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BY THE U.S. GENERAL ACCOUNTING OFFICE

**Report To The Commissioner Of Internal
Revenue And The Commissioner Of
Social Security**

**IRS And SSA Can Improve The Verification
And Recording Of Data Provided By
Self-Employed Taxpayers**

Self-employed workers are required to report Social Security self-employment earnings to the Internal Revenue Service and pay any taxes that are due. IRS forwards all relevant self-employment data to the Social Security Administration (SSA) where it is accumulated and eventually used to help determine the amount of Social Security benefits to which these workers are entitled.

Because of the importance of properly processing this information, GAO made a review to determine how well IRS and SSA were performing this task. GAO found that although the system is functioning well, more could be done to (1) properly credit self-employment earnings to taxpayers' accounts and (2) more accurately account for the taxes that are due. IRS and SSA expressed general agreement with GAO's recommendations.



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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT
DIVISION

B-217878

The Honorable Roscoe L. Egger, Jr.
Commissioner of Internal Revenue
Department of the Treasury

The Honorable Martha A. McSteen
Acting Commissioner of Social Security
Department of Health and Human Services

This report discusses our review of whether the Internal Revenue Service and the Social Security Administration were properly processing self-employment earnings information and crediting it to taxpayers' accounts. We made this review because self-employment earnings information is used in determining the amount of Social Security benefits that an individual is entitled to receive.

The report points out that both agencies usually do an effective job of verifying the correctness of the Social Security self-employment tax on reported earnings and recording the correct self-employment earnings in the proper individual's account. However, both agencies could make some administrative changes which would enable them to more accurately determine the amount of Social Security self-employment taxes that are due, the earnings to be credited to individuals' Social Security accounts, and the amount of tax revenues that Social Security's trust funds should receive.

As you know, 31 U.S.C. §720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

B-217878

Copies of this report are being sent to the Secretary of Health and Human Services; the Secretary of the Treasury; the Director, Office of Management and Budget; and other interested parties.

W. J. Anderson

William J. Anderson
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE COMMISSIONERS OF
INTERNAL REVENUE AND SOCIAL
SECURITY

IRS AND SSA CAN IMPROVE THE
VERIFICATION AND RECORDING
OF DATA PROVIDED BY SELF-
EMPLOYED TAXPAYERS

D I G E S T

Workers are required to report their self-employment earnings to the Internal Revenue Service (IRS) on a schedule specifically designed for this purpose--schedule SE. IRS processes the information contained on the schedule, collects any Social Security self-employment taxes that are due, and furnishes all relevant self-employment data to the Social Security Administration (SSA). SSA uses the self-employment information to credit individuals' Social Security accounts with their earnings. (See pp. 1 and 2.)

Because self-employment earnings information is used to determine the amount of Social Security benefits that an individual is entitled to receive, GAO made a review to assess whether IRS and SSA were properly processing and crediting the correct amount of reported earnings to taxpayers' accounts. GAO found that although the system is functioning well for most of the nation's 8.3 million self-employed workers who had taxable earnings, IRS and SSA could make improvements to (1) increase the amount of self-employment earnings being properly credited and (2) more accurately account for the taxes that are due. Specifically, GAO found the following types of problems:

- Errors in computing self-employment earnings on SE schedules were not always being detected. GAO estimated that for SE schedules processed by IRS in 1980, which was the most recent data recorded by SSA to taxpayers' accounts at the time GAO began its review, about 83,000 computational errors were made. The effect of such errors on self-employment earnings and Social Security taxes was about \$98.7 million and \$8 million, respectively. (See pp. 4 to 7 and app. I.)

--Some self-employed individuals also earn wages while working for employers in a job covered by Social Security. GAO found that during returns processing, IRS does not routinely verify wage amounts that self-employed taxpayers show on their SE schedules. GAO estimated that if IRS had verified wages for workers who earned the maximum amount taxable under Social Security--in 1979 this was \$22,900--it could have detected about 26,800 errors. The wage errors resulted in a net understatement of self-employment earnings of \$37.8 million and a net underpayment of Social Security taxes of \$3.1 million. (See pp. 9 to 12.) GAO also estimated that if SSA had examined this same group to see if all earnings were being credited, it could have properly credited an additional \$147.8 million to about 15,900 Social Security accounts. (See pp. 12 to 16 and app. I.)

--IRS forwards all relevant self-employment data to SSA where earnings are recorded in individuals' accounts. GAO found that IRS could help SSA correctly credit earnings to individuals' Social Security accounts by making sure that whenever it corrects a Social Security number on a tax return, the corrected number is provided to SSA. GAO estimated that, in 1980, IRS furnished an incorrect number to SSA--when the correct number was available--for about 64,600 individuals. Of these, GAO estimated that SSA was not able to credit or incorrectly credited the accounts of about 27,200 individuals whose earnings totaled about \$138.4 million. (See pp. 19 to 21 and app. I.)

--GAO also found that SSA and IRS need to establish better control over SE schedules to help ensure that all self-employed persons are receiving credit for their self-employment earnings. GAO estimated that because some 1980 records were not processed, about \$258 million in earnings were not credited to individuals' Social Security accounts and SSA did not receive about \$20.8 million in Social Security self-employment taxes on these earnings that had been collected by IRS. (See pp. 21 to 25.)

RECOMMENDATIONS

IRS has taken action to correct some of the problems noted in this report. For example, it has begun to check the mathematical accuracy of earnings amounts claimed by certain types of self-employed workers and it has improved its process for providing corrected Social Security numbers to SSA. To provide additional assurance that the data received from self-employed taxpayers are properly processed and recorded, GAO is making a number of recommendations to the Commissioners of Internal Revenue and Social Security. GAO is also recommending that the agencies work together to

- identify and correct the accounts of those self-employed individuals who did not receive full credit for their earnings, (see p. 17) and
- establish overall control of the self-employment records received for processing so that differences between the number processed by IRS and SSA can be reconciled. (See p. 27.)

AGENCY COMMENTS AND GAO'S EVALUATION

The Commissioners of Internal Revenue and Social Security expressed general agreement with GAO's recommendations and outlined actions to be undertaken to implement them. (See app. II and III.) These actions should improve the processing and recording of self-employment data provided by taxpayers.



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ABBREVIATIONS

GAO	General Accounting Office
IRS	Internal Revenue Service
SSA	Social Security Administration

CHAPTER 1

INTRODUCTION

Self-employed workers report their self-employment earnings to the Internal Revenue Service (IRS) and pay IRS any Social Security self-employment taxes that are due. Under the provisions of the Self-Employed Contributions Act, self-employed workers are generally required to pay Social Security taxes if they have net earnings of \$400 or more. Workers who meet this requirement pay taxes on all reported earnings that are covered by Social Security up to a maximum amount established each year.

The Social Security tax money collected by IRS is credited to the Social Security trust funds (Federal Old-Age and Survivors Insurance Trust Fund and Disability Insurance Trust Fund). Trust fund money is used by the Social Security Administration (SSA) to pay retirement, death, or disability benefits to eligible individuals. Because eligibility for benefits and the amount of the benefits are based, in part, on the amount of an individual's wages and self-employment earnings, we made a review to determine how well IRS and SSA were processing and recording this information.

THE TAX RETURN AND SELF-EMPLOYED EARNINGS PROCESSING SYSTEMS

Self-employment earnings are reported to IRS on the schedule SE which is a part of an individual's federal income tax return. Upon their arrival at an IRS service center, tax returns are reviewed, coded, and edited by tax examiners. The relevant data are entered into computers by data transcribers.

IRS uses computer programs to examine whether certain portions of returns are mathematically accurate and whether all the tax data necessary for processing them are present and accurately transcribed. Returns which fail the computer checks are printed on an error register and sent to tax examiners for correction. The corrections are then entered into the computer.

¹Some self-employed individuals also earn wages while working for employers in a job covered by Social Security. In determining these individuals' self-employment tax liability, credit is given for Social Security taxes paid on these wages when total earnings exceed the maximum taxable amount.

method for computing their self-employment earnings.² We also determined whether IRS and SSA could make improvements that would reduce tax errors or help to ensure proper crediting of earnings.

To assess the accuracy of earnings, taxes, and Social Security numbers, we selected more than 800,000 computerized tax returns with SE schedules from about 7.8 million such returns that IRS processed at all of its service centers in 1980. These returns generally contained 1979 earnings information. Further details of our statistical estimates and confidence intervals for the projections we made based on returns processed in 1980 are shown in appendix I.

We examined calendar year 1979 earnings information because when we started our review in October 1982, SSA had substantially completed crediting individuals' Social Security accounts with their 1979 earnings. Thus, 1979 data was the most recent data available at the time we began our work. Additionally, we used a computer to review a total of about 15.5 million SE schedules provided by IRS to SSA during 1981 and 1983 and about 7.8 million tax returns from self-employed workers that IRS processed from January through mid-September 1983. This was done to (1) determine whether the tax and earnings problems we found continued to exist in later years, (2) evaluate the corrective action taken by IRS on some of the problems we identified, and (3) help IRS pinpoint areas requiring further corrective action.

In working with IRS' computerized records, we confirmed schedule SE earnings amounts by examining other supporting schedules of the tax returns. These included schedule C (Profit or Loss From Business or Profession), schedule F (Farm Income and Expenses) and schedule E, Part II (Supplemental Income Schedule, Income or Losses from Partnerships). If clarifying or more complete data was needed, we reviewed the actual tax returns.

Our audit work, which was done from October 1982 to October 1983, was performed in accordance with generally accepted government auditing standards.

²The Congress provided self-employed workers with optional tax methods for computing net earnings. By using an optional tax method, workers with very low earnings or a loss could claim earnings of up to \$1,600. This was done so that an individual's earnings would be high enough to maintain Social Security coverage.

CHAPTER 2

IRS AND SSA COULD DO MORE TO MAKE SURE THAT EARNINGS INFORMATION FOR THE SELF- EMPLOYED IS CORRECT

If all goes well with the processing of returns from self-employed taxpayers, and it usually does, IRS verifies the correctness of the Social Security self-employment tax on reported earnings, SSA records the correct self-employment earnings in the proper account based on earnings records provided by IRS, and SSA's trust funds receive the correct amount of Social Security self-employment tax money from IRS. However, we found that certain administrative changes would enable IRS and SSA to more accurately determine Social Security self-employment taxes, the earnings to be credited to individuals' Social Security accounts, and the amount of tax revenues that SSA's trust funds should receive.

