

United States General Accounting Office

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**GAO**

Report to the Chairman, Subcommittee  
on Social Security, Committee on Ways  
and Means, House of Representatives

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November 1989

# SOCIAL SECURITY

## Alternative Wage- Reporting Processes



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Human Resources Division

B-237002

November 8, 1989

The Honorable Andy Jacobs, Jr.  
Chairman, Subcommittee on  
Social Security  
Committee on Ways and Means  
House of Representatives

This report responds to your March 31, 1988, request that we study alternative approaches for employer wage reporting. The question of alternatives to the existing combined annual wage-reporting system arose because of the shortcomings we uncovered in the current system.<sup>1</sup> We found that in millions of cases wages reported to the Internal Revenue Service (IRS) differed from those reported to the Social Security Administration (SSA). These differences were not being reconciled, and the differences could lead to several kinds of adverse consequences. In cases where more wages were reported to IRS than to SSA, workers' earnings might not be accurately recorded and this could result in lower Social Security benefits for some. In cases where more wages were reported to SSA, social security taxes might have been underpaid.

As a remedy to this situation, IRS and SSA reexamined how they receive and share wage information. They agreed to make changes to address these wage-reporting problems. The corrective actions focus on improving the existing system rather than considering alternative systems that might improve the process.

The objective of our study was to examine several alternatives to the existing system and analyze their potential for improving the wage-reporting process. We imposed a number of constraints on selecting alternatives in order to restrict the almost limitless number of ways the current system could be rearranged and modified. We only considered systems that (1) were distinctly different from each other and the current approach; (2) would, by and large, not increase employer reporting burdens; (3) would have the potential for improving the accuracy of SSA earnings records; and (4) we and others have studied or have proposed for study in the past.

The alternatives were selected based on a review of the literature and discussions with cognizant federal and state officials. The pros and cons

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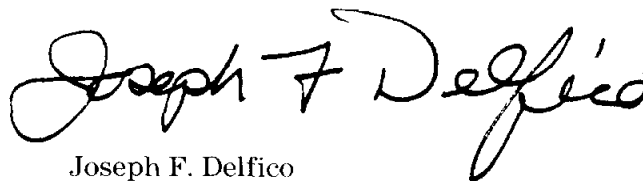
<sup>1</sup> Social Security: More Must Be Done to Credit Earnings to Individuals' Accounts (GAO/HRD-87-52, Sept. 18, 1987).

We solicited comments on this report from IRS, SSA, and Labor. IRS stated it was in general agreement with the report and its conclusion (see app. III). Labor expressed concerns with alternatives 2 and 3. Most of Labor's comments were extensions of problems that we discussed in the report. They related to matters such as privacy, incomplete and varying coverage of workers by state programs, limits on the time state wage data are currently maintained, and a loss in the priority for meeting the needs of the unemployment compensation program under the alternatives discussed. To recognize Labor's comments and improve report clarity, we have added some of these comments to appropriate sections of appendix I. Appendix IV contains the full text of Labor's comments. SSA did not provide any comments on this report.

As agreed with your office, we are providing copies of this report to officials of SSA, IRS, Labor and other congressional committees with an interest in this matter. We will also make copies available to others upon request.

Appendix V contains a list of the major contributors to this report.

Sincerely yours,

A handwritten signature in black ink that reads "Joseph F. Delfico". The signature is written in a cursive, flowing style.

Joseph F. Delfico  
Director, Income Security Issues  
(Retirement and Compensation)

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**Abbreviations**

IRS	Internal Revenue Service
SSA	Social Security Administration
PEBES	Personal Earnings and Benefit Estimate Statements

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 Wage Reporting: Its Importance, History, and  
 Alternative Strategies

Figure I.1: Form W-3 Transmittal of Income and Tax Statements

<b>1 Control number</b> 33333		<b>For Official Use Only ▶</b> OMB No. 1545-0008		
<input type="checkbox"/> <b>Kind of Payer</b> ▶	<b>2 941/941E</b> <input type="checkbox"/>	<b>Military</b> <input type="checkbox"/>	<b>943</b> <input type="checkbox"/>	<b>3</b>
	<b>CT-1</b> <input type="checkbox"/>	<b>942</b> <input type="checkbox"/>	<b>Medicare gov't emp.</b> <input type="checkbox"/>	
<b>5 Number of statements attached</b>				
<b>6 Allocated tips</b>	<b>7 Advance EIC payments</b>		<b>8</b>	
<b>9 Federal income tax withheld</b>	<b>10 Wages, tips, and other compensation</b>		<b>11 Social security tax withheld</b>	
<b>12 Employer's state I.D. number</b>	<b>13 Social security wages</b>		<b>14 Social security tips</b>	
<b>15 Employer's identification number</b>			<b>16 Establishment number</b>	
<b>17 Employer's name</b>			<b>18 Gross annuity, pension, etc. (Form W-2P)</b>	
			<b>20 Taxable amount (Form W-2P)</b>	
<b>19 Employer's address and ZIP code (If available, place label over boxes 15, 17, and 19.)</b>			<b>21 Income tax withheld by third-party payer</b>	

Under penalties of perjury, I declare that I have examined this return and accompanying documents, and to the best of my knowledge and belief they are true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law in attempting to secure such numbers from the recipients.

Signature ▶

Title ▶

Date ▶

Form **W-3** Transmittal of Income and Tax Statements **1988**

Department of the Treasury  
 Internal Revenue Service

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**Figure I.3: Form 941 Employer's Quarterly Federal Tax Return**

**Form 941**  
(Rev. January 1989)  
Department of the Treasury  
Internal Revenue Service

**Employer's Quarterly Federal Tax Return**

4141 For Paperwork Reduction Act Notice, see page 2.  
Please type or print.

OMB No. 1545-0029  
Expires: 5-31-91

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**Your name, address, employer identification number, and calendar quarter of return.**  
(If not correct, please change.)

