credits they plan to claim, as well as other income they expect to earn. Employers would use this information to determine an employee's withholding. Treasury officials told us that they are aware employers will need extra time to implement any significant changes to the withholding structure, and have taken this into account when considering significant changes for 2019.²⁰

IRS and Treasury Conducted Outreach to Encourage Employees to Reassess Their Withholding

IRS and Treasury Planned and Implemented Outreach to Employees, Employers, and Industry Associations

To conduct outreach to taxpayers, IRS drafted a communications plan that identified the following goals, phases, strategies, and messages for both individual taxpayers and employers.

- **Key goals:** (1) Encourage taxpayers to check their withholding and direct them to the withholding calculator on IRS.gov; (2) provide employers with information they need to help employees; and (3) educate taxpayers about what actions they need to take, if any, based on their personal situations, especially if they were likely to have tax underwithheld and potentially be subject to a penalty in 2019.
- **Key phases:** (1) Initial communications and guidance; (2) the roll-out of the withholding calculator and Form W-4; (3) the "Paycheck

²⁰For example, the draft Form W-4 notes that although Treasury and IRS generally do not release drafts of forms until they believe the forms are final, for Form W-4 Treasury and IRS issued an early draft for comment and plan to post a new draft in the summer of 2018 that is not expected to change.

Checkup” campaign, including news releases and “Tax Reform Tax Tips” emails; (4) messaging during the end of the 2018 filing season; and (5) post-filing season messaging from May 2018 to December 2018.

- **Strategies and messages:** IRS’s strategies included (1) enlisting the help of the tax professional community and employer groups, (2) tailoring the message to different types of taxpayers (including dual income, large families, and “gig economy” employees), and (3) tying withholding information to other campaigns and communications, such as Small Business Week communications.²¹ In some materials, IRS emphasized that for key groups, it was especially important to revisit withholding. These groups included people in households with two or more jobs, who have children or dependents, who itemize their deductions, or who have high incomes or complex tax situations.

In its plan, IRS also included key activities and a status tracker for each of those activities.

To provide relevant information to employees related to reassessing withholding, IRS updated or created pages on its website with the new withholding tables, Form W-4 and withholding calculator, and Frequently Asked Questions. Treasury officials told us they supported IRS outreach efforts by facilitating the Secretary of the Treasury’s press conference and press release publicizing the new materials on IRS’s website.

IRS used its multiple email listservs to disseminate information on reassessing withholding. Listservs are self-selected by subscribers when they visit IRS.gov. IRS sent news releases and emails through its “Tax Reform Tax Tips” and “IRS Newswire” listservs on topics such as “Paycheck Checkup” and “Step-by-Step Instructions for Using the IRS Withholding Calculator.” While IRS does not collect demographic information on subscribers, IRS officials told us that they have found anecdotally that IRS listservs are used throughout the tax professional community. However, officials stated that some of the listserv options they used to communicate about withholding may have more general appeal to a wider audience. The “IRS Tax Reform Tips” listserv IRS

²¹Gig economy employees include those that are self-employed and performing single projects or tasks on demand, providing labor services (rather than capital goods or assets), working for pay (rather than in-kind) and working either part-time or full-time. This type of work can also be referred to as on-demand work, the 1099 economy, or micro-preneurship, among other terms.

created has more than 690,000 subscribers, while its “e-News for Small Businesses” listserv has over 330,000 subscribers.

IRS used social media, including Twitter and Facebook, to promote a national “Paycheck Checkup” campaign. Further, IRS posted seven YouTube videos related to reassessing withholding for 2018, including several in both English and Spanish. IRS also issued news releases on withholding and a media advisory for the “Paycheck Checkup” for distribution to national, regional, and local media. IRS media specialists also conducted radio and TV interviews nationally.

IRS and Treasury officials met and partnered with tax-related groups and employers to disseminate information and materials on reassessing withholding. IRS officials reported that they attended 22 events from February 2018 through April 2018 to discuss the withholding calculator and the need to reassess withholding, including IRS’s Monthly Practitioner Meeting and calls with representatives from the payroll industry.²²

IRS also sent emails with materials about reassessing withholding to its partners, such as associations of tax professionals, as well as to large employers, employer associations such as unions, and small businesses.

- **IRS’s National Public Liaison members:** IRS officials told us that they drafted and shared emails for the withholding calculator launch with the members of the IRS National Public Liaison.²³ IRS officials said that these partners have a combined membership of over 125,000 tax practitioners.
- **Associations representing tax professionals:** IRS worked with national tax professional associations to assist in communicating the need to update withholding to their members. IRS officials reported that they sent emails with withholding materials to these IRS partners, including over 550 practitioner organizations representing tax

²²Monthly Practitioner meetings are regularly scheduled meetings IRS holds to engage with external stakeholders in the tax professional community. The National Public Liaison develops agendas based on requests from both IRS staff and external participants.