PROCEDURES FOR VERIFYING THE ACCURACY OF SELF-EMPLOYMENT EARNINGS AND TAXES COULD BE IMPROVED

IRS can improve its performance with regard to (1) detecting computational errors on SE schedules, (2) ensuring compliance for some taxpayers who are not adhering to certain restrictions for using optional tax methods for determining their self-employment earnings, (3) verifying wages on SE schedules that are claimed by self-employed taxpayers who have earned the maximum amount taxable for Social Security purposes, and (4) working with SSA to resolve discrepancies between the earnings amounts claimed on individuals' SE schedules and amounts credited to their accounts by SSA.

Schedule SE computational errors resulted in inaccurate Social Security earnings and taxes

We estimated that by improving the detection of computational errors made on SE schedules that were processed in 1980, IRS could have detected an additional \$8 million in erroneously determined Social Security taxes and helped SSA accurately credit individuals' Social Security accounts with earnings of \$98.7 million. About 83,000 SE schedules that were processed in 1980 contained computational errors that were not detected by IRS.

IRS has already taken some corrective action to improve its ability to resolve computational problems and is considering further action.

IRS did not detect math errors
in net earnings computations

Workers determine their self-employment earnings by taking the smaller of (1) net earnings--normally, the sum of earnings from farm and nonfarm self-employment or (2) the maximum earnings taxable under Social Security less any wages earned while working for someone else in Social Security covered employment.

The following table gives five examples of possible self-employment earnings calculations if the maximum amount of earnings subject to tax is \$32,400.

Computing Self-Employment Earnings

<u>Net earnings</u>			<u>Maximum earnings taxable less wages</u>			<u>Self- employment earnings</u>
<u>Farm</u>	<u>Nonfarm</u>	<u>Total</u>	<u>Maximum</u>	<u>Wages</u>	<u>Result</u>	
\$5,000	\$ 0	\$ 5,000	\$32,400	\$ 0	\$32,400	\$ 5,000
0	7,000	7,000	32,400	0	32,400	7,000
7,000	6,000	13,000	32,400	0	32,400	13,000
0	40,000	40,000	32,400	0	32,400	32,400
0	40,000	40,000	32,400	5,000	27,400	27,400

IRS' computers are programmed to use only the total net earnings and wage figures in determining self-employment earnings. The computers do not consider whether farm and nonfarm earnings actually equal the total net earnings shown. In this regard, we sampled 816,588 of 7,776,920 computerized tax returns with SE schedules that IRS processed in 1980. We found that 40,184, about 4.9 percent, had a schedule SE with a net earnings figure that did not equal farm and nonfarm earnings.³ We also found that this trend continued through 1981. In that year, our examination of 7.7 million computerized SE schedules showed that 296,040 had a net earnings figure that did not equal the sum of farm and nonfarm earnings.

³Returns with SE schedules that used an optional method for determining earnings were excluded from these counts. Workers who use an optional method are generally authorized to claim more than they actually earned. Thus, net earnings should not equal the sum of farm and nonfarm earnings.

Improper use of optional method for
computing self-employment earnings
also can result in erroneous net
earnings computations

We examined nearly 6,000 SE schedules processed in 1980 where taxpayers used an optional method for determining their net earnings. Of these, 2,300 used the optional method to claim lower earnings for Social Security tax purposes. This is generally not a valid reason for its use. Similarly, of the 169,268 SE schedules processed in 1981 that showed use of the optional method, 35,690 showed lower amounts than were actually earned.

IRS has taken partial corrective action
on erroneous net earnings computations

On December 2, 1982, we presented to IRS officials some preliminary estimates of the errors that were not detected for self-employment returns processed in 1980 and 1981. IRS officials said that they believed many of the errors were caused by taxpayer confusion over the use of (1) the SE schedule and (2) optional tax methods for determining self-employment earnings. In this regard, IRS informed us that it had found from its own study of 138 returns in 1982 that 57 percent of optional method users were not qualified to use this method. IRS estimated that, as a result, several million dollars in self-employment taxes were not being paid.

To correct these problems, IRS redesigned the SE schedule for its 1983 processing year and decided to use an error register--a computer-generated listing of returns that do not meet specified criteria--to review SE schedules for problems with optional method use.

IRS believed that it lacked sufficient time to select and examine potential problem returns processed in 1980 because it has only 3 years to initiate reviews of tax returns. However, IRS agreed to take retroactive corrective action in those instances where the optional method was improperly used on SE schedules processed in 1981 and 1982. During our review, IRS referred schedules which met its selection criteria to its service centers for corrective action.

To see whether the redesigned SE schedule reduced computational errors for returns processed in 1983, we examined 7,764,516 SE schedules that IRS provided SSA through mid-September 1983. (Through December, 1983, IRS recorded SE schedules for about 8.3 million self-employed workers.) We found that 400,791 SE schedules--about 5.2 percent--had net

earnings that seemed to be computed erroneously. We also examined the first 39,580 computerized SE schedules processed in 1983 where net earnings did not total to see whether the use of an error register was resulting in effectively detecting and correcting improper use of the optional method. We found some SE schedules where optional method problems had not been identified and others where problems were properly identified but never corrected.

After examining the data we provided, IRS realized that it did not detect some returns showing improper use of the optional method during its retroactive review and recovery operation. Therefore, it asked us to provide it with the results of our review of returns that were processed during 1981. Based on this information, IRS referred 34,000 returns to its service centers for corrective action.

IRS also improved procedures for checking the accuracy of net earnings and expanded its use of the error register to include these SE schedules where the sum of the farm and non-farm earnings was greater than total net earnings. This change, which was implemented in January 1984, will enable IRS to detect and correct most of the computational errors being made. Our examination of returns processed in 1980 showed that about 65,400 of the 83,000 computational errors fell into this category. The amount of earnings and taxes that were affected by these errors were \$71,211,000 and \$5,816,000, respectively.

IRS also said it would consider extending the computational check to instances where the sum of the component earnings was less than total net earnings after it had an opportunity to review our report. Our review showed that there were 17,600 such errors. The amount of earnings and taxes that were affected by these errors were \$27,525,000 and \$2,231,000, respectively.

Taxpayers are not adhering to certain restrictions for using an optional method of computing net self-employment earnings

Self-employed persons engaged in nonfarm work must comply with several provisions if they elect to use the nonfarm optional method for determining total net earnings. Two such provisions follow:

- The individual must have been self-employed in two of the three years immediately prior to the year the optional method is used to determine earnings.

--The optional method can, at most, be used five times in a person's life.

We examined about 46,200 SE schedules that showed use of the nonfarm optional method for the 1982 tax year and found that taxpayers are not complying with these restrictions for using the nonfarm optional tax method. We also found that IRS and SSA do not have a systematic way of checking for compliance and that the agencies are uncertain of the role that each should have.

Provision for being self-employed

Neither IRS nor SSA verifies the two-of-three previous years' requirement. To determine the compliance rate, we examined the earnings histories of 266 nonfarm workers who elected the optional method for 1979.⁴ SSA's earnings records showed 38.3 percent of those workers did not meet the requirement. Because the optional method allows individuals to claim more than they actually earned, these individuals overpaid their Social Security taxes by about \$11,900, thereby gaining 278 quarters of Social Security coverage and about \$147,000 in earnings.

Similarly, we checked the compliance rate for the 46,200 SE schedules showing use of the nonfarm optional method for the 1982 tax year and found that 44.3 percent of those workers did not meet the requirement.

Provision that limits lifetime use

In checking for compliance with the provision that restricts usage to five times in a person's life, we were limited in the amount of work we could do. The provision had been instituted in 1973 and the returns we examined were for the 1979 tax year. We noted from SSA records that there were 104 violations of this provision between September 1982 and February 1983. However, because we believed that the effects of noncompliance could not be completely assessed until more time has elapsed, we examined the established process for overseeing compliance by interviewing officials at both agencies.

IRS officials said they do not check for compliance with this provision because they do not have the means to detect violations using the existing returns processing system. However, SSA has established a detection and notification process. Specifically, upon discovering instances of the lifetime provision being violated, SSA officials send IRS the names and Social

⁴The workers we examined represent a subsample of those 3,700 workers who seemed to have validly used the optional method by claiming higher earnings than they had (see p. 6).

Security numbers of the violators. The information that SSA sends to IRS, however, is not complete because it does not specify the years that a taxpayer used the optional tax method. IRS needs this information to adequately deal with questions involving noncompliance.

SSA officials said that until IRS tells them otherwise, such individuals receive credit for their earnings even though they are in apparent violation of the lifetime provision. When asked to whom the data on violators was sent, SSA could only provide the IRS address and room number. IRS officials checked the location, but found no records.

IRS and SSA do not agree on
who should enforce provisions

Both IRS and SSA officials said that they believed the job of checking compliance with the optional method restrictions was not their primary concern. SSA officials believed the restrictions were tax provisions and, therefore, SSA should not be checking compliance. Although IRS officials recognized that the two restrictions were tax provisions, they believed the optional provision was intended to help the self-employed maintain their Social Security coverage, something that was not really IRS' responsibility. IRS officials also said that, since SSA already maintains individuals' self-employment earnings histories, SSA was in a better position to check if individuals met the restrictions. IRS officials added that those not meeting the restrictions could be notified and advised to file an amended tax return to claim the Social Security tax overpayment.

Erroneously claimed wages on
SE schedules resulted in
self-employment errors

SSA receives earnings information from employers and IRS. Employers report wages earned by their employees, and IRS reports self-employment earnings.

Wages that a self-employed person earns from Social Security-covered employment are counted first in determining the amount of self-employment tax that an individual is required to pay. Because wages affect taxable self-employment earnings if more than the maximum amount subject to taxation is earned, wages are required to be shown on the SE schedule. Examples showing how wages affect self-employment earnings follow. As in the table on page 5, the maximum amount of taxable earnings is assumed to be \$32,400.