If address is different from prior return, check here

Name (as distinguished from trade name) \_\_\_\_\_ Date quarter ended \_\_\_\_\_

Trade name, if any \_\_\_\_\_ Employer identification number \_\_\_\_\_

Address and ZIP code \_\_\_\_\_

T
FF
FD
FP
I
T

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If you do not have to file returns in the future, check here

If you are a seasonal employer, see **Seasonal employer** on page 2 and check here

IRS Use

1	1	1	1	1	1	1	1	2	3	3	3	3	3	4	4	4
5	5	5	6	7	8	8	8	8	9	9	9	9	9	10	10	10

Date final wages paid \_\_\_\_\_

---

<b>1a</b>	Number of employees (except household) employed in the pay period that includes March 12th	
<b>b</b>	if you are a subsidiary corporation AND your parent corporation files a consolidated Form 1120, enter parent corporation employer identification number (EIN)	<b>1b</b>
<b>2</b>	Total wages and tips subject to withholding, plus other compensation	
<b>3</b>	Total income tax withheld from wages, tips, pensions, annuities, sick pay, gambling, etc.	
<b>4</b>	Adjustment of withheld income tax for preceding quarters of calendar year (see instructions)	
<b>5</b>	Adjusted total of income tax withheld (see instructions)	
<b>6</b>	Taxable social security wages paid \$ _____ x 15.02% (.1502)	
<b>7a</b>	Taxable tips reported \$ _____ x 15.02% (.1502)	
<b>7b</b>	Taxable hospital insurance wages paid \$ _____ x 2.9% (.029)	
<b>8</b>	Total social security taxes (add lines 6, 7a, and 7b)	
<b>9</b>	Adjustment of social security taxes (see instructions for required explanation)	
<b>10</b>	Adjusted total of social security taxes (see instructions)	
<b>11</b>	Backup withholding (see instructions)	
<b>12</b>	Adjustment of backup withholding tax for preceding quarters of calendar year	
<b>13</b>	Adjusted total of backup withholding	
<b>14</b>	Total taxes (add lines 5, 10, and 13)	
<b>15</b>	Advance earned income credit (EIC) payments, if any	
<b>16</b>	Net taxes (subtract line 15 from line 14). <b>This must equal line IV below</b> (plus line IV of Schedule A (Form 941) if you have treated backup withholding as a separate liability)	
<b>17</b>	Total deposits for quarter, including overpayment applied from a prior quarter, from your records	
<b>18</b>	Balance due (subtract line 17 from line 16). This should be less than \$500. Pay to IRS	
<b>19</b>	If line 17 is more than line 16, enter overpayment here \$ _____ and check if to be: <input type="checkbox"/> Applied to next return <b>OR</b> <input type="checkbox"/> Refunded	

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**Record of Federal Tax Liability (Complete if line 16 is \$500 or more.)** See the instructions on page 4 for details before checking these boxes.  
Check only if you made eighth-monthly deposits using the 95% rule  Check only if you are a first time 3-banking-day depositor

Date wages paid	Show tax liability here, <b>not deposits</b> . IRS gets deposit data from FTD coupons.		
	First month of quarter	Second month of quarter	Third month of quarter
1st through 3rd	A	I	Q
4th through 7th	B	J	R
8th through 11th	C	K	S
12th through 15th	D	L	T
16th through 19th	E	M	U
20th through 22nd	F	N	V
23rd through 25th	G	O	W
26th through the last	H	P	X
Total liability for month	I	II	III

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**IV Total for quarter (add lines I, II, and III). This must equal line 16 above**

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**Sign Here**

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Date \_\_\_\_\_

---

Signature \_\_\_\_\_

Title \_\_\_\_\_

Date \_\_\_\_\_

**Appendix I  
Wage Reporting: Its Importance, History, and  
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**Figure I.4: Sample of a State Quarterly Detailed Wage Report**

TYPE WRITE OR PRINT IN INK			EMPLOYMENT REPORT FOR QUARTER ENDING	TO AVOID PENALTY MUST BE FILED BY
EMPLOYER'S NAME AND ADDRESS OR EMPLOYER NUMBER	EMPLOYEE'S NAME, SOCIAL SECURITY NUMBER, MIDDLE INITIAL, LAST NAME, ZIP	EMPLOYEE'S DATE OF BIRTH		
1				
2				
3				
4				
5				
6				
7				
8				
9				
10				
11				
12				
13				
14				
EMPLOYER'S COPY — RETAIN FOR YOUR FILES			Total wages for this sheet. Grand total for this and any additional sheets. Amount must agree with line 2 page 1 of Contribution return. Number of employees who are listed on this sheet. Grand total of all employees included on this report if more than one sheet is used.	
			INDUSTRY	COUNTY
			EMPLOYER'S NUMBER	THIS REPORT DUE
			FEDERAL ID. NO.	
			(ADDITIONAL SHEETS ARE AVAILABLE UPON REQUEST)	

## History of Wage Reporting

The basic federal requirements governing wage reporting remained virtually unchanged from the mid-1930s (when social security started) until 1978. In 1976, a major change was made when the Congress amended the Social Security Act to reduce employer reporting burdens. Effective with the 1978 reporting year, the number of required employer wage reports was reduced.

IRS forwarded Attachment A to SSA, which used the detailed earnings data to update individual earnings files every 3 months. Thus, SSA and IRS used a single source of earnings information, the quarterly Form 941 with Schedule A, to record earnings. There was no chance of differences in IRS and SSA records if the processing was carried out accurately. Errors, such as the omission of wages for one or more employees, would have been undetected as long as the Form 941 and its associated Schedule A were in agreement.

To facilitate the processing of individual income tax returns, employers also reported annually to IRS the earnings and taxes withheld for each employee. Employers filed a Form W-3, which summarized information, such as total wages and taxes withheld for all employees, and individual Forms W-2 showing specific information for each employee. For a limited number of cases, IRS used the Form W-2 information to verify the wages reported by individuals on their tax returns. Even though it could have, IRS did not compare the annual Form W-3 information to the previously reported quarterly Form 941 information to determine if differences existed.

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## Current Wage-Reporting Process

The combined annual wage-reporting system that began in 1978 responded to complaints from employers about the burden of government paperwork. This new system reduced the number of detailed earnings reports sent to the federal government from five to one. The basic outline of combined annual wage reporting is depicted in figure I.6.