²³The Office of National Public Liaison collaborates with external partners on policy matters related to tax administration. Primary external stakeholder groups include national organizations representing paid tax return preparers, business organizations, payroll associations, and volunteer taxpayer assistance organizations.

practitioners such as accountants and paid tax return preparers, and 100 payroll organizations.

- **Large employers and other organizations:** IRS partnered with large employers and other organizations—such as unions and industry associations—that IRS estimated had the potential to reach over 24 million individuals. IRS officials told us they sent withholding information to these employers and associations to encourage them to post information on their websites, newsletters, and employee communications.
- **Small businesses and self-employed:** To reach small businesses and self-employed taxpayers, IRS created a campaign for Small Business Week, which began in late April 2018. IRS officials reported that they also sent emails with withholding information to over 900 small business industry organizations.

Representatives of the three selected associations we interviewed were generally positive about IRS’s outreach efforts. Association representatives told us that IRS had leveraged its available tools to publicize the need to reassess withholding, including emails, the campaign for the “paycheck checkup” and articles for use as part of their newsletters. Association representatives also emphasized the importance of IRS’s efforts; for example, representatives from one association we spoke with told us that its members had reported that many employees may not realize that the Tax Cuts and Jobs Act affected individual income taxes. They also noted that outreach is especially important because employees tend not to update their Form W-4s.

To Assess Effectiveness of Outreach, IRS Monitored Key Metrics and Met With Relevant Partners

IRS officials assessed the results of their outreach by monitoring unique page views on IRS web pages related to withholding and the reach of IRS social media efforts and email listservs. Federal standards for internal control require certain control activities, including establishing activities to monitor performance measures and indicators.²⁴ Throughout the first 2 days of the calculator launch, IRS officials monitored and internally disseminated key website metrics. These metrics included the number of page views for the withholding calculator the day after the launch. IRS found that the calculator received over 300,000 unique views on March 1, 2018—compared to over 44,000 unique views on January 31, 2017, the day with the most unique views in 2017. IRS also monitored how many

²⁴See [GAO-14-704G](#).

users successfully completed the withholding calculator or exited the calculator without completing it. For example, it found that the step of the withholding calculator at which users most often exited was the page that required entering paystub information. After the initial launch, IRS continued to monitor usage of the withholding calculator. For example, for the period between February 28, 2018, and April 6, 2018, the calculator had 352 percent more hits in 2018 than during the same period in 2017. IRS officials stated that these results inform their communication and outreach activities.

IRS tracked information on the reach and engagement on its tweets, including “retweets,” likes, and number of people who clicked on included links to IRS webpages. IRS also cited lists of relevant articles in major media outlets in the days following the launch of the withholding calculator.

As described earlier, IRS met with relevant groups to receive feedback during the rollout of the withholding calculator and “Paycheck Checkup.” For example, TRIO conducted a listening session during the IRS National Public Liaison Practitioner Meeting and technical experts from IRS spoke about the withholding calculator to discuss usage and get feedback.

IRS officials stated that they will continue to monitor usage of the withholding calculator to inform development of communications and outreach activities related to withholding for the rest of 2018.

Conclusions

Many taxpayers have preferences about the tax refund that they will receive or the balance they will have to pay when they file their tax returns. The tax withholding tables that Treasury and IRS update each year are an important tool that both employers and employees rely upon to form their expectations. This reliance underscores the importance of accurate withholding tables.

Although Treasury and IRS described to us the process for updating the withholding tables in a typical year and documented their analysis for new required decisions for 2018, there is currently no documentation of Treasury’s and IRS’s roles and responsibilities for annual updates. Documenting roles and responsibilities for this annual process—which is consistent with federal standards for internal controls—would help Treasury and IRS adequately ensure that the process to update the withholding tables is consistently implemented.

While officials described their roles in annually updating withholding tables as routine prior to 2018, the changes to the tax code and withholding made in the Tax Cuts and Jobs Act highlight the importance of this process. Treasury's new discretion over the withholding structure and potential future changes it could make to it may make updating the tables more complex. The changes to withholding for 2018—and potential changes in the future—present an opportunity to implement appropriate internal controls over the process for updating the withholding tables to ensure that the tables are effectively updated each year.