Covered Wage Effect on Self-Employment Earnings

<u>Worker</u>	<u>Maximum earnings taxable less wages</u>			<u>Total net self-employment earnings</u>	<u>Taxable self- employment earnings</u>
	<u>Maximum</u>	<u>Wages</u>	<u>Result</u>		
1	\$32,400	\$35,000	\$ 0	\$10,000	\$ 0
2	32,400	30,000	2,400	10,000	2,400
3	32,400	25,000	7,400	10,000	7,400
4	32,400	20,000	12,400	10,000	10,000
5	32,400	15,000	17,400	10,000	10,000

During returns processing, IRS does not routinely verify wage amounts shown on SE schedules. By comparing earnings shown on a sample of 43,686 SE schedules processed during 1980 with maximum taxable earnings that included wages to amounts recorded in individuals' Social Security accounts, we found 6,087 instances where the amounts shown in the individuals' accounts were less than what had been recorded on the SE schedules. These differences resulted from (1) wages being overstated on the SE schedules--employers reported actual wages which were lower than what the individuals claimed on their tax returns or (2) self-employment earnings or wages were not properly credited to individuals' Social Security accounts.

Based on our sample of returns processed in 1980, we estimated that 26,800 tax returns had erroneous wage amounts on the accompanying SE schedule. The wage errors resulted in a net understatement of self-employment earnings of \$37.8 million and a net underpayment of Social Security taxes of \$3.1 million.

There were two primary reasons wages were overreported. First, self-employed taxpayers erroneously included their spouse's wages when calculating their self-employment earnings. Second, taxpayers selected the wrong earnings item shown on the W-2 form. The W-2 form showed total earnings and "FICA" (Federal Insurance Contribution Act) earnings, which are wages subject to Social Security taxation. FICA earnings can be lower than total earnings because earnings are not always subject to Social Security taxation. IRS recently recognized that taxpayers were confused by the term "FICA" earnings on wage statements, and it changed the term on wage statements for 1983 to "Social Security" earnings.

By overstating wages, self-employed workers who have earned the maximum amount of taxable earnings understate their self-employment earnings and taxes. These individuals will not receive the amount of Social Security credit to which they are

entitled. The following examples illustrate the effects of overstating wages, as well as some of the circumstances under which this situation could occur.

--Self-employed worker included spouse's wages:

Bill had self-employment earnings of \$20,618 and wages of \$4,962. On his SE schedule, Bill correctly reported his self-employment earnings, but erroneously reported his wages as being \$17,541. Bill incorrectly included his wife's wages of \$12,579 with his own. Instead of paying 1979 Social Security self-employment taxes on \$17,938 (\$22,900, which was the maximum taxable earnings for 1979, minus his wages of \$4,962), Bill paid taxes on \$5,359 (\$22,900 minus his incorrectly reported wages of \$17,541). As a result, Bill underpaid his Social Security taxes by \$1,019 and did not receive Social Security credit for \$12,579 of his self-employment earnings.

--Self-employed worker used wrong W-2 earnings:

Mary had self-employment earnings of \$48,790. She also had total wages of \$7,567, but only \$500 was earned in employment covered by Social Security. On her SE schedule, Mary correctly reported her self-employment earnings, but erroneously reported all wages of \$7,567. Instead of paying 1979 Social Security self-employment taxes on \$22,400 (\$22,900 minus \$500), Mary paid taxes on \$15,333 (\$22,900 minus \$7,567). As a result, Mary underpaid her Social Security taxes by \$572 and did not receive Social Security credit for \$7,067 of her self-employment earnings.

If IRS examined SE schedules with wages and maximum earnings during returns processing by using an error register, we estimate that it would have had to check about 387,500 tax returns to find the 26,800 returns which had listed wages erroneously and had a tax error. IRS could also have identified such persons after returns processing by using a method similar to the one we used. IRS could ask SSA to check the Social Security accounts of those individuals whose SE schedules showed both wages and maximum earnings and identify those where SE schedule earnings were not fully credited to Social Security accounts. We estimated that SSA would have identified about 54,800 individuals' accounts that would have required resolution by both agencies for 1979. Our estimates for both options were based on the computerized SE schedules that IRS recorded on its data base.

Neither approach will be fully successful unless IRS begins to record SE schedules where wages alone equal or exceed maximum taxable earnings and verify the wage amounts that are claimed. Under present procedures, if a self-employed person earned the maximum taxable amount of \$32,400 or more in wages in 1982, IRS would not enter any SE schedule information on its data base under the assumption that the individual had no reportable or taxable self-employment earnings. It would also not verify the wage amount that was claimed on the SE schedule or forward SE information to SSA. Unless such procedures are changed, IRS would not have any assurance that the taxpayer properly determined that there were no reportable and taxable self-employment earnings.

SSA and IRS could do more to identify individuals who did not receive proper credit for their earnings

The self-employment data that IRS routinely provides SSA contain the wage amounts listed on the SE schedule. These wages represent amounts that individuals claimed to have earned in Social Security covered employment. SSA does not use the wage data reported on the SE schedule. It uses employers' reports to credit individuals' wages.

Using the wage data provided by IRS for those individuals who earned the maximum amount of taxable earnings, but did not have the maximum amount credited to their Social Security accounts, would provide SSA with information it could use to correctly credit earnings to individuals' accounts. If SSA had used the data provided by IRS for the 1979 tax year and reconciled the differences that existed between it and SSA's accounts, it could have correctly credited individuals' accounts with an estimated \$147.8 million in earnings, as shown in the following table.

<u>Effect on individuals' Social Security accounts</u>	<u>Instances of unresolved earnings^a</u>	<u>Estimated earnings (millions)</u>
Wages not credited	9,200	\$108.8
Self-employment earnings not credited	4,100	35.7
Wages undercredited	1,800	1.3
Wages overcredited	800	2.0
Total	<u>15,900</u>	<u>\$147.8</u>

^aThe number of individuals closely approximates 15,900 but is not exact because in a few cases more than one instance pertained to the same person.

The following examples show some situations where individuals' earnings accounts were not fully credited for 1979. We identified these cases in 1983 and worked with SSA to examine them.

--Employer did not report wages to SSA:

Tom earned wages of \$19,500 in employment covered by Social Security, as shown on his wage statement and SE schedule filed with his tax return. He also had self-employment earnings of \$3,400. Tom's Social Security records showed that he did not receive credit for his wages but did receive credit for his self-employment earnings. Working with the employer's name and identification number from Tom's tax return, SSA found that it had no record of Tom's employer submitting any employee wage statements for 1979.

--SSA did not process wages:

George earned wages of \$20,640 in employment covered by Social Security, as shown on his wage statement and SE schedules filed with his tax return. He also had self-employment earnings of \$2,260. SSA found that it had no record of George's wages but did credit the self-employment earnings to his account. When SSA checked the employer's report accompanying George's tax return, it found that George's wages had been properly reported to SSA by his employer. This indicated to SSA that it had received the report of George's wages but had not properly processed it.

--Incomplete information provided by employer:

John earned wages totaling \$1,505 in employment covered by Social Security. He worked for two employers, earning \$650 from one and \$855 from the other. He also had self-employment earnings of \$21,395. John's self-employment earnings and wages of \$650 were credited to his account but his wages of \$855 were not. John's employer reported the wages of \$855 to SSA but did not include John's Social Security number. Without it, SSA was unable to credit the wages and placed the data in its suspense file. Using the employer's data from the wage statement submitted with John's tax return, SSA checked its wage suspense file and found the unresolved wage item.

--Wage data entered in error:

Peter earned wages of \$15,500 in employment covered by Social Security, and also had self-employment earnings of \$7,400. SSA credited the self-employment earnings but not the wages. SSA was unable to credit Peter's account because the name that SSA entered as Peter's did not correspond to the name for whom the Social Security number was issued. SSA placed the wage data in its suspense file.

Using the employer wage statement identification submitted with Peter's tax return, SSA researched the problem of why it was unable to credit the individual's account. SSA found that Peter's name was incorrectly entered during its initial processing of the employer's wage report.

--Multiple posting problems can also be resolved:

George was married and filed a joint return with his wife Mary. George had self-employment earnings of \$19,398 and wages of \$623. His wife had wages of \$3,585. In completing his schedule SE, George erroneously included his wife's wages with his own and, thereby, underpaid his self-employment taxes by \$57.

George's Social Security earnings record showed that the \$623 wage item was credited twice. (The \$3,585 was not entered in George's account since this amount was his wife's wages.)

SSA examined the employer's report and found that the employer submitted duplicate wage reports for all its employees in 1979. SSA processed both reports. This resulted in excessive postings for 2,186 employees with earnings totaling \$2.6 million. During its review SSA noticed it had credited the employees' wages three times for 1978. This resulted in excessive postings for 2,219 employees with earnings totaling \$4.6 million.

Crediting problems similar to those found for wages were also found for self-employment earnings as shown in the following examples.

--IRS provided SSA with inaccurate names:

Joe earned wages of \$8,225 and had self-employment earnings of \$14,675. IRS processed his SE schedule but provided SSA his name incorrectly. As a result, SSA was unable to credit Joe's self-employment earnings to his account and placed his record in its self-employment suspense file.

We examined the SE schedule Joe submitted with his tax return and found that Joe's name had been erroneously entered in the data IRS provided SSA. As listed on the taxpayer's SE schedule, Joe's name did correspond with the name listed in SSA's records.

--SSA did not process some 1979 earnings records:

Linda earned wages of \$780 and had self-employment earnings of \$22,120 for 1979. IRS processed the SE schedule, but SSA did not. As a result, Linda did not receive credit for her self-employment earnings.

To determine why SSA did not process Linda's self-employment earnings, we worked with IRS to identify when it had processed the SE schedule. We checked other self-employed returns IRS processed at the same time as Linda's and found that SSA had not processed them either. SSA did not have the record controls necessary to indicate that some schedules were not processed. In total, about 65,900 tax returns with self-employment earnings totaling about \$237.5 million were not processed.

--IRS provided SSA with inaccurate account numbers:

John and Mary filed a joint return for 1979. Mary earned wages of \$17,049, and also had reportable self-employment earnings of \$5,851. Mary's schedule SE showed her name, but incorrectly listed John's Social Security number instead of her own. IRS processed the SE schedule and provided SSA with the incorrect number. SSA erroneously credited John's account for Mary's self-employment earnings of \$5,851. Thus, John received too much earnings credit and Mary received no credit for her self-employment earnings.

Investigating and solving one worker's problem also provides SSA with the potential for solving problems for other workers who are similarly affected. As shown on page 14, for example, examining an employer's report to see whether one wage item for \$623 was overcredited resulted in SSA finding \$7.2 million in excessive wage postings for 2 years for about 2,200 employees. Also, in a September 1982 hearing before the House Subcommittee on Social Security, Committee on Ways and Means, SSA said that it did not post 1978 wages for 575,000 Air Force employees, and identified two additional instances involving about 30,000 employees where it did not post 1979 wages. These omissions were discovered through chance inquiries made by individual employees.