Employers continue to file Form W-3 and associated Forms W-2 annually, but these forms are now sent to SSA rather than IRS. SSA receives, processes,<sup>1</sup> and uses the Form W-2 wage data to record workers' earnings in their accounts. SSA sends a copy of selected wage data from Form W-2 on computer tapes to IRS. IRS aggregates its quarterly information and compares it to the annual wage information provided by SSA. IRS also compares the Form W-2 wage information with wages reported by individuals on their tax returns. This new system did not change the number of wage reports employers sent to states.

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## Impact of Change and Associated Problems

The change to the annual wage-reporting system reduced the federal wage-reporting burden of employers as intended by the Congress, but it also changed where certain tax related documents had to be filed. It required that wage information formerly sent to IRS (Forms W-3 and W-2) now be sent to SSA, causing some confusion about where to submit required documents. The change also led to the cross-checking of wage information reported separately to IRS and SSA to help ensure that data filed on different reports and covering different time periods were consistent.

The results of comparing wage reports has become the most troublesome feature of the current process. Each year the comparison identifies over 1 million employers who may have reported different wage amounts to IRS and SSA. About half of the time, employers appear to have reported more wages to IRS than to SSA, implying that SSA may not have recorded all employee wages or that employers may have overpaid taxes. The other half of the time, employers appear to have reported more wages to SSA than to IRS, implying that all taxes may not have been paid or that SSA may have recorded too much in earnings. Some of these differences are resolved when employers file late or amended wage reports or when IRS and SSA discover and correct their own processing problems. For the remaining cases, however, employers have to be contacted to resolve the differences.

In our September 1987 report, we stated that IRS and SSA were not resolving differences in wage reports. Under a formal 1978 agreement, IRS was to resolve these differences. It achieved limited success in collecting additional taxes from those employers that had reported more

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<sup>1</sup>The processing of Forms W-3 and W-2 consists of steps, such as the verification of identifying information, the comparison of the amounts reported on Form W-3 with the aggregate of Forms W-2, and the conversion of the reports to a tape format that can be used by SSA's computer system to credit wages to employee accounts.

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## **Three Possible Alternatives to the Current Wage- Reporting Process**

Given the wage-reporting problems experienced to date, the Chairman of the House Subcommittee on Social Security asked us to identify alternative wage-reporting systems, with associated advantages and disadvantages, that might improve the situation. We analyzed three alternatives to the current wage-reporting system that might improve its efficiency and effectiveness.

It should be recognized that the alternatives are designed to represent a range of approaches and, to some extent, they build on each other. With four participants (employers, IRS, SSA, and states) providing or using wage reports, the number of unique combinations defining a logical flow of information is limited. However, many variations of these basic combinations are possible because of the numerous specific operating requirements and relationships, such as the frequency of employer reporting and agency responsibility for comparing and reconciling reports, that could be established.

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### **Alternative 1: Modified Combined Annual Wage Reporting**

The first alternative is the closest in concept to the existing system. In alternative 1, IRS, rather than SSA, is responsible for receiving and processing the Forms W-3 and W-2 submitted by employers.

We selected this approach for consideration because it retained most of the structure of the current wage-reporting process and it consolidated all tax reporting with IRS, which has the data and authority needed to identify and resolve problems with wage reports from employers. A Department of Health and Human Services Inspector General report outlined a similar approach in 1988.<sup>3</sup> Figure I.7 depicts the broad constructs of such a system.

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<sup>3</sup>Opportunities Exist for Government to Increase Use of Data Operations Centers' Resources, Richard Kusserow, Inspector General (CIN: A-09-87-00076, July 11, 1988).

so it could post worker earnings. IRS would then compare the Form W-2 data to the previously received Form 941 data and resolve any differences. Afterwards, adjustments arising from the reconciliation would be shared with SSA so that earnings records could be corrected.

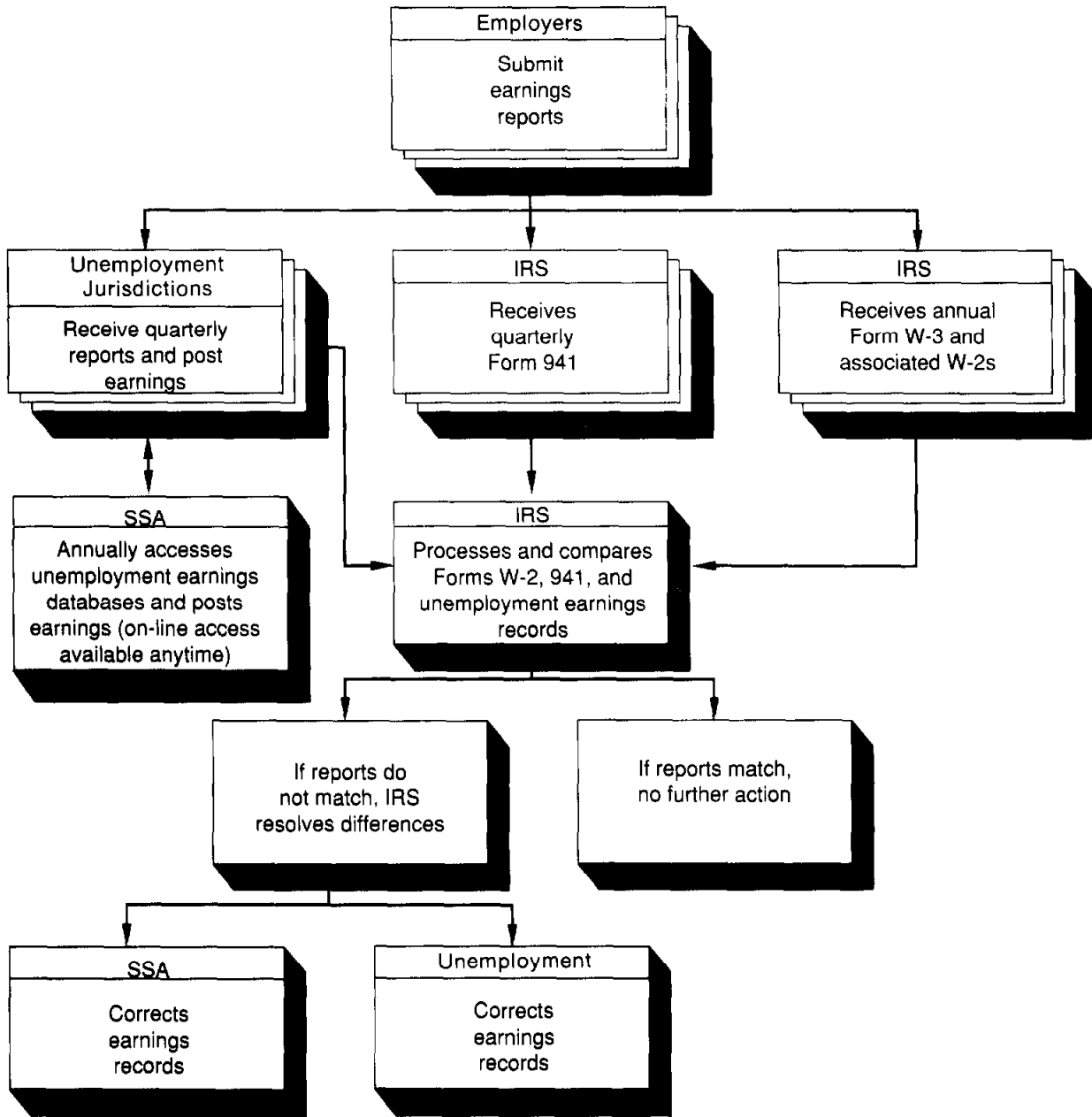
The modified system could provide several significant benefits over the current one. First, it could establish a more efficient and effective reconciliation process leading to more accurate SSA wage posting. Reconciliation should improve because IRS has the most current information, such as quarterly reported totals and current employer identification numbers (which can frequently change), needed to do the reconciliation. Second, IRS could penalize employers who fail to file required reports; SSA said that it lacks such authority. Consequently, to avoid possible penalties, employers may respond more quickly to IRS reconciliation inquiries than they now do to SSA inquiries. Third, employers may be less confused by reporting requirements and consequently less likely to submit information to the wrong government entity because all tax-related documents would go to IRS.

