

New Measures to Counter Tax Refund Fraud

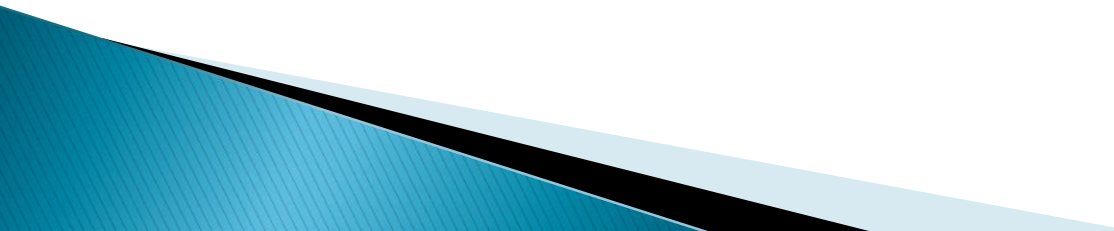
Views from the Payroll Service Industry
National Payroll Reporting Consortium

August 8, 2016

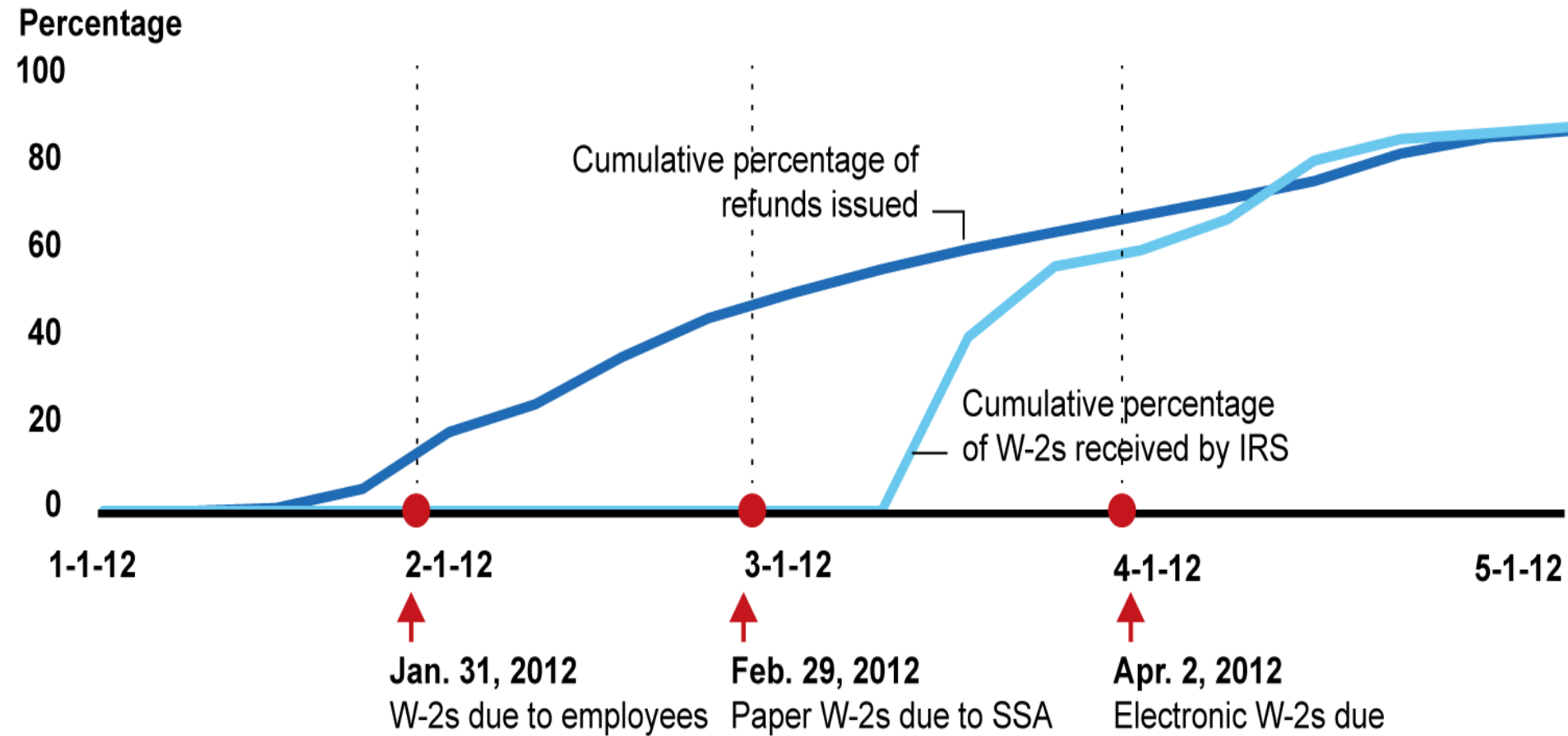
National Payroll Reporting Consortium

- ▶ A trade association of the largest 12 payroll service providers
 - 1.4 million employers
 - ~ 1 / 3 of the private sector work force
- ▶ NPRC is strictly policy-neutral on issues affecting employer reporting obligations.
- ▶ NPRC provides impartial feasibility analyses on proposals involving employment taxes

What's New with Employer W-2 Reporting?

- ✓ **Broad shift of employer W-2 reporting to January 31**
 - ✓ **Increase W-2 electronic filing**
 - ✓ **SSN Truncation?**
 - ✓ **W-2 Verification Code pilot**
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Current Tax System Can't Validate Refund Claims



Source: GAO analysis of IRS data. | GAO-14-633

Move W-2 Reporting to January 31

- ▶ **2014: Five states (plus DC, PR) had a W-2 Filing Deadline of January 31**
 - Kentucky
 - Mississippi
 - Nebraska (2 / 1)
 - Pennsylvania
 - Wisconsin

Move W-2 Reporting to January 31

- ▶ 2015: Ten states (plus DC, PR) had a W-2 Filing Deadline of January 31

Alabama
Connecticut
District of Columbia
Indiana
Kentucky
Mississippi

Nebraska (2/1)
Pennsylvania
Puerto Rico
Utah
Virginia
Wisconsin

Example: Utah SB 250 (2015)

- ▶ All employers must file Forms W-2 electronically by January 31.
- Tax refunds are contingent on W-2 matching:
 - 59-10-529.1. Time period for commission to issue a refund.
 - (1) Except as provided in Subsection (2), the commission may not issue a refund before March 1.
 - (2) The commission may issue a refund before March 1 if, before March 1, the commission determines that:
 - (a) an employer has filed the one or more forms in accordance with Subsection 59-10-406(8) the employer is required to file with respect to an individual; and
 - (b) the individual has filed a return in accordance with this chapter..

Federal Law Shifted the Employer W-2 Deadline to January 31

- ▶ On December 18, 2015, President Obama signed into law “The Protecting Americans from Tax Hikes Act of 2015” (PATH Act, Public Law 114-113).
- ▶ Section 201 accelerated Form W-2 Filings
 - Forms W-2, W-3, and returns or statements to report nonemployee compensation (i.e., Forms 1099 with Box 7 entries) to be filed on or before January 31, beginning with tax year 2016
- ▶ Section 202 delays refunds of returns with Earned Income Tax Credit (EITC) and Additional Child Tax Credit (ACTC) to February 15

Accelerated W-2 Reporting

- ▶ As of July 2016, 20 states (plus DC, PR) adopted the January 31 deadline

Alabama
Connecticut
District of Columbia
Georgia
Iowa
Idaho
Indiana
Kentucky
Louisiana
Maryland
Mississippi
Minnesota (vetoed)

Missouri (2018)
Nebraska (2/1)
North Carolina
Oregon
Pennsylvania
Puerto Rico
South Carolina
Utah
Vermont
Virginia
Wisconsin

State Conformity with the IRC?