SSA does not have to depend on chance inquiries to discover and resolve unposted or erroneously posted earnings. By utilizing the IRS data and its own earnings records, SSA can systematically identify situations where employees are not receiving the proper credit for all the earnings to which they are entitled.

Conclusions

For most self-employed workers, IRS verifies the correctness of Social Security taxes on reported earnings and forwards information to SSA that can be used to properly credit the accounts of self-employed individuals. However, we found there were some instances where IRS did not detect earnings and tax errors that were made and provided SSA with self-employment earnings data that were incorrect.

IRS has already taken some steps to improve its processing of SE schedules. In 1984, it began to use an error register to check for certain types of incorrectly computed earnings. For example, IRS took action to investigate those situations where the sum of farm and nonfarm earnings was greater than the earnings amount shown on the SE schedule. IRS also took some retroactive action to correct returns that had improperly used an optional method for determining earnings.

To further improve the processing of self-employment earnings data, IRS should (1) use the error register to identify those situations where the sum of farm and nonfarm earnings is less than the total earnings amount shown on the SE schedule and (2) verify wages listed on schedule SE by those self-employed taxpayers with maximum taxable earnings.

We also believe that actions can be taken jointly with SSA to verify the accuracy of self-employment earnings. SSA could use the wage data on SE schedules in conjunction with the reports it receives from employers to help ensure that earnings

are properly credited to taxpayers' accounts and seek IRS' help in resolving identification and earnings problems that are preventing it from properly crediting individual Social Security accounts. Also, by jointly working to improve the processing of returns from self-employed taxpayers, SSA and IRS could also resolve other problems, such as whether self-employed persons who used the nonfarm optional method of computing net earnings have complied with certain restrictions on its use.

Recommendations

We recommend that the Commissioner of Internal Revenue:

- Expand use of the error register to include those situations where the sum of farm and non-farm earnings is less than the total earnings amount being recorded, and correct any identified earnings and tax errors.
- Identify, review, and correct those SE schedules processed in 1983 with math problems-- similar to action taken for 1981 processed SE schedules.
- Modify existing returns processing procedures to (1) record SE schedules whose wages alone equal maximum taxable earnings and (2) verify wages on schedule SE for workers with maximum taxable earnings.

We recommend that the Commissioner of Internal Revenue and the Commissioner of Social Security work together to:

- Identify those self-employed individuals who did not receive proper credit for their earnings and correct their accounts. Specifically, SSA should identify for IRS, using SE schedules with maximum reportable earnings, those individuals whose earnings were not properly credited. IRS should help SSA identify specific individuals and their earnings. SSA should then correct the problem for those individuals, as well as any others similarly affected.
- Develop a systematic way of identifying and correcting tax and earnings overpayments for self-employed persons who erroneously elected the nonfarm optional method of determining their earnings either because they (1) were not

self-employed in two of the three previous years or (2) exceeded the five-year usage limit.

Agency comments and our evaluation

The Commissioners of Internal Revenue and Social Security commented on a draft of this report by letters dated January 22, 1985, and January 17, 1985, respectively. (See app. II and III.) The Commissioner of Internal Revenue stated that IRS was aware of the ongoing need to continually monitor and improve self-employment data recordation and agreed with the general thrust of our recommendations. The Commissioner of Social Security also expressed general agreement with the findings and recommendations in this report.

In our draft report, we proposed that IRS identify, review, and correct those SE schedules processed in 1982 and 1983 that had math problems. In commenting on that proposal, IRS stated that it would perform a recovery operation for the schedules processed in 1983, but that its workload, limited resources, and the 3-year statute of limitations precluded additional work on schedules that were processed in 1982. In view of IRS' comments, we have excluded returns processed in 1982 from our recommendation.

The Commissioner of Internal Revenue agreed with our recommendation to expand use of the error register and stated that IRS' target date for implementing this recommendation is January 1986. IRS also agreed with our recommendation to modify existing returns processing procedures to record and verify wages on SE schedules for workers with maximum taxable earnings. IRS stated that effective January 1, 1986, it would verify all SE schedules claiming maximum taxable earnings against wage information shown on the taxpayer's W-2. IRS did not offer any specific comments on the recording of such data--a procedure which would be beneficial to SSA. If this information were recorded, SSA would be able to verify employers' wage reports on individuals with maximum taxable earnings. Verification would help SSA identify situations where employers reported an employee's Social Security number incorrectly. It would also help SSA identify errors that it made in crediting earnings to individuals' accounts.

Both agencies agreed to meet and discuss our recommendations to the Commissioners of Internal Revenue and Social Security to work together to (1) identify and correct the accounts of self-employed individuals who claimed maximum earnings on their SE schedules but who did not receive proper credit for their earnings and (2) systematically enforce certain self-employment optional method restrictions.

MORE COULD BE DONE TO ENSURE
THAT SELF-EMPLOYMENT EARNINGS ARE
ACCURATELY BEING RECORDED IN
INDIVIDUALS' SOCIAL SECURITY ACCOUNTS

IRS could help SSA credit the correct Social Security accounts by making sure that whenever it corrects a Social Security number on a tax return, the corrected number is also provided to SSA. We estimated that, in 1980, IRS furnished an incorrect number to SSA--when the correct number was available--for about 64,600 individuals. As a result, SSA was either not able to credit or incorrectly credited about \$138.4 million of self-employment earnings.

SSA and IRS have taken a fragmented approach to ensuring that all self-employed persons receive credit for their self-employment earnings. Because some 1980 records were not processed, about \$258 million in earnings were not credited to individuals' Social Security accounts. Further, SSA did not receive about \$20.8 million in Social Security self-employment taxes on these earnings.

Many of the computational and Social Security number discrepancies that resulted in individuals not receiving proper credit for their earnings would have been apparent if SSA examined the SE schedules that IRS provided.

IRS provided SSA with some
inaccurate Social Security numbers

Both IRS and SSA recognize the importance of correct Social Security numbers. IRS places its emphasis on making sure the Social Security number on the form 1040 is correct, and SSA relies on the number listed on the SE schedule. A problem arises if the two numbers are different.

When a self-employed taxpayer's return reaches 1 of IRS' 10 service centers, the Social Security number on the form 1040 is checked against the Social Security number on the schedule SE. The return information is not sent to IRS' National Computer Center in Martinsburg, West Virginia, until the two numbers can be matched.

In Martinsburg, IRS checks the Social Security number on the form 1040 against an SSA file containing all issued Social Security numbers. If the number and name on the form 1040 correspond to the number and name in the issuance file, IRS forwards all relevant information to SSA. If the 1040 number does not correspond, the return is sent back to the service center with instructions that the discrepancy be corrected. The

service center researches available tax return documentation to determine the correct number and sends the corrected number and any other relevant data back to Martinsburg.

We found that when the service center corrected the number reported on a tax return, it did not correct the number reported on the schedule SE. Thus, after the corrected number has been checked against the issuance file number, IRS forwards a schedule SE to SSA that has not been updated. Our sample of 816,588 computerized returns for the 1979 tax year contained 7,174 instances of the 1040 number differing from the SE number. After examining them, we projected that IRS provided SSA with 64,600 inaccurate Social Security numbers. Of these, we estimated that SSA

- correctly identified (using its own procedures) 37,400 individuals and properly credited their Social Security accounts;

- was unable to identify 10,600 individuals, placed their records in its suspense file, and did not credit their Social Security accounts for self-employment earnings totaling \$62.1 million; and

- incorrectly identified 16,600 individuals and improperly credited the wrong individuals' accounts with self-employment earnings totaling \$76.3 million.⁵

In discussing this matter with IRS officials, we were informed that the inaccurate number problem could no longer occur because of specific controls that had been instituted subsequent to the 1979 tax year. To check the adequacy of the action taken by IRS, we compared SE and 1040 Social Security numbers for about 7.8 million computerized SE schedules that had been processed during 1983. We found 65,250 instances of differing numbers and presented this information to IRS so that it could begin to address this problem.

⁵Some of the individuals that SSA either was unable to identify or incorrectly identified used the same incorrect Social Security number in other years. We estimate that SSA could correct errors amounting to an additional \$1.9 million from other years where an individual's earnings were erroneously credited to another person's account. Further, we estimate that SSA could credit \$19.4 million of unresolved earnings from other years for individuals who had not received credit.

After IRS investigated, it made further corrections that became effective in January 1984. IRS' action should result in SSA receiving the most accurate Social Security number that IRS can provide.

IRS and SSA need to ensure that all self-employment records are processed

The agencies' present methods for processing self-employment records do not ensure that all self-employed persons who have reportable earnings receive credit for them. We estimate that for returns processed in 1980, IRS did not provide SSA with information on about 2,600 tax returns with earnings totaling \$20.5 million and SSA never processed an estimated 65,900 tax returns with earnings totaling about \$237.5 million. Additionally, since SSA's trust funds are credited for self-employment taxes based on self-employment earnings that SSA records, not recording these earnings resulted in SSA not receiving an estimated \$20.8 million in Social Security taxes.

IRS did not provide SSA with all SE schedules

Under IRS' returns processing procedures, employees are instructed to record only those SE schedules that have reportable and taxable earnings. To implement this procedure, IRS screens out, prior to computer entry, SE schedules with insufficient net earnings (less than \$400) and those who do not have to pay self-employment taxes because their wages alone equaled maximum reportable earnings. SE schedules that are to be sent to SSA are annotated for further processing.

We sampled 818,380 self-employment tax returns processed in 1980 and found 4,587 SE schedules were not annotated. We then analyzed them to determine whether they contained reportable self-employment earnings. Based on the results of our analysis, we estimate that IRS should have provided SSA with the SE schedules from about 2,600 additional returns. These self-employed individuals did not receive credit in their Social Security accounts for an estimated \$20.5 million, and SSA's trust funds did not receive self-employment taxes of \$1.6 million.

Working with IRS, we found that the problem was partially caused by either (1) the taxpayer making an error on his SE schedule that was not detected by IRS or (2) IRS--in correcting one error--inadvertently introducing another. In January 1984, IRS officials implemented a math check to correct this situation.

We also found the following:

--Some returns had a self-employment tax error which required manual IRS intervention to correct. In correcting the error, IRS personnel used a procedure to instruct the computer that an examiner looked at the tax problem and that it should use the amount the examiner decided was correct. In so doing, the computer ignored self-employment earnings amounts.