There are potential disadvantages to this alternative. Historically, IRS has not demonstrated a willingness to pursue projects that do not have a potential for collecting additional taxes. Therefore, SSA posting of employee earnings may be delayed because SSA would have to depend on IRS to receive, process, and send the wage information. Delays in recording earnings could affect the accuracy of current benefit payments, thereby increasing the number of under- and overpayments. The timeliness of SSA corrections to employee earnings files would also be dependent on how quickly IRS completes its reconciliation. Timeliness of corrections to earnings records could also affect payment accuracy.

From the IRS perspective, this alternative would require it to undertake major new workloads: receiving, verifying, and converting Form W-2 wage data to a usable magnetic format. Under this alternative, SSA would need fewer resources and IRS would need more. There is no reason to expect that administrative costs would be higher because the same work would need to be done and would most likely require similar resources. There could be some temporary transition problems, such as confusion among employers about where they should file wage reports and disruptions to work processes during the transfer period.

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Figure I.8: Unemployment Compensation Wage File



Under this alternative, employers would continue to file quarterly detailed wage reports with states and the states would continue to maintain wage data on a quarterly basis for limited historical periods (the

employer-reported wage information on Forms 941, W-3, and W-2. To the extent that wage and employer data are improved, unemployment compensation programs and other users of this data, such as law enforcement agencies searching for fugitives or administrators of entitlement programs authorized access to these files, should also benefit.

There are several major disadvantages associated with this alternative. First, it will increase the reporting burden for some employers. Those employers, such as government agencies, which do not currently report to the states would need to report wages under this system. Second, the alternative greatly increases administrative costs for IRS by requiring five separate reconciliations each year involving many separate wage files. The consideration of the state wage files in conjunction with the quarterly 941 and annual W-2 wage reports could greatly increase the number of mismatches and reconciliation problems. Third, SSA has to connect its wage-reporting systems with 53 wage files, which would likely be complex and expensive. Finally, it makes SSA dependent on the states to process wage reports in a timely and accurate manner.

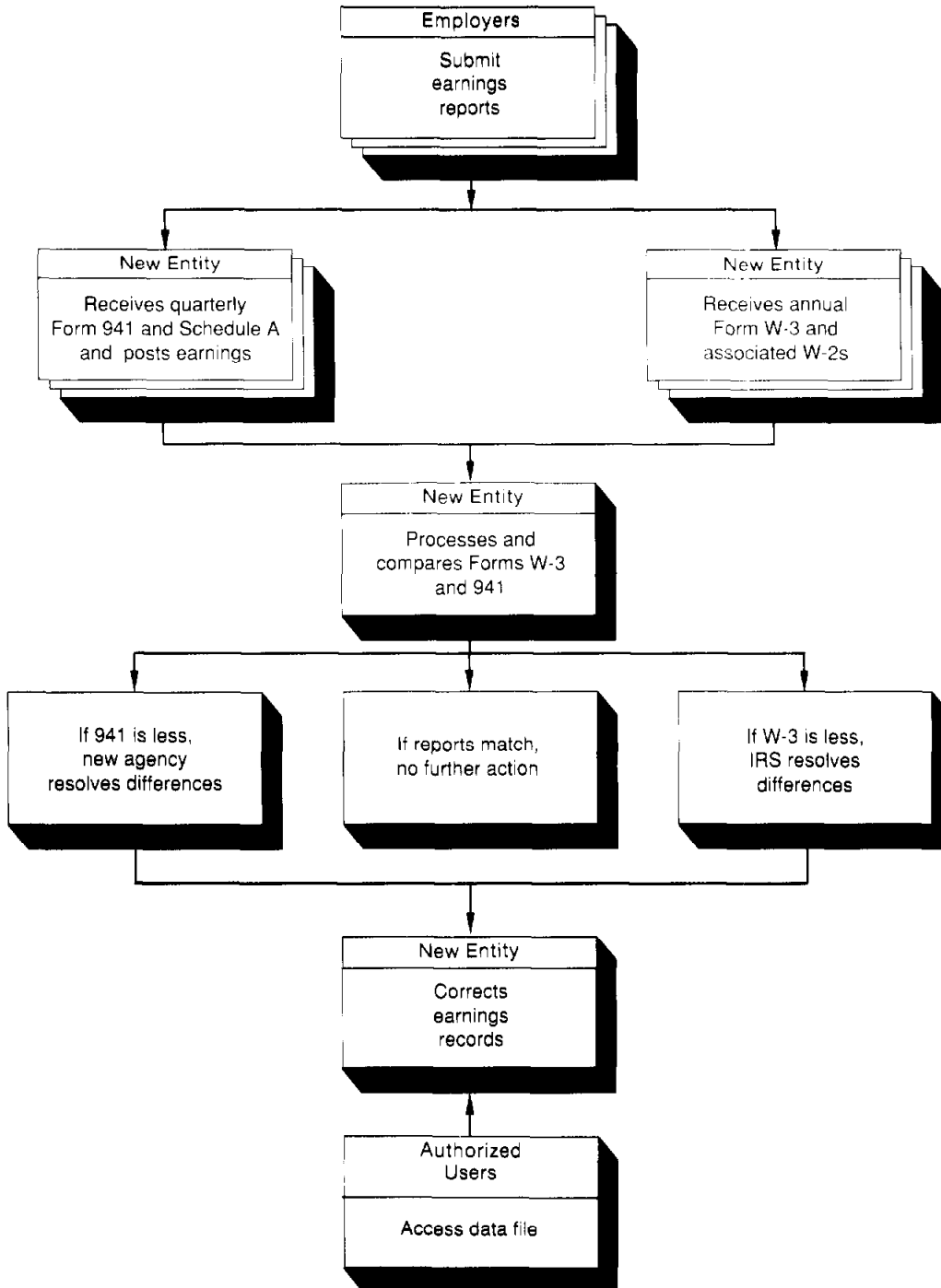
In commenting on this report, Labor said the major disadvantages that we described are valid. Labor discussed a number of its concerns relating to the privacy and operating issues associated with Alternative 2. We believe these comments warrant consideration.