- ▶ Some states automatically adopt changes to the Internal Revenue Code, which may include the January 31 filing deadline.
- ▶ States with automatic conformity and W-2 filing deadlines later than Jan. 31:

Colorado
Delaware
Illinois
Kansas
Louisiana
Massachusetts

Missouri
Montana
New Mexico
North Dakota
Oklahoma
Rhode Island

State Conformity with the IRC?

- ▶ Other states have enacted legislation to adopt changes in the IRC through 2015
- ▶ Need to modify tax forms, specifications, guidance; notify employers, etc.?

Why Not January 10? 15? 20?

- ▶ Could employers electronically file W-2s before January 31?
 - Cash wages are generally known as of Dec. 31
 - But W-2s include up to 50 different elements of taxable compensation – many administered by third parties
 - Third-party disability and sick pay is not required to be provided to employers until January 15th.
 - Various benefits; e.g., dependent care assistance, non-accountable plan expense reimbursements, the value of company travel, personal use of a vehicle...

Ernst & Young study

- ▶ **Impact & feasibility of accelerating W-2 reporting deadlines**
 - <http://www.nprc-inc.org/govc.html>
- ▶ **W-2Cs and amendments may multiply as much as eightfold**
 - Employers need time to gather the many elements of non-cash taxable compensation

✓ Consider Other Sources

- ▶ What is the experience of states with quarterly reporting?
 - (CA, ME, MA, **OR** (*new for 2016*) NY...)
 - How effective?

Expand Electronic Filing

- ▶ Employer W-2 data isn't helpful in paper form
- ▶ States are ahead of IRS in terms of electronic filing threshold
 - 250+ W-2s
 - About half of 1% (0.005) are required to e-file
 - Threshold set in 1982
 - ...when you needed a mainframe/tape drive to e-file
- ▶ At least seven states require all employers to e-file Forms W-2
 - ~ 14 states require all employers to efile UI quarterly wage reports

Form W-2 Verification Code Pilot

- ▶ A W-2 Verification Code (VC) pilot was in effect for TY2015
- ▶ The VC is designed to make Forms W-2 self-authenticating
 - W-2 data reported on electronically filed income tax returns
- ▶ Four large payroll firms printed about 2 million 2015 Forms W-2 with a Verification Code
 - 16 alphanumeric characters
 - Unique to each W-2
 - Calculated using EIN, SSN, wages, withholding

W-2 Verification Code

Free tax prep at irs.gov/freefile.		freefile	
Employee Reference Copy			
W-2		2015	
Wage and Tax		Statement	
<small>Copy C for employer's records.</small>		<small>OMB No. 1545-0045</small>	
d Control number	Dept.	Corp.	Employer use only
216543 ROSE/ABC	100	AABB	A 223
c Employer's name, address, and ZIP code			
ACME SUPPLIES CORPORATION 15 CENTER STREET ANYTOWN, USA 12345			
Batch# 00001			
e/f Employee's name, address and ZIP code			
JANE HARPER 101 MAIN STREET ANYTOWN, USA 12345			
b Employer's FED ID number	a Employee's SSA number		
12-1233338	999-99-9999		
1 Wages, tips, other comp.	2 Federal income tax withheld		
32937.80	2560.00		
3 Social security wages	4 Social security tax withheld		
35037.80	2172.34		
5 Medicare wages and tips	6 Medicare tax withheld		
35037.80	508.05		
7 Social security tips	8 Allocated tips		
9 Verification Code	10 Dependent care benefits		
11 Nonqualified plans	12a See instructions for box 12		
	C		37.80
14 Other	12b D		2100.00
31.20 SDI	12c DD		8543.00
500.00 AUTO	12d		
	13 Stat emp.	Ret. Plan	3rd party sick pay
		X	
15 State Employer's state ID no.	16 State wages, tips, etc.		
NY 12-1233338	32937.80		
17 State income tax	18 Local wages, tips, etc.		
1163.35	32937.80		
19 Local income tax	20 Locality name		
751.60	NYC RES		

W-2 Instructions:

Verification Code: If this field is populated, enter this code when it is requested by your tax return preparation software. It is possible your software or preparer will not request the code. The code is not entered on paper-filed returns.