--Problems existed with regard to aliens who were United States residents for the first part of the tax year, and nonresidents for the second part of the same tax year. Aliens are required to pay Social Security self-employment tax only for the periods when they are residents. The tax processing system is organized to record one tax return a year; year-end status governs. So, while the tax shown was correctly paid and recorded on the earnings when the aliens were residents, IRS did not give the record to SSA because its computers did not search tax returns of such aliens for Social Security taxes and earnings.

IRS data services and returns processing officials changed the computer programs to correct these two problems. Effective January 1984, returns processing controls were implemented to ensure that (1) whenever taxes are recorded, self-employment earnings must also be recorded and (2) resident aliens who become nonresidents in the same tax year will get credit for their self-employment earnings while residents.

IRS data services officials told us the flaws in the returns process which prevented self-employment records from being given to SSA existed for several years before being discovered. At our request, IRS data services officials agreed to save computerized SE schedules processed in 1980 to help SSA recover records never received. No computerized records are available on returns processed before that date.

SSA did not process
all SE schedules

SSA tracks the number of self-employment records that it receives from IRS by counting the number of individuals on each week's processing tapes--measured after the computer tapes are received and "logged in" at SSA's tape library--and reconciling

that figure to an IRS-provided control figure. IRS' figure represents the number of self-employment records that IRS placed on the weekly tape. SSA does not check with IRS to make sure all of the records are sent.

In evaluating SSA's control over the receipt of computerized records, we found that 1 week's cycle of IRS records--the tenth week of 1980--was not processed. Based on a sample of 6,994 tax returns that IRS processed during the tenth week of 1980, we estimated that SSA did not process about 65,900 tax returns. As a result, about \$237.5 million was not credited to self-employed individuals' Social Security accounts, and SSA's trust funds did not receive self-employment taxes of \$19.2 million.

We were not able to determine if IRS actually sent SSA the missing records, nor could we determine whether SSA received the missing records and lost them. Records showing signed receipts of computer tapes for 1980 were no longer maintained by IRS; SSA still had all IRS tape receipts from the 1980 processing year--except for the missing cycle.

SSA has had problems with receiving and controlling magnetic tapes. The Inspector General, Department of Health and Human Services, pointed out in a July 30, 1982, report to the Commissioner of Social Security the following problem with wage reporting:

"SSA was not prepared to fully accept, manage, and control the approximately 5,000 reels of magnetic tape received for 1978, the initial annual reporting period. The following conditions existed then, and continue to exist today: First, SSA's tape library receipt system did not account for the number of tape reels received, or for the number of individual separate, and distinct employers who submitted employee wage information on magnetic tape. Further there was no effective control over multiple reels of tape, when each reel represented a self-contained file (complete in itself) and not part of the large multi-reel file.

Thus, SSA can not accurately determine (i) what employer tapes had been received, (ii) whether employers authorized to submit tapes actually did so, or (iii) whether tapes that were received actually entered the data processing system. Further, data from SSA's tape control system makes

it appear that some tapes had not been received, when in fact they have been received and processed."

We previously reported (B-202537), on July 13, 1982, to the Secretary of Health and Human Services that "We have found internal control weaknesses in the design of the system which impact the reliability of earnings records and could contribute to fraud and abuse." We pointed out the need to strengthen controls in several areas. One such area was "assuring reconciliation of all differences between the Internal Revenue Service data and Social Security Administration data."

SSA should periodically check
the accuracy of the self-employment data

In January 1969, when IRS began providing SSA self-employment earnings information by magnetic tape, a formal agreement between the agencies provided for "continuing verification of taped earnings information." Specifically, the original agreement provided that

"The Administration and the Internal Revenue Service shall initiate and implement system checks, quality control programs, and validity tests necessary to insure the accuracy of products within each operation, and such checks and tests shall be carried on so that problem areas shall be readily identified and corrected on a current basis."

We found that SSA is accepting and processing self-employment earnings data received from IRS without checking its accuracy. Using a computer, we checked 7,764,516 SE schedules IRS provided SSA from January through mid-September 1983. We found 400,791 instances where net earnings seemed to be computed incorrectly--about 5 of every 100 SE schedules. We also found 19,623 instances of Social Security number discrepancies and other data inaccuracies, such as the use of erroneous coding to designate whether a person used the optional method of computing net earnings. The computational, Social Security number, and processing problems we identified during our review indicate the need for SSA to oversee the accuracy of IRS-provided self-employment data.

SSA relies on workers to inquire about their earnings records, thereby helping to identify and resolve errors. However, workers do not routinely make such inquiries. On the

contrary, self-employed individuals rely upon SSA, and to some extent IRS, to correctly credit their reported self-employment earnings to their Social Security accounts.

We checked about 7,100 Social Security accounts from the SE schedules SSA never processed and from those IRS had not provided for 1979. As of May 1983, none of these accounts had been changed to include the self-employment earnings. Thus, these self-employed workers--at least after a period of about 3 1/2 years--did not know their earnings were not recorded. Also, if workers do discover earnings errors, the earnings data generally are not current. This helps to explain why it takes an average of about 430 days to resolve an earnings discrepancy case. Working with IRS when data is relatively current would make it easier to locate and resolve earnings discrepancies that might occur.

In a September 23, 1982, hearing before the House Subcommittee on Social Security, which covered the progress SSA was making in posting annual wage reports, the Commissioner of Social Security recognized the size of the earnings crediting problem but did not offer individuals' much hope that unresolved earnings would be credited. The Commissioner said:

"It is true that we are continuing to accumulate reports of earnings which we cannot post to persons' accounts at the present time. We have over \$88 billion in earnings which are not posted to people's accounts. We have a project designed to reduce that amount and to get those earnings posted to accounts, but the fact of the matter is that too often the only way a person can be sure his earnings have been posted accurately is for that individual to check once every 3 years ..."

On three occasions after the hearings, we briefed SSA on its self-employment earnings problems. In December 1982, we told SSA about the math and Social Security number problems so that SSA could contact IRS before IRS erased the self-employment identifying and earnings data, as it normally does after the established record retention period expires. At that time, SSA officials said that the problems discussed were IRS', not SSA's. In August 1983, we told SSA officials that SSA never processed an estimated 65,900 tax returns with earnings totaling about \$237.5 million. We suggested that SSA contact IRS to assure itself that such data would be available before IRS routinely destroyed it; however, SSA did not take any action. Also, in February 1984, we briefed SSA officials on the results of this review. SSA officials said that they planned to wait until they received our draft report before committing SSA to any corrective action.

Conclusions

For most self-employed workers, SSA records the correct self-employment earnings in the proper account, and SSA's trust funds receive the correct amount of Social Security self-employment tax money from IRS. However, we found some problems with IRS' processing of SE schedules and with SSA's efforts to credit earnings to individual Social Security accounts.

With regard to processing SE schedules, there were some instances where IRS did not provide all self-employment earnings records to SSA. There were also instances where IRS provided SSA with self-employment earnings and identification data that contained discrepancies in Social Security numbers. IRS corrected the latter problem in January 1984.

SSA needs to periodically check the accuracy of the data provided by IRS so that any discrepancies can be called to IRS' attention and expeditiously resolved. Also, IRS and SSA should establish better control over SE schedules. In the past, SSA was not aware that it had not processed some SE schedules and IRS did not realize that it had not provided SSA with others. Because earnings were not recorded for these taxpayers, SSA's trust funds did not receive the proper amount of Social Security self-employment taxes.

Recommendations

We recommend that the Commissioner of Internal Revenue:

- Identify and provide SSA, starting with the 1980 processing year, with self-employment records showing different Social Security numbers for the same person or self-employment earnings that were not previously provided.

We recommend that the Commissioner of Social Security:

- Use the self-employed persons' records with different Social Security numbers obtained from IRS to correct earnings accounts credited erroneously and those not previously credited.
- Credit the Social Security accounts of those self-employed individuals whose records were never processed and ensure that the trust funds are provided the correct tax amount from their earnings.

--Periodically conduct tests of the accuracy of self-employment earnings and identification data and work with IRS to resolve any problems that are identified.

Also, we recommend that the Commissioner of Internal Revenue and the Commissioner of Social Security work together to:

--Establish overall control of the number of self-employment records received for processing so that differences between the number processed by IRS and SSA can be reconciled. IRS should provide SSA overall control totals of all SE schedules processed; SSA should then account for all records received and processed.

Agency comments and our evaluation

IRS responded to our recommendation to provide SSA with the self-employment records of individuals with differing Social Security numbers and unrecorded self-employment earnings by stating that it would review the problem during meetings with SSA, identify what records are required and available, and determine the feasibility of a correction project.

IRS maintains individuals' income tax returns on yearly transaction tapes. In anticipation of SSA's need for the information contained on these tapes, we requested, and IRS agreed, to retain the transaction tapes for returns processed in 1980 and 1981 beyond IRS' normal 3-year retention period. Thus, the self-employment records needed by SSA are still available. Regarding IRS' comment as to the feasibility of identifying these records, we recognize that IRS must sort through a large number of magnetic tapes and that it may be difficult to find the computer time to accomplish this task. However, we see no other practical alternative if self-employed persons are to receive proper credit for their earnings.

To optimize the use of the information to be developed by IRS, we recommended that SSA use it to correct individuals' accounts that were either credited erroneously or not previously credited. We also recommended that SSA credit the Social Security accounts of those self-employed individuals whose records were never processed, ensure that SSA's trust funds receive the correct tax amount from these earnings, and periodically conduct tests of the accuracy of self-employment earnings and identification data provided by IRS. Although SSA generally agreed with all of these recommendations, it provided no specific comments on implementing them.

Our report also contains a recommendation that IRS and SSA work together to establish overall control of the number of self-employment records received for processing so that differences between the number processed by IRS and SSA can be reconciled. Although both agencies expressed the belief that their present procedures for controlling magnetic tapes are adequate, we believe the matter still needs management attention.

SSA acknowledged that there were some problems with control and timely processing of the SE tapes in 1979, 1980, and 1981 but stated that these problems have been corrected. SSA stated, however, that it sometimes has a problem obtaining missing information from IRS because IRS only retains information for 28 days. SSA stated it would work with IRS to extend the retention period to 60 days so that readable, complete data can be obtained.