With regard to privacy, Labor said a primary concern relates to transporting data out of the unemployment insurance system and using it for other purposes. According to Labor, direct federal access to state wage data bases has not been previously permitted because it could violate state privacy requirements. States having stringent privacy and confidentiality requirements are unlikely to welcome intrusion into their data banks without enforceable and clear protection requirements. Thus, Labor said that the release of state data electronically to SSA would require a change in federal and most state laws.

Labor also emphasized several operating issues related to this alternative. First, it said that a uniform definition of wages would have to be used by all parties (IRS, SSA, and states). Second, it said that state agencies do not have uniform data processing equipment, which would complicate data transfer between IRS and SSA. Lastly, it said that the integration and reconciliation of three data bases of this size is physically and technically an enormous and questionable undertaking. The interaction with state wage-reporting systems would require states to have more powerful computer systems and additional staff to trace

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Figure I.9: Central Wage File



cross-checked nationally, providing for better income verification. Better wage data should increase the accuracy of payments under entitlement programs. Together these factors should reduce government operating costs.

There are also disadvantages to this alternative. Like alternative 2, the reporting burden for some employers would be increased because they would have to begin filing detailed quarterly wage reports. And it may also be difficult and costly to integrate systems and informational needs on an on-line basis for multiple authorized users. There are two other significant issues that will need to be addressed.

First, the privacy issue will have to be considered. Some would argue that the government should not have such a central comprehensive file on its citizens because the potential for abuse is great. They would question whether controls can be designed and maintained to protect individual privacy rights. Others might argue that the central wage file would offer the opportunity to better protect individual privacy rights because it is easier to control access to one file than it is to the many files that now exist.

Second, such a system would have significant organizational consequences for SSA, IRS, and states. A new entity would have to be staffed and perhaps some of the staffing could come from persons currently performing these functions at SSA, IRS, and the states. However, centralization may mean lost jobs in the many geographic areas where wage reports are now processed. Disruptions in wage-reporting operations could be expected with the adoption of such a different system requiring a new entity, changed roles, funding, organization, and location.

In commenting on this report, Labor discussed several disadvantages of this alternative. Labor said that the states would lose control over data critical to the operation of their program. Any delays in being able to access wage data would delay awareness of late or missing employer reports, possibly affect solvency of the state unemployment insurance trust funds, and could delay payment of benefits. Also, without responsibility for the employer wage reports, the states would lose authority to penalize employers for failing to file timely reports. Finally, Labor said that it did not agree that fewer files would result under this system because states would have to maintain separate files for each employer and employee to operate their tax and work experience rating systems.

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# Objectives, Scope, and Methodology

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Our objectives were to identify and consider alternative means of providing IRS and SSA with required earnings information. As requested, our primary considerations in the formulation of each alternative were that they (1) not be any more burdensome to employers than the present system, and (2) have the potential to improve the accuracy of SSA's earnings records. In developing each alternative, we considered wage reporting in the larger context of all federal requirements and retained most of the current tax reporting and collection structure. Sometimes these goals conflicted. Thus, in some of the alternatives we had to make trade-offs between objectives.

It is important to recognize that there are numerous other wage-reporting systems that could be developed besides those discussed in this report. We selected these three alternatives because they represented distinctly different approaches to wage reporting. The alternatives range from only adjusting the information flow under the current system to creating a new entity for administering the collection and maintenance of wage data.

Before developing alternatives, we searched available literature to identify previous reports on the subject and found limited published information about alternative wage-reporting systems. We obtained most information, therefore, from interviewing persons knowledgeable of wage reporting in SSA headquarters, the Maryland Office of Unemployment Insurance, IRS, the Office of Management and Budget, and in business. From this information we developed several alternatives and theorized advantages and disadvantages from the perspectives of employers, employees, and the federal and state governments. We then discussed the alternatives with SSA and IRS officials.

Comments were obtained from IRS and the Department of Labor and are incorporated in our report where appropriate. Although SSA was asked to comment on this report, it did not provide comments. Our work to identify and analyze alternative wage-reporting processes was performed between September 1988 and February 1989.



# Comments From the Department of Labor

Note: GAO responses supplementing those in the report text appear at the end of this appendix.