Recommendation for Executive Action

We are making the following recommendation to the Department of the Treasury and the Internal Revenue Service:

The Secretary of the Treasury should work with the Commissioner of Internal Revenue to document roles and responsibilities for updating the tax withholding tables, such as in the Internal Revenue Manual. (Recommendation 1)

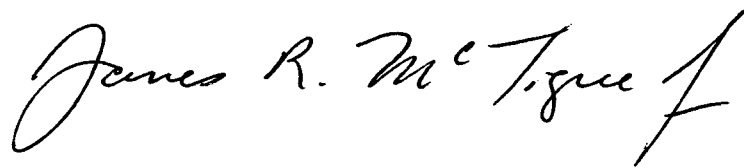
Agency Comments and Our Evaluation

We provided a draft of this report to the Secretary of the Treasury and the Commissioner of Internal Revenue. In its written comments, reproduced in appendix I, IRS stated that it and Treasury agreed with the recommendation and that documenting the roles and responsibilities for the annual updates will help them to implement the process consistently. IRS also provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to the Chairmen and Ranking Members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. We will also send copies of the report to the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9110 or mctiguej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in black ink that reads "James R. McTigue Jr." with a stylized flourish at the end.

James R. McTigue Jr.
Director
Strategic Issues

Appendix I: Comments from the Department of the Treasury and the Internal Revenue Service



DEPUTY COMMISSIONER

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

July 13, 2018

Mr. James R. McTigue, Jr.
Director, Tax Issues, Strategic Issues Team
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. McTigue:

Thank you for providing the GAO-18-548 draft report "Federal Tax Withholding: Treasury and IRS Should Document the Roles and Responsibilities for Updating Annual Withholding Tables (JC#102616)" and allowing the IRS and the Department of the Treasury (Treasury) to review and respond to the draft. In this letter, I am responding on behalf of both the IRS and Treasury.

Each year the IRS routinely updates tax withholding tables and related formulas and worksheets for inflation. The Tax Cuts and Jobs Act (TCJA) necessitated more fundamental changes and provided Treasury certain authority to establish new rules governing federal tax withholding. For the 2018 withholding tables, Treasury analyzed a variety of factors, including the burden on employers, payroll providers, and employees, and determined that the 2018 withholding tables should remain compatible with the existing Form W-4. Treasury set the value of the 2018 withholding allowance after analyzing available data. Treasury then worked with key IRS offices to update withholding tables, worksheets, and instructions to reflect these decisions, as well as the new tax rates, increased standard deduction, increased child tax credit, and reduction of the personal exemption to zero. These key IRS offices included Research, Applied Analytics & Statistics, Office of Chief Counsel, Wage & Investment Tax Forms and Publications, and the Tax Reform Implementation Office (established to coordinate the TCJA implementation). The IRS and Treasury also updated the online withholding calculator to help taxpayers check their 2018 withholding considering the new tax law. In addition, the IRS developed and implemented outreach explaining TCJA changes in general and for different types of families and encouraging employees to reassess their withholding. Under tight time constraints, these concerted activities resulted in a successful roll-out of new withholding tables, a new Form W-4 and related publications, and the updated withholding calculator for 2018.

The conclusion of your report emphasizes the importance of accurate withholding tables and recommends that the IRS and Treasury improve documentation of the annual

**Appendix I: Comments from the Department
of the Treasury and the Internal Revenue
Service**

2

updating process. We agree that documenting the roles and responsibilities for the annual updates will help us to implement the process consistently.

Again, thank you for providing the report and valuable feedback. We provided technical comments on the draft separately. If you have questions, please contact me, or a member of your staff may contact Benjamin Herndon, Chief Research and Analytics Officer at 202-317-4276.

Sincerely,



Jeffrey J. Tribiano
Deputy Commissioner for
Operations Support

Enclosure

Enclosure

**Recommendation and the IRS and Treasury Responses to
GAO-18-548 Draft Report Federal Tax Withholding: Treasury and IRS Should
Document the Roles and Responsibilities for Updating Annual Withholding
Tables (JC#102616)**

Recommendation:

1. The Secretary of the Treasury should work with the Commissioner of Internal Revenue to document roles and responsibilities for updating the tax withholding tables, such as in the Internal Revenue Manual. (Recommendation 1).

Comment:

IRS and Treasury agree with Recommendation 1, recognizing the need to document the roles and responsibilities governing the annual process of updating tax withholding tables.

Appendix II: GAO Contact and Staff Acknowledgments

GAO Contact

James R. McTigue, Jr., (202) 512-9110, mctiguej@gao.gov

Staff Acknowledgments

In addition to the contact named above, Jeff Arkin (Assistant Director), Alexandra Edwards (Analyst-in-Charge), Jacqueline Chapin, Ann Czapiewski, Farrah Stone Graham, Loren Lipsey, and Andrew J. Stephens made significant contributions to this report.

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