After receipt of SSA's comments, we discussed SSA's tape processing procedures with an SSA systems official. According to that official, the main difference between SSA's self-employment tape processing procedures then and now is that a specific individual receives the tapes and records their receipt before the tapes are sent to the tape library. This individual also initiates any follow-up with IRS if something is missing or unreadable. We noted, however, that these current practices are not written. We believe that these procedures, as well as any additional ones that IRS and SSA agree upon, should be formally written to help ensure that they will be consistently implemented.

SSA's comments related only to controlling the tapes that were submitted to SSA by IRS. During our review, we found that controls were also needed over the SE schedules that are recorded by IRS but never placed on the magnetic tapes. As noted on page 21 of our report, from a sample of 818,380 self-employed tax returns processed in 1980, we estimated that a universe of 2,600 tax returns with earnings totaling \$20.5 million should have been placed on the tapes, but were not. In its comments, IRS stated that it will initiate computer programming changes that will enable SSA to account for all SE schedules processed by IRS. Although the changes were not specifically identified, we were informed that IRS will review SE schedules it recorded but did not provide to SSA to make sure that the decision not to provide these schedules was proper. Use of this review procedure should help to resolve the problem of incomplete records being provided to SSA.

SAMPLING METHODOLOGY AND RESULTS

IRS maintains the individual income tax returns it has processed in nine segments. These segments are organized in ascending Social Security number sequence of the primary taxpayer. During our review, we selected one segment processed during 1980. IRS officials told us the returns we selected were representative of tax returns processing for all self-employed filers. From the selected segment, we identified all individuals who filed SE schedules--902,344 SE schedules filed with 874,278 tax returns.

We linked the segment of SE schedules we sampled at IRS to the corresponding individuals' Social Security earnings accounts. However, we limited the linking, because of the size of SSA's earnings files, to Social Security numbers from 113-xx-xxxx to 222-xx-xxxx. This resulted in deleting 32,863 tax returns from the selected segment--about 3.8 percent of the sampled returns. From the remaining returns in the segment, consisting of 816,588 returns filed for calendar year 1979 and 24,827 returns filed for other periods, we made estimates for the universe of income tax returns processed during 1980. This universe was 8,129,967 SE schedules filed with 7,776,920 tax returns.

We used these linked records to estimate schedule SE (1) computational errors, (2) erroneously listed wages and earnings not properly credited to individuals' Social Security accounts, (3) inaccurate Social Security numbers, and (4) earnings data either not provided by IRS or not processed by SSA into individuals' Social Security accounts. Details of the samples and results for each of these areas follow.

Schedule SE computational errors resulted in inaccurate Social Security earnings and taxes

From the segment we selected--843,967 SE schedules filed with 816,588 returns for calendar year 1979--we examined whether the sum of farm and nonfarm earnings equaled the schedule SE amount shown for net self-employment earnings. For those that did not equal, we estimated those with no errors and those with potential errors. We then estimated the actual number of errors, and the related amount of earnings and Social Security self-employment taxes for SE schedules that IRS provided SSA, and for those not provided. Estimates for these categories follow.

Category	Estimate	Confidence interval ¹	
A. Number of SE schedules whose net earnings did not equal the sum of farm and nonfarm earnings	420,056	416,563 to	423,577
a. Number of SE schedules whose net earnings did not total that had no actual earnings/tax error	102,504	100,756 to	104,284
Number of SE schedules whose farm and nonfarm earnings were:			
—greater than net earnings	63,699	62,321 to	65,108
—less than net earnings	38,805	37,731 to	39,910
b. Number of SE schedules whose net earnings did not total that had possible errors	317,551	314,492 to	320,639
1. Number of SE schedules that IRS provided SSA whose farm and nonfarm earnings were:			
—greater than net earnings	103,541	101,783 to	105,328
(1) With actual errors:			
a. Understated earnings underpaid taxes			
Taxpayers	62,149	59,807 to	64,491
Earnings	\$60,386,830	\$52,368,856 to	\$68,404,804
Taxes	\$ 4,937,840	\$ 4,281,719 to	\$ 5,593,961
b. Overstated earnings overpaid taxes			
Taxpayers	1,266	443 to	2,089
Earnings	\$ 1,016,501	\$ 7,601 ² to	\$ 2,245,575
Taxes	\$ 83,573	\$ 624 ² to	\$ 183,308
c. Combined errors—over and under			
Taxpayers	63,415	60,995 to	65,835
Earnings	\$61,403,340	\$53,309,207 to	\$69,497,473
Taxes	\$ 5,021,413	\$ 4,360,035 to	\$ 5,682,791
—less than net earnings	208,235	205,743 to	210,756
(1) With actual errors:			
a. Understated earnings/underpaid taxes			
Taxpayers	10,807	5,333 to	16,281
Earnings	\$16,421,530	\$ 9,348,633 to	\$23,494,427
Taxes	\$ 1,330,636	\$ 758,198 to	\$ 1,903,074

Category	Estimate	Confidence interval ¹	
b. Overstated earnings/ overpaid taxes			
Taxpayers	6,764	2,914	to 10,614
Earnings	\$10,893,010	\$ 719,770	to \$21,066,250
Taxes	\$ 883,359	\$ 59,144	to \$ 1,707,574
c. Combined errors— over and under			
Taxpayers	17,571	10,974	to 24,168
Earnings	\$27,314,520	\$15,001,330	to \$39,627,710
Taxes	\$ 2,213,995	\$ 1,216,547	to \$ 3,211,443
2. Number of SE schedules that IRS did not provide SSA whose farm and nonfarm earnings were:			
—greater than net earnings	4,379	4,027	to 4,761
(1) With actual errors:			
a. Understated earnings/ underpaid taxes			
Taxpayers	1,851	1,469	to 2,233
Earnings	\$9,266,201	\$4,348,599	to \$14,183,803
Taxes	\$ 750,537	\$ 352,183	to \$ 1,148,891
b. Overstated earnings/ overpaid taxes			
Taxpayers	124	2 ²	to 293
Earnings	\$ 541,672	\$ 10,114 ²	to \$ 1,603,326
Taxes	\$ 44,371	\$ 826 ²	to \$ 130,345
c. Combined errors— over and under			
Taxpayers	1,975	1,570	to 2,380
Earnings	\$9,807,873	\$4,848,191	to \$14,767,555
Taxes	\$ 794,879	\$ 393,114	to \$ 1,196,644
—less than net earnings	1,397	1,204	to 1,620
(1) With actual errors:			
(a) Understated earnings/ underpaid taxes			
Taxpayers	54	1 ²	to 157
Earnings	\$ 210,306	\$ 3,927 ²	to \$ 622,521
Taxes	\$ 17,034	\$ 318 ²	to \$ 50,418

Category	Estimate	Confidence interval ¹	
(b) Overstated earnings/ overpaid taxes			
Taxpayers	none	none	
Earnings	none	none	
Taxes	none	none	
(c) Combined errors— over and under			
Taxpayers	54	1 ² to 157	
Earnings	\$ 210,306	\$ 3,927 ² to \$ 622,521	
Taxes	\$ 17,034	\$ 318 ² to \$ 50,418	

¹Confidence intervals are computed at the 95-percent level of statistical confidence. Thus, the particular category can be expected with 95-percent confidence to fall within the range specified.

²The lower limit of the confidence interval is less than the results of our sample. Therefore, the sample amount is the figure that we used.

Erroneously listed wages and
earnings not properly credited to
individuals' Social Security accounts

From the segment we selected, we analyzed all tax returns filed for calendar year 1979 which had an SE schedule with wages and with total earnings of \$22,900--the 1979 maximum taxable earnings for Social Security purposes. There were 43,567 tax returns with 43,686 SE schedules meeting these characteristics. We then identified those schedules whose corresponding Social Security accounts were not fully credited--6,087 SE schedules filed with 6,085 tax returns. The following categories show our estimates of the extent of erroneously listed wages on the SE schedules and earnings not properly credited to individuals' Social Security accounts.

Category	Estimate	Confidence interval	
A. Taxpayers and returns with SE schedules having both wages and maximum taxable earnings			
Taxpayers	393,603	390,209	to 397,026
Tax returns	387,539	384,207	to 390,899
B. Taxpayers and returns with SE schedules having both wages and maximum taxable earnings which were not fully credited to self-employed individuals' accounts ²			
Taxpayers	54,843	53,564	to 56,152
Tax returns	54,128	52,866	to 55,419
C. Erroneously claimed wages on SE schedules resulted in:			
1. Understating self-employment earnings and underpaying Social Security taxes			
Tax returns	25,787	22,210	to 29,410
Understated earnings	\$38,606,530	\$25,431,780	to \$ 51,781,280
Underpaid taxes	\$ 3,127,168	\$ 2,060,009	to \$ 4,194,327
2. Overstating self-employment earnings and overpaying Social Security taxes			
Tax returns	1,021	399	to 2,567
Overstated earnings	\$ 835,309	\$ 3,271 ³	to \$ 1,836,815
Overpaid taxes	\$ 67,660	\$ 265 ³	to \$ 150,969
3. Combined errors—over and under			
Tax returns	26,809	23,210	to 30,417
Earnings	\$39,441,810	\$26,271,300	to \$ 52,612,320
Taxes	\$ 3,194,828	\$ 2,128,012	to \$ 4,261,644

Category	Estimate	Confidence interval ¹	
D. Earnings not properly credited to individuals' Social Security accounts			
1. Wages not posted:			
Number of instances	9,192	6,784	to 12,233
Uncredited earnings	\$108,842,700	\$68,115,850	to \$149,569,550
2. Wages underposted:			
Number of instances	766	262	to 2,203
Uncredited earnings	\$ 2,010,394	\$ 7,874 ³	to \$ 5,509,572
3. Wages overposted:			
Number of instances	1,787	872	to 3,599
Uncredited earnings	\$ 1,314,901	\$ 5,150 ³	to \$ 2,902,715
4. Self-employment earnings not posted:			
Number of instances	4,085	2,546	to 6,439
Uncredited earnings	\$ 35,687,440	\$ 13,947,520	to \$ 57,427,360
5. All types of crediting problems			
Number of instances	15,830	12,744	to 19,314
Earnings not properly credited	\$147,855,500	\$103,272,590	to \$192,438,410

¹Confidence intervals are computed at the 95-percent level of statistical confidence. Thus, the particular category can be expected with 95-percent confidence to fall within the range specified.

²Individuals whose accounts were credited for \$22,800 or more were considered fully credited, a \$100 tolerance of the 1979 maximum taxable earnings amount.