**U.S. Department of Labor**

Assistant Secretary for  
Employment and Training  
Washington, D.C. 20210



SEP 22

Mr. Lawrence H. Thompson  
Assistant Comptroller General  
General Accounting Office  
Washington, D.C. 20548

Dear Mr. Thompson:

We have received your letter of September 19 limiting the comment period on your draft report Social Security: Alternative Wage Reporting Processes to September 22. While we appreciate the opportunity to review and comment on this report, this sudden departure from the verbal agreement with your staff for an extended review period was unanticipated. Due to the major effects, adoption of two of the alternatives would have on the unemployment insurance (UI) system, we are compelled to provide at least an outline of our concerns regarding the wage reporting alternatives presented in your report within this revised comment period.

The following are our comments on the subject report.

General

- o At present three states, Michigan, New York, and Massachusetts do not collect detailed wage data to be used for UI benefit determinations. Other State employment security agencies (SESAs) collect detailed wage data only for workers that are covered under the State's UI laws.
- o Under any of the proposed approaches, priority must be given to States' requirements for processing UI benefits. The need for detailed wage data by the States in terms of cycling updates for claims purposes and timely benefit payments has not been addressed.
- o It is not clear whether the States would maintain the current level of 16 quarters of detailed wage data on the computer files, or be required to collect the data on a "lifetime" basis. Wage record data are needed on a quarterly basis for the operation of the UI program.
- o The primary concern from a privacy perspective is the transporting of data out of the UI system and using it for purposes other than those prescribed in connection with the administration of the UI program.

See response 1.

See response 2.

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Comments From the Department of Labor

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- o State wage record files are unique to the individual State and its UI law in terms of the elements, beyond the basic required items, each State collects. There is no annual summary within a State for each worker, nor is there an aggregate total for workers who have wages in two or more states (construction and trucking industries).
- o The IRS would have great difficulty accessing the wage files electronically. There is no uniform reporting format nor standardized data collection required for electronic retrieval from the SESAs. On-line access is technically unsound and questionable in its feasibility. Data access on-line to fifty-three (53) sites is not a solution for annual access. The cost of such a telecommunications network and the proposed workload would be prohibitive.
- o The "major advantage", according to this report, is that SSA should be able to pay more accurate benefits due to access to the current wage information. This is not necessarily true, as the percentage of amended or adjusted wage reports as discovered through claim for UI benefits runs high in several States.
- o On line access to SESA files is unnecessary if the SESA reports to IRS, and the IRS to SSA. Many states do not have on line capability.
- o The integration and reconciliation of three data bases of this size is physically and technically an enormous and questionable undertaking. It would take years to achieve uniform and total integration.
- o SESAs do not have uniform data processing equipment which will complicate the data transfer to IRS/SSA.
- o Increased volume of usage on SESA systems would mean the need for more powerful computer systems, and additional staff to trace delinquent reports.
- o Significant additional resources would be needed to input, verify, and report.
- o The impact on SESAs to verify and crosscheck IRS data 5 times a year is significant in terms of staff resources. The UI files and the IRS files are currently as similar as possible.

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## GAO Responses

1. GAO advised Labor staff that an extension of the comment period could be requested and would be granted if justified. Labor made a request for an extension of about 70 days and we denied their request because the report is informational and does not recommend any changes in the wage-reporting process.
2. To address Labor's comments, the report was modified to clarify the issue.

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# Major Contributors to This Report

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**Philadelphia Regional  
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William S. Justice, Evaluator-in-Charge

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- o Traditionally, we have not permitted direct Federal access to State wage data bases. The violation of State privacy requirements would have to be resolved. The release of State data electronically to SSA would require a Federal law change as well as law changes in most States.
- o The legality of other Federal agencies accessing these files at will is also questionable. The major disadvantages listed by GAO are valid and should be taken into consideration with our comments.

Alternative 3: Central Agency Wage File.

- o The SESAs would lose control over data critical to the operation of the State's UI program.
- o SESAs would have no responsibility for the employer wage reports and would lose the authority to penalize employers for failing to report wages timely.
- o Any delay to the accessibility of the wage data by the SESAs would delay awareness of delinquent employers reports, possibly affect the solvency of the State UI Trust Funds, and could delay payments of UI benefits to claimants.
- o We disagree that fewer files would be necessary. Separate files would have to be maintained for each employer, for each employee and for each State in order for SESAs to operate their tax and experience rating systems.
- o We more than agree that the establishment of a Central Agency and Data Base will be difficult and costly. The ongoing maintenance of the system would also be costly.

I am concerned, however, that the implementation of these alternatives need to be discussed in further detail, and would like to request that a meeting be set up with the Director of the Unemployment Insurance Service, Ms. Mary Ann Wyrsh. She can be reached on 523-7831.

Sincerely,



CAROLYN M. GOLDING  
Deputy Assistant Secretary of Labor

- 2 -

- o States which now have stringent privacy and confidentiality requirements are unlikely to welcome the intrusion into their data banks by central or regional SSA offices unless an enforceable, clear and unambiguous provision concerning the privacy and confidentiality requirements for SSA to meet is specified.
- o The centralized concept includes a suggestion that security would be maintained and access would be controlled. However, the potential for the development of a complex profile of individuals would exist and could be developed without the individuals being aware of its existence.
- o The report contains no recommendation for adoption of any of the three approaches. However, from our standpoint, implementation of Alternative 1 should have no impact on employer reporting or SESA's operations for UI purposes. We would also like to point out the Federal/State partnership nature of the UI system and that there are privacy and confidentiality issues, employer reporting burdens, and possibly a loss of control over the UI Trust Funds.

Alternative 1: Modified Combined Annual Wage Reporting.

We do not have any direct comments on this alternative, as it does not involve or use SESA's wage record files or data bases, or require SESAs involvement in the reporting or reconciliation of missing or erroneous wage data from employers. The employer's quarterly reporting of detailed wage information to SESAs for UI purposes would continue as now.

Alternative #2: IRS/SSA Access State Wage Files.

- o Not all SESAs have wage files; many State wage files are not "clean" and reliability of data is questionable. Three States do not use quarterly wage files for UI purposes.
- o A uniform definition of "wages" would have to be required and agreed to by all parties (SESAs, IRS, SSA)
- o States vary in the scope of UI coverage, specifically: non-profit, religious, public, self-employed, agricultural, domestic, fishery workers, and reimbursable employers are rarely reported. None of the States retain Military or Federal employee wage records. UI is not applicable in Guam or American Samoa, but SSA/FICA is.