Form W-2 Verification Code Pilot

- ▶ When a VC is reported, the validation success rate is over 94%
- ▶ Omitted/incorrect VCs did not delay the processing of a tax return.
- ▶ No impact to paper returns, State/local returns or employer submissions of Forms W-2s to SSA or states

Form W-2 Verification Code Pilot

Filing Season 2017 (TY2016):

- ▶ Planning to expand the W-2 VC pilot
 - Up to 20% of all Forms W-2
 - May add more service providers, federal agencies
- ▶ States involved through the Security Summit Authentication Working Group
 - States may receive an indicator (e.g., VC present; VC verified/failed) through Secure Data Transfer, although a final decision has not yet been reached for FS 17.

SSN Truncation

- ▶ Section 409 of the PATH Act of 2015 (P. L. 114–113) authorized the IRS to permit employee Social Security Numbers to be truncated on Forms W–2 (e.g., XXX–XX–9999).
- ▶ IRS regulations are expected to be permissive
 - Effective date?
- ▶ NPRC letter to state tax commissioners (4/5/2016):
 - *Will state tax authorities require the full display of SSNs on recipient copies of Form W–2, including the recipient filing copy; “Copy 2—To Be Filed With Employee’s State, City, or Local Income Tax Return”?*

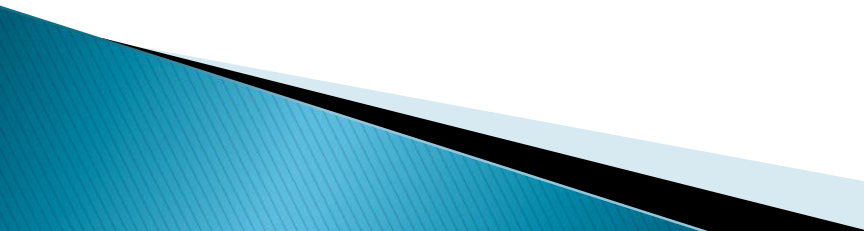
SSN Truncation

- ▶ Some states may have an independent statutory or regulatory requirement to display the full SSN on Forms W-2.
- ▶ It may take time to make changes to legislation, regulations, administrative specifications, forms and instructions.
 - *One state thought they would need legislation to permit truncation.*
 - *Another state scans employee W-2s with paper returns, and relies on the full SSN. It could be a problem to make a change for 2016.*

✓ Consider Other Sources

- Pending federal legislation would permit access to the National Directory Of New Hires for tax administration
- NDNH and state directories contain new hire reports and quarterly wage data
 - Would confirm employment relationship
 - Wages paid through September would be on file by Dec. 31

Payroll Service Failures

- How to safeguard taxes that are administered by payroll service providers
 - Implement an electronic verification system for employers similar to the IRS EFTPS.
 - Make employers aware of EFTPS and any state system to verify tax payments.
 - The IRS has required all payroll firms to make disclosures each quarter since 2012.
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IMPORTANT INFORMATION FROM THE IRS:

- ▶ *“The employer is ultimately responsible for the deposit and payment of federal tax liabilities, even if a third party is making the deposits. The IRS recommends that employers enroll in and use EFTPS (Electronic Federal Tax Payment System) to confirm payments made on their behalf. Enroll online at www.eftps.gov, or call 800-555-4477 for an enrollment form.*
- ▶ *State tax authorities generally offer similar means to verify tax deposits. Contact the applicable state offices directly for details.”*

For Further Study...

- The Maryland legislature conducted a comprehensive study of possible regulatory approaches in 2014:
 - Final report & testimony:
www.csrps.maryland.gov.

Tax System Design Recommendations

- NPRC members appreciate the opportunity to work with state tax authorities to improve tax administration
 - NPRC actively supports appropriate electronic filing systems
 - General recommendations for state tax systems:
 - http://www.nprc-inc.org/efile_WH.html
 - http://www.nprc-inc.org/efile_UI.html
 - Enrollments
 - Taxpayer information verification
 - Edits; error handling protocols...

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