³The lower limit of the confidence interval is less than the results of our sample. Therefore, the sample amount is the figure that we used.

IRS provided SSA with some
inaccurate Social Security
numbers for the self-employed

From the IRS segment selected and linked with SSA's earnings records, we analyzed 843,967 SE schedules to see if the Social Security number differed from the Social Security number shown on the form 1040. From this review, we identified 7,174 instances in which there were different numbers for the same person. We then examined these instances to determine whether SSA directly posted the earnings to the account number shown on the SE schedule or placed the data in its suspense file.

If the earnings were directly posted to the account number shown on the SE schedule, we matched the name and Social Security number of the worker involved to determine whether the earnings were properly credited. If the information was placed in the suspense file, we examined whether the earnings were subsequently posted and whether the posting was correct. We also examined other years of suspense activity for these individuals to determine their status.

Estimates for these categories follow.

<u>Category</u>	<u>Estimate</u>	<u>Confidence interval¹</u>	
A. Individuals whose schedule SE Social Security number was different than their 1040 number	64,637	63,247	to 66,056
B. Individuals with a discrepant number for 1979 whose earnings SSA was not able to credit for:			
—1979			
Number of individuals	10,641	10,084	to 11,228
Earnings not credited	\$62,140,084	\$58,454,523	to \$65,825,645
—Related years other than 1979			
Number of SE schedules	2,739	2,464	to 3,045
Earnings not credited	\$19,350,955	\$17,354,397	to \$21,347,513

Category	Estimate	Confidence interval ¹	
C. Individuals with a discrepant number for 1979 whose earnings SSA incorrectly credited			
a. In SSA's suspense file initially			
1. 1979			
Individuals	1,595	1,388	1,832
Earnings credited erroneously	\$ 9,178,099	\$ 7,843,986	\$10,512,212
2. Related years other than 1979			
Number of SE schedules	270	193	378
Earnings credited erroneously	\$ 1,900,100	\$ 1,351,924	\$ 2,448,276
b. Not in SSA's suspense file			
Individuals	14,989	13,606	16,244
Earnings credited erroneously	\$67,136,026	\$53,030,757	\$81,241,295
c. Combined 1979 erroneous postings			
Individuals	16,584	14,994	18,076
Earnings credited erroneously	\$76,314,116	\$62,145,886	\$90,482,346

¹Confidence intervals are computed at the 95-percent level of statistical confidence. Thus, the particular category can be expected with 95-percent confidence to fall within the range

IRS did not provide SSA
all SE schedules

We tested whether all computerized SE schedules were given to SSA by analyzing 818,380 self-employment tax returns processed in 1980--816,588 returns for calendar year 1979 and 1,792 returns filed for other than calendar year 1979. Of these, 4,587 were not sent to SSA. We then examined them to determine the extent of those with reportable self-employment earnings that should have been provided SSA.

Details of our results follow.

Category	Estimate	Confidence interval ¹
Self-employment data that IRS processed in 1980 but did not provide SSA		
1. Calendar year 1979:		
Number of returns	884	715 to 1,053
Self-employment reportable earnings	\$ 5,901,722	\$ 232,769 ² to \$22,361,402
Taxes	\$ 459,874	\$ 18,798 ² to \$ 1,794,968
2. Other than calendar year 1979:		
Number of returns	1,693	1,064 to 2,322
Self-employment reportable earnings	\$14,592,490	\$ 7,888,091 to \$21,296,889
Taxes	\$ 1,153,783	\$ 623,996 to \$ 1,683,570
3. Combined--1979 and other:		
Number of returns	2,577	1,926 to 3,228
Self-employment reportable earnings	\$20,494,200	\$ 2,721,470 to \$38,266,930
Taxes	\$ 1,613,657	\$ 177,289 to \$ 3,050,025

¹Confidence intervals are computed at the 95-percent level of statistical confidence. Thus, the particular category can be expected with 95-percent confidence to fall within the range specified.

²The lower limit of the confidence interval is less than the results of our sample. Therefore, the sample amount is the figure that we used.

SSA did not process
all SE schedules

We tested whether all computerized SE schedules which IRS' records showed were provided to SSA were actually processed by analyzing 818,380 self-employment tax returns processed in 1980--816,588 returns for calendar year 1979 and 1,792 returns filed for other than calendar year 1979. Of these, 6,994 were shown as being provided to SSA, but were never processed.

Details of our results follow.

Category	Estimate	Confidence interval ¹	
Self-employment data that IRS' records showed were provided to SSA in 1980, but were never subsequently processed by SSA.			
1. Calendar year 1979:			
Number of returns	65,599	64,151	to 67,047
Self-employment earnings	\$235,762,200	\$228,696,885	to \$242,827,515
Taxes	\$ 19,084,780	\$ 18,360,960	to \$ 19,808,600
2. Other than calendar year 1979:			
Number of returns	313	41	to 585
Self-employment earnings	\$ 1,728,989	\$ 1,246,381	to \$ 2,211,597
Taxes	\$ 135,937	\$ 14,063	to \$ 257,811
3. Combined--1979 and other:			
Number of returns	65,913	64,440	to 67,386
Self-employment earnings	\$237,491,200	\$230,409,422	to \$244,572,978
Taxes	\$ 19,220,720	\$ 18,486,711	to \$ 19,954,729

¹Confidence intervals are computed at the 95-percent level of statistical confidence. Thus, the particular category can be expected with 95-percent confidence to fall within the range specified.

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

JAN 22 1985

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

Thank you for the opportunity to review your draft report entitled, "IRS and SSA Can Improve the Verification and Recording of Data Provided by Self-Employed Taxpayers."

The Service recognizes the importance of accurate processing and reporting of self-employment earnings and taxes to both ensure the workers Social Security entitlements and to credit the Social Security Trust Funds. We appreciate your acknowledgement that the system is working well and that we are continuing to enhance or correct it.

We also express our appreciation for the cooperation of your staff during their review. On numerous occasions they shared information with us that, along with their insight, enabled us to make some of the system changes cited in the draft report.

As stated earlier, we are aware of the ongoing need to continually monitor and improve the self-employment data recordation. We, therefore, agree with the general thrust of your recommendations. We have already had staff level discussions with representatives of the Social Security Administration regarding our respective reviews of the draft report. Our specific comments on each of the recommendations directed at IRS are enclosed.

With kind regards,

Sincerely,



Enclosures

Department of the Treasury Internal Revenue Service

IRS COMMENTS ON GAO REPORT
ENTITLED "IRS AND SSA CAN IMPROVE
THE VERIFICATION AND RECORDING
OF DATA PROVIDED BY SELF-EMPLOYED
TAXPAYERS"

Recommendation I (Page 11):

Expand use of the error register to include those situations where the sum of farm and non-farm earnings is less than the total earnings amount being recorded, and correct any identified earnings and tax errors.

Comments:

We agree with the recommendation. We will correct those Schedules SE that erroneously report more total earnings than the sum of farm and non-farm earnings when the optional method has not been used. Anticipated operational date is January 1, 1986.

Recommendation II (Page 17):

Identify, review, and correct those SE Schedules processed in 1982 and 1983 with math problems, similar to action taken for 1981 processed SE Schedules.

Comments:

The Tax Year 1980 recovery was done using all of the criteria furnished by GAO to identify improper use of the optional method. Due to unresolved legal issues we deleted some of the criteria when we did Tax Year 1981 recovery. We have now resolved the legal issue and will include all of the GAO criteria in the recovery project for Tax Year 1982 scheduled to commence in July 1985. Programming changes were made in 1984 that corrected the problems identified eliminating the need for recovery for Tax Year 1983 and subsequent years.*

Although the criteria not used in the Tax Year 1981 recovery has now been determined to be appropriate for making further corrections, a second recovery effort is not practicable. Our present adjustment workload, limited resources and imminent statute expiration preclude an additional recovery.

Recommendation III (Page 17):

Modify existing returns processing procedures to (1) record SE Schedules whose wages alone equal maximum taxable earnings and (2) verify wages on Schedule SE for workers with maximum taxable earnings.

*GAO note: Our report uses terminology relating to the year in which the return was processed rather than the tax year. For example, schedules for tax year 1980 are referred to in our report as schedules processed in 1981.

Comments:

We agree with your recommendation. Effective January 1, 1986 all Schedules SE, claiming maximum taxable earnings, will be verified against Forms W-2 information. Any returns claiming the maximum taxable earnings will be corrected to reflect the proper earnings amount.

Recommendation I (Page 17): *

Identify those self-employed individuals who did not receive proper credit for their earnings, and correct their accounts. To do so, SSA should identify for IRS, using SE Schedules with maximum reportable earnings, those individuals whose earnings were not properly credited, and IRS should help SSA identify specific individuals and their earnings. SSA should then correct the problem for those individuals, as well as any others similarly affected.

Comments:

This issue has been discussed with SSA. SSA has agreed to meet with IRS to discuss this and other recommendations in the report requiring joint resolution actions.

Recommendation II (Page 17): *

Develop a systemic way of identifying and correcting tax and earnings overpayments for self-employed persons who erroneously elected the non-farm optional method of determining their earnings, either because they (1) were not self-employed in two of the three previous years, or (2) exceeded the 5-year usage limit.

Comments:

Neither of these erroneously elected uses of the non-farm optional method can be determined during the initial processing of the Form 1040 and the attached Schedule SE. However, we believe that the necessary historic information necessary to resolve both types of erroneous elections are available from either SSA or IRS files. SSA and IRS presently have an ongoing program for correcting other types of self-employment record errors. During future meetings with SSA, we will pursue the feasibility of including these cases within the existing system.

Recommendation I (Page 26)::

Identify and provide SSA, starting with the 1980 processing year, with self-employment records showing different Social Security numbers for the same person or self-employment earnings that were not previously provided.

*GAO note: The page number has been changed to correspond with pagination in the final report.

Comments:

During the meetings we will arrange with SSA, we will review this problem, identify what records are required and are available, and determine the feasibility of a correction project.

Recommendation III (Page 27):

Establish overall control of the number of self-employment records received for processing so that differences between the number processed by IRS and SSA can be reconciled. IRS should provide SSA overall control totals of all SE schedules processed; SSA should then account for all records received and processed.

Comments:

We have reviewed the tape record controls that are used by our National Computer Center when transmitting self-employed earning records to SSA. We believe the tapes and the related controls currently provide SSA with sufficient control totals to ensure complete processing.