# Comments From the Internal Revenue Service



COMMISSIONER

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

SEP 19 1989

Mr. Lawrence H. Thompson  
Assistant Comptroller General  
United States General Accounting Office  
Washington, DC 20548

Dear Mr. Thompson:

We have reviewed your recent draft report entitled "Social Security: Alternative Wage Reporting Processes" (HRD-89-134), and are in general agreement with its contents.

The report examines three alternative concepts for reporting wage and employment tax data to the Federal government, but concludes that none of them are sufficiently attractive to justify a change in the current process at this time. We agree with this conclusion.

We believe the adjustments to the current process that are planned or have been made by IRS and the Social Security Administration recently, including those related to the new Memorandum of Understanding, have addressed the problems previously identified by GAO and have substantially improved the process. Since the full effect of these adjustments will not be known for several years, we feel that any move to a new reporting concept now would be premature.

I hope you find these comments useful.

Best wishes.

Sincerely,

A handwritten signature in dark ink, appearing to read "Fred T. Goldberg, Jr.", written over a printed name.

Fred T. Goldberg, Jr.

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**Appendix I**  
**Wage Reporting: Its Importance, History, and**  
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While we agree that each of these situations are potential disadvantages, some balancing comments are in order. For example, while states may no longer be able to penalize employers for delinquent reports, the alternative envisions a timely system that identifies and enforces compliance with reporting requirements. This is the reason that the alternative cross-checks quarterly and annual reports and states that the central agency needs authority to resolve reporting differences. Also, although states will need to maintain certain records for program administration they will no longer have to record and enter detailed data on their own, resulting in some operational savings.

Under this alternative, a new entity is established to centralize the collection of wage data. The new entity's basic mission would be to receive, process, and record (reconciling when necessary) all wage information needed by authorized agencies in the performance of their legislated duties.

All employers would submit quarterly wage reports in detail and summary to the new entity for processing. This wage information could be similar in format to the reporting done formerly on the quarterly Forms 941 and Schedule A. Quarterly reports would no longer be filed with either states or IRS. However, employers would submit the annual Form W-3 and W-2 reports to the new entity for it to cross-check with the quarterly submitted data. When different, reconciliation would be done by IRS or the new entity. For example, IRS could be responsible for resolving differences where taxes were possibly due, while the new entity could be responsible and have authority to resolve differences where wages were possibly underreported to the wage file.

Access to the central wage file would be instantaneous (on-line) and would have to be controlled by specific agreements and security measures that specify and electronically control what data within a file could be accessed. Access to the file would have to comply with the "Privacy Act" and other requirements of federal law. Local, state, and federal government agencies with authority under federal law could use the file to accomplish their various program objectives. For example, SSA could access the system to update its earnings file, answer beneficiaries' questions, or obtain recent earnings data of current beneficiaries in order to calculate a new monthly benefit amount. IRS could access the file to verify reported tax deposits by employers and income reported by individuals. And other users, such as a police department authorized access for the purpose of locating persons, could use the file to identify a current employer and address. Presumably, information not required to accomplish an authorized purpose would be electronically blocked from access through internal control programs. For example, a police department might have no need to know wage amounts so that data could be blocked from police access.

The central wage file offers several advantages. Fewer wage files would be maintained because states would be relieved of maintaining separate wage files. With a single mission, the system should be designed to streamline the processing of large amounts of data. The states and other agencies operating entitlement programs would gain access to wage files

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problem reports, increase reliability of input to their systems, and to work with IRS on the reconciliation of reports.

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### **Alternative 3: Central Wage File**

Alternative 3 establishes a single point for collecting and maintaining wage data, and a new wage-reporting form. We selected this approach for consideration for several reasons. It is a distinctly different approach to wage reporting. It (1) simplifies reporting by requiring employers to report to only one entity, (2) looks to the future and presumes that technological improvements will make such a system feasible, and (3) builds on a concept discussed in a previous GAO report. This system is depicted in figure I.9.

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<sup>5</sup>A Central Wage File for Use by Federal Agencies: Benefits and Concerns (GAO/HRD-85-31, May 11, 1985).

past 16 quarters). They would also continue to file quarterly summary wage reports with IRS. Like alternative 1, employers would annually submit Form W-3 and W-2 wage reports to IRS rather than to SSA. The relationship among IRS, SSA, and the states in the use of the information, however, would be significantly altered.

IRS would be the primary agency responsible for verification of wage records through quarterly and annual reconciliations. Specifically, IRS would electronically compare its quarterly Form 941 reports with the total quarterly wages reported by each employer to the states and reconcile any differences. Annually, IRS would also compare each employer's Form W-2 reports with the total of the previously verified Form 941 reports, reconciling any differences. This alternative provides IRS with the potential to identify additional cases of underreported income because an additional wage file would be used to cross-check wage information.

SSA's operations would be significantly changed under this alternative. SSA would rely on state wage files as its original source of data to record worker wages. Thus, SSA would have to electronically connect its system with each state file. Through the connection, SSA would annually access each of the 53 wage files and update its earnings files using the reconciled records. When required, SSA field offices could electronically access state files directly to retrieve current earnings information not yet updated to SSA earnings files.

A major advantage of this system is that SSA should be able to pay more accurate benefits because it will have access to more current wage information. For example, under this alternative, if a person visited an SSA field office to file an application for retirement benefits, SSA could electronically access that worker's wage file in the appropriate state to obtain earnings not yet recorded in the SSA master file. Under the current system, if the person could not provide evidence of their latest earnings when applying for retirement benefits, they may not initially receive the full monthly retirement benefit to which they were entitled. Any resulting underpayment should be corrected by a lump-sum payment without interest when the earnings file is later updated.

A second advantage associated with integration and reconciliation of the three data bases would be the potential enhancement in the efficiency and effectiveness of other government programs that rely on unemployment compensation wage files. For the first time, the wage data employers report to the states would be systematically cross-checked with

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**Alternative 2:  
Unemployment  
Compensation Wage File**

Alternative 2 departs significantly from the current wage-reporting system by using existing state wage files to provide SSA with more current wage information than it now gets. In this alternative, SSA updates its earnings files by using quarterly wage data now submitted by employers to states.

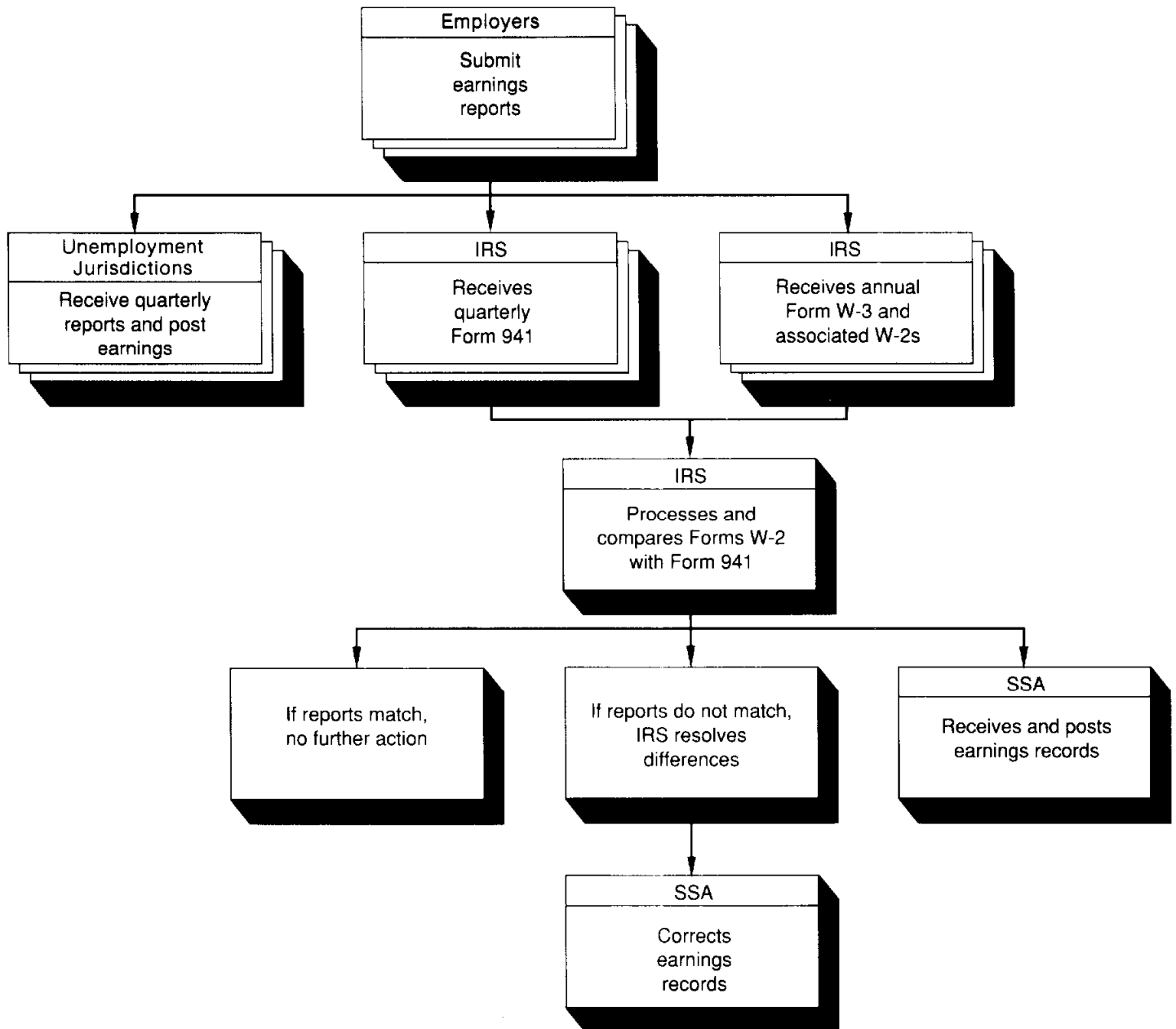
We selected this approach for consideration for several reasons. It is a distinctly different approach; it uses existing wage files; it provides SSA with quarterly wage data, which should increase payment accuracy; it offers an opportunity to compare all existing employer wage reports; and it is based on a concept presented in SSA's strategic plan.<sup>4</sup> This alternative is depicted in figure I.8.

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<sup>4</sup>This concept was discussed by SSA in its long-range plan, 2000, A STRATEGIC PLAN, dated January 1988.

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Figure I.7: Modified Combined Annual Wage Reporting



This alternative would change the wage-reporting process in several basic ways. IRS would receive Forms W-3 and W-2, convert them to a computer-usable format, and send the computerized information to SSA

earnings to SSA than to IRS. However, in 1980, IRS stated that it did not have the resources to deal with what it thought was essentially an SSA problem; that is, those cases where employers had reported more earnings to IRS than to SSA.

We reported that between 1978 and 1983 there were 3.5 million wage reports with such differences and more were being added each year. No efforts were being made to solve this ever-growing backlog of unresolved differences. The differences in wage reports indicated that SSA may not have recorded more than \$58 billion in wages to workers' accounts (about 1 percent of total wages credited in the period). Subsequent SSA reconciliation efforts showed, however, that some of this amount had already been recorded in workers' accounts because, in some cases, employers had used different employer identification numbers in reporting the same earnings to IRS and SSA.

In response to recommendations in our 1987 report, IRS and SSA entered into a new cooperative agreement in July 1988 to resolve differences in their records. The agreement provides for IRS to continue to identify employers who may have underreported wages to either agency, with SSA initially responsible for resolving reported differences where it has recorded less wages than IRS. If employers do not cooperate when contacted by SSA, those employers will be referred to IRS for possible follow-up action, which could include penalties for failing to file required reports. SSA said that it lacks such penalty authority. IRS continues to be responsible for resolving all cases where SSA has recorded more wages than IRS and it appears that taxes are due.<sup>2</sup>

This new agreement has the potential to be effective in resolving problem wage reports. It was developed to correct known causes of reporting problems, it better defined each agency's responsibilities, and it established procedures for (1) reviewing how each agency was performing and (2) addressing any performance problem. In commenting on this report, IRS said the adjustments made or planned under the new agreement have addressed the problems and substantially improved the process.

The results of the new agreement will not be evident, however, before 1990. This lag between the end of the first affected tax year (1987) and any results is due to the time needed for processing and reconciliation.

