

#10 REQUIRE EMPLOYERS FILING MORE THAN FIVE FORMS W-2, 1099-MISC, AND 941 TO FILE ELECTRONICALLY AND PROVIDE A BREAKDOWN BY EMPLOYEE OF THE AMOUNTS REPORTED ON FORM 941

Present Law

IRC § 6011(e)(1) authorizes the IRS to issue regulations that provide standards for determining which returns must be filed on magnetic media or in other machine-readable form. IRC § 6011(e)(2) provides that when issuing regulations, the IRS cannot require any person to file returns on magnetic media unless the person is required to file at least 250 returns during the calendar year, except that partnerships having more than 100 partners must file returns on magnetic media. The term “person” is broadly defined to include “an individual, a trust, estate, partnership, association, company or corporation.”⁵⁷ Under Treasury regulations, taxpayers must file IRS Forms W-2, *Wage and Tax Statement*, and 1099-MISC, *Miscellaneous Income*, electronically when they file 250 or more information returns.⁵⁸ “[T]he 250-threshold applies separately to each type of form required to be filed.”⁵⁹ Taxpayers may request waivers of the electronic filing requirement if they cannot comply due to technological constraints or if compliance with the requirement would result in undue financial burden.⁶⁰

Every employer is generally required to make a return on Form 941, *Employer’s Quarterly Federal Tax Return*, for the first calendar quarter in which the employer pays wages subject to the tax imposed by the Federal Insurance Contributions Act and for each subsequent quarter (whether or not wages are paid therein) until the employer has filed a final return.⁶¹ Employers report the number of employees, total wages paid, and federal income tax withheld from employees’ wages in the aggregate. Employers are not required to provide an employee-specific breakout of this information.⁶² Employers currently are not required to file Forms 941 electronically but can do so voluntarily.⁶³ In contrast, a corporation required to file a corporate income tax return must file Form 1120, *U.S. Corporation Income Tax Return*, electronically if it files at least 250 required returns of any type during the calendar year in the aggregate (including Forms W-2, 1099-MISC, and 941).⁶⁴

Reasons for Change

Increasing the electronic filing of information returns and requiring the electronic filing of Forms 941 with a breakdown of the amounts reported by employee would significantly benefit taxpayers and the IRS in several ways.

First: Effective data matching is an indispensable tool in the IRS’s battle to combat identity theft (IDT) and refund fraud. Requiring employers to provide each employee’s name, address, Social Security number (SSN),

57 IRC § 7701(a)(1). See also Treas. Reg. § 301.6011-2(a)(3).

58 Treas. Reg. § 301.6011-2(c)(1)(i).

59 Treas. Reg. § 301.6011-2(c)(1)(iii).

60 See IRS Pub. 8508, *Request for Waiver From Filing Information Returns Electronically* (Rev. 9-2017).

61 Treas. Reg. § 31.6011(a)-1(a)(1). See Treas. Reg. § 31.6011(a)-1(a)(2) through (5) for details about when an employer must use something other than Form 941.

62 Although the final version of Pub. L. No. 115-97 (2017) did not include a provision modifying the reporting requirements of Form 941, a proposal to include the name, address, and wages of each employee was included in the version of the tax reform bill approved by the House. See H.R. REP. No. 115-409, at 142-144 (2017). See also H.R. REP. No. 115-466, at 235 (2017) (Conf. Rep.).

63 See <https://www.irs.gov/businesses/small-businesses-self-employed/e-file-form-940-941-or-944-for-small-businesses> (last visited Dec. 28, 2017).

64 Treas. Reg. § 301.6011-5(a)(1) and (d)(5).

and wages on a quarterly basis on an electronically filed Form 941 would allow the IRS an opportunity to gather information for purposes of data matching in advance of the filing season.

The earlier availability of Forms W-2 and 1099-MISC via electronic filing would provide the IRS with real-time data on wages and withholding, without the delays and errors associated with transcribing data from paper-filed forms. When information about a taxpayer's wages and withholding is processed before the IRS processes a taxpayer's tax return, the IRS can match the data on the tax return with the data reported on the information returns. If there are significant disparities, the IRS can review the tax return more carefully before paying a refund. Similarly, the IRS could more quickly match wages and withholding reported on information returns against the employer's Forms 941. From the government's perspective, data matching reduces the revenue loss associated with unpaid employment taxes, improper payments, and stolen refunds. From the taxpayer's perspective, the IRS helps the legitimate taxpayer either avoid a refund delay or resolve a delay more quickly by spotting an IDT return before a refund is paid.

The potential benefits of earlier access to taxpayers' wages and withholding information are significant because of the magnitude of the IDT problem. The IRS estimates that at least \$14.59 billion in IDT tax refund fraud was attempted in calendar year 2015. It estimates that it prevented at least \$12.35 billion (85 percent) but paid at least \$2.24 billion (15 percent). Business IDT is a growing subset of the IDT problem. The IRS handled nearly three times as many business IDT cases in 2017 as it did in 2016, an increase of more than 10,000 cases. Yet in 2017, less than half of Forms 941 were filed electronically. Greater electronic filing of Forms 941 would allow the IRS to match Form 941 data against Form W-2 and Form 1099-MISC data to identify instances of potential business IDT fraud.

Second: Data submitted on paper returns must be manually entered into Social Security Administration (SSA) or IRS computer systems, and manual data entry necessarily produces transcription errors. When a transcription error on an information return or on an employer's Form 941 occurs, the IRS's document matching process will identify a disparity that may delay a refund or initiate an erroneous adjustment notice, causing needless hassle for the taxpayer and unnecessary work for the IRS.

Third: Manual data entry of information returns is much more expensive than electronic data processing. For example, the SSA reports a cost of \$0.53 to process each paper Form W-2, as compared with a cost of \$0.002 for each electronically filed Form W-2.⁶⁵

The current threshold of 250 returns that triggers the requirement for electronic filing was established in 1989.⁶⁶ The electronic filing requirement applies to Form 1120, *U.S. Corporation Income Tax Return*, if a corporation files at least 250 required returns of any type during the calendar year in the aggregate (including Forms W-2, 1099-MISC, and 941). In light of the significant advances in technology and digital capability that have taken place since that time, the National Taxpayer Advocate believes the threshold should be reduced substantially.

There are still some employers for whom an electronic filing requirement would impose disproportionate burden. An elderly individual who pays one or several health aides and is required to file Form W-2s may not have the technological skills to file electronically without help. But a threshold of five should provide most of the benefits of electronic submission of these forms without imposing undue burden on very small employers.

65 See GAO, GAO-14-633, *Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud* (Oct. 20, 2014).

66 Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7713, 103 Stat. 2106, 2394 (1989) (codified as amended at 26 U.S.C. § 6011).

We note that the SSA has a fillable Form W-2 available on its website that employers can use to submit Forms W-2 electronically at no cost.⁶⁷ The IRS should develop a similar fillable Form 941, *Employer's Quarterly Federal Tax Return*, and a fillable Form 1099-MISC for those small businesses that may not have access to tax software to electronically file. By doing so and making it easier for businesses to file electronically, the IRS will then be in a better position to protect revenue by identifying and resolving inaccurate reporting at the time of return filing and preventing the release of improper refunds.

Recommendations

Amend IRC § 6011(e)(2), *Requirements of Regulations*, to require employers with more than five employees to electronically file Forms W-2 and Forms 941, and require payors who issue more than five Forms 1099-MISC with nonemployee compensation to electronically file Forms 1099-MISC.⁶⁸

Amend IRC § 6011 to require that Form 941 contain information about each employee's name, address, SSN, and wages.

To promote electronic filing, direct the IRS to create fillable Forms 941 and Forms 1099-MISC that can be electronically filed at no cost directly from the irs.gov website.

⁶⁷ See www.ssa.gov/employer/what.htm (last visited Dec. 1, 2017).

⁶⁸ In 2016, Senator Hatch introduced a bill proposing a staggered reduction over five years of the 250 return threshold triggering the requirement for electronic filing. Stolen Identity Refund Fraud Prevention Act, S. 3157, 114th Cong. § 203 (2016). Under the terms of the bill, for calendar years after 2022, electronic filing would be required if the person was required to file at least 20 returns during the calendar year.