We will also initiate requests for additional computer programming changes to ensure complete and valid earning record data on service center transaction tapes containing the self employment schedule indicator. This change along with changes referred to earlier, should provide complete and accurate data that will enable SSA to account for all SE Schedules processed by IRS.

Although we believe these actions will resolve both of the above problems, we will also review these issues during our future meetings with SSA.



THE COMMISSIONER OF SOCIAL SECURITY
BALTIMORE, MARYLAND 21235

JAN 17 1985

Mr. Richard L. Fogel
Director Human Resources Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Fogel:

Enclosed is our response to the draft report entitled "IRS and SSA Can Improve the Verification and Recording of Data Provided by Self-Employed Taxpayers" (GAO/GGD-85-21).

We are in general agreement with the findings and recommendations in the report. We will work with the Internal Revenue Service to develop procedures to improve the verification and recording of data.

Sincerely,

Martha A. McSteen
Acting Commissioner

Enclosure

THE SOCIAL SECURITY ADMINISTRATION'S COMMENTS ON THE GENERAL ACCOUNTING OFFICE'S DRAFT REPORT, "IRS AND SSA CAN IMPROVE THE VERIFICATION AND RECORDING OF DATA PROVIDED BY SELF-EMPLOYED TAXPAYERS"

General

We are in general agreement with the findings and recommendations in the report which is addressed jointly to the Commissioners of Internal Revenue and Social Security. The Social Security Administration's (SSA) ability to act on many of the recommendations depends on our receiving cooperation and input data from the Internal Revenue Service (IRS). We do not anticipate any major problems in this regard.

To work with IRS in implementing the recommendations and improving self-employment (SE) reporting in general, we in SSA are exploring the possibility of establishing an intercomponent group which would be responsible for the required operational policy and procedure changes. We plan to correct any existing records which could be identified and amended electronically, and to take the necessary steps to prevent the recurrence of similar errors.

We have the following specific comments for the General Accounting Office's (GAO) consideration before the final report is prepared.

GAO Recommendations

We recommend that the Commissioner of Internal Revenue and the Commissioner of Social Security work together to:

- Identify those self-employed individuals who did not receive proper credit for their earnings, and correct their accounts. To do so, SSA should identify for IRS, using SE schedules with maximum reportable earnings, those individuals whose earnings were not properly credited, and IRS should help SSA identify specific individuals and their earnings. SSA should then correct the problem for those individuals, as well as any others similarly affected.
- Develop a systematic way of identifying and correcting tax and earnings overpayments for self-employed persons who erroneously elected the non-farm optional method of determining their earnings, either because they (1) were not self-employed in two of the three previous years, or (2) exceeded the 5-year usage limit.

SSA Comment

As stated in our general comments above, SSA will work with the IRS to develop a methodology to identify and correct the records of self-employed individuals who did not receive proper credit for their earnings.

We currently have the capability for determining whether an individual reporter is eligible to elect the non-farm option for determining earnings. These data can be made available to IRS for their use in notifying taxpayers who are improperly using the option and requiring them to submit a corrected SE earnings report.

GAO Recommendations

We recommend that the Commissioner of Social Security:

- Use the self-employed persons' records with different Social Security numbers obtained from IRS to correct earnings accounts credited erroneously and those not previously credited.
- Credit the Social Security accounts of those self-employed individuals whose records were never processed, and ensure that the trust funds are provided the correct tax amount from their earnings.
- Periodically conduct tests of the accuracy of self-employment earnings and identification data, and work with IRS to resolve any problem areas that are identified.

Also, we recommend that the Commissioner of Internal Revenue and the Commissioner of Social Security work together to:

- Establish overall control of the number of self-employment records received for processing so that differences between the number processed by IRS and SSA can be reconciled. IRS should provide SSA overall control totals of all SE schedules processed; SSA should then account for all records received and processed.

SSA Comment

Although there were some problems with control and timely processing of the SE tapes in 1979, 1980, and 1981, these problems have been corrected. All SE input data are now being closely monitored to assure that all tapes are received and that they contain all of the information IRS processed. When data are missing or received on unreadable tapes we sometimes have a problem getting backup tapes because IRS only retains the information for 28 days. This does not always give us enough time to adequately determine usability of the original tape and request a backup if it is needed. We will work to get IRS agreement to retain self-employment income tapes for at least 60 days so that readable, complete data can be obtained.

Miscellaneous

We note, on page 6 of the report, the comment that some taxpayers had used optional reporting to lower their earnings and taxes. This is not necessarily an error since the rules of farm optional reporting permit, under certain conditions, a taxpayer to report as self-employment income an amount less than actual net earnings.*

*GAO note: Our report on page 6 states that use of the optional method to lower earnings is generally not a valid reason for its use. As stated in the Social Security Handbook: "The purpose of the optional method of computation is to enable a self-employed individual to maintain Social Security coverage for years during which he or she has very low net earnings or a net loss." To do this, self-employed persons must claim higher earnings than they actually had. We realize that under certain circumstances taxpayers are able to use the optional method to claim less than they actually earn. But only a small number of taxpayers are able to use the optional method in this manner.

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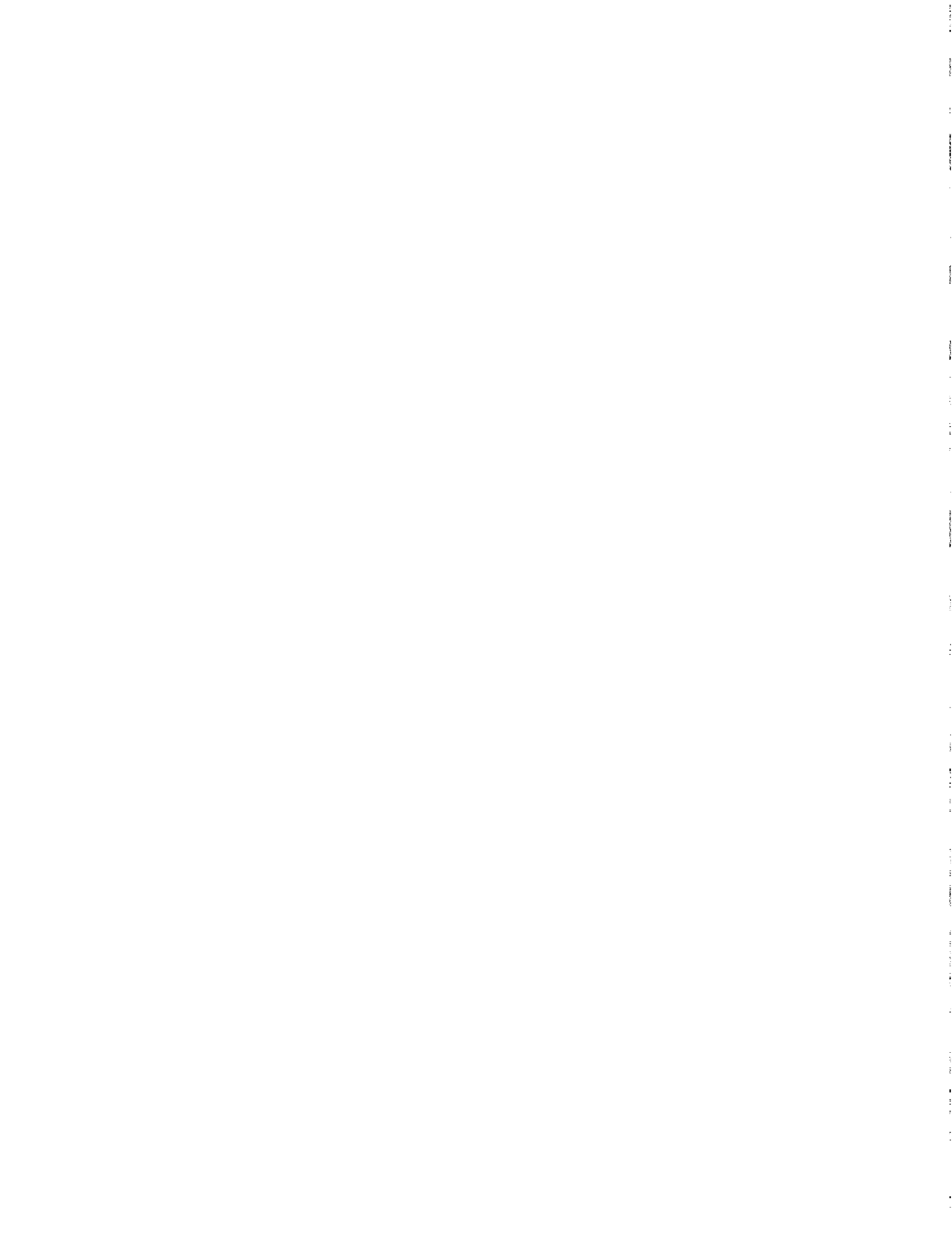
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IRS sends computer tapes containing information from returns that passed the service centers' computer checks to its National Computer Center in Martinsburg, West Virginia, for entry in the master file. (The master file is a compilation of individual tax return information summarized for each return for the last 5 years.) Also, IRS provides SSA with computerized records (magnetic tapes) that contain identification and earnings information from SE schedules.

SSA checks the identification data on the magnetic tapes before crediting an individual's account with self-employment earnings. If SSA can verify that an individual's Social Security number is correctly shown on the tapes, it credits his/her Social Security account with the reported earnings amount. If the number cannot be verified, SSA places the record in a suspense file until the problem is resolved. Throughout 1983, the suspense file contained about \$4 billion in self-employment earnings that had not been credited to individuals' accounts. Some of these earnings have been in SSA's suspense file since 1951.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were to determine (1) the extent to which IRS verifies that the amount of Social Security self-employment taxes computed by taxpayers is correct and (2) whether SSA is accurately recording earnings information in self-employed individuals' accounts.

To accomplish these objectives, we reviewed IRS' processing of tax returns with SE schedules. We interviewed IRS officials responsible for the returns processing and computer systems at IRS' national office in Washington, D.C., and at its Philadelphia, Pennsylvania, service center. We only visited 1 of IRS' 10 service centers because we were informed by IRS officials that all service centers followed the same processing procedures. We also reviewed SSA's procedures for crediting earnings to individual accounts and discussed these procedures with SSA headquarters officials who have responsibility for crediting earnings.

We concentrated our efforts on the accuracy of math computations, wages, Social Security numbers, and on compliance with certain conditions imposed on those persons who used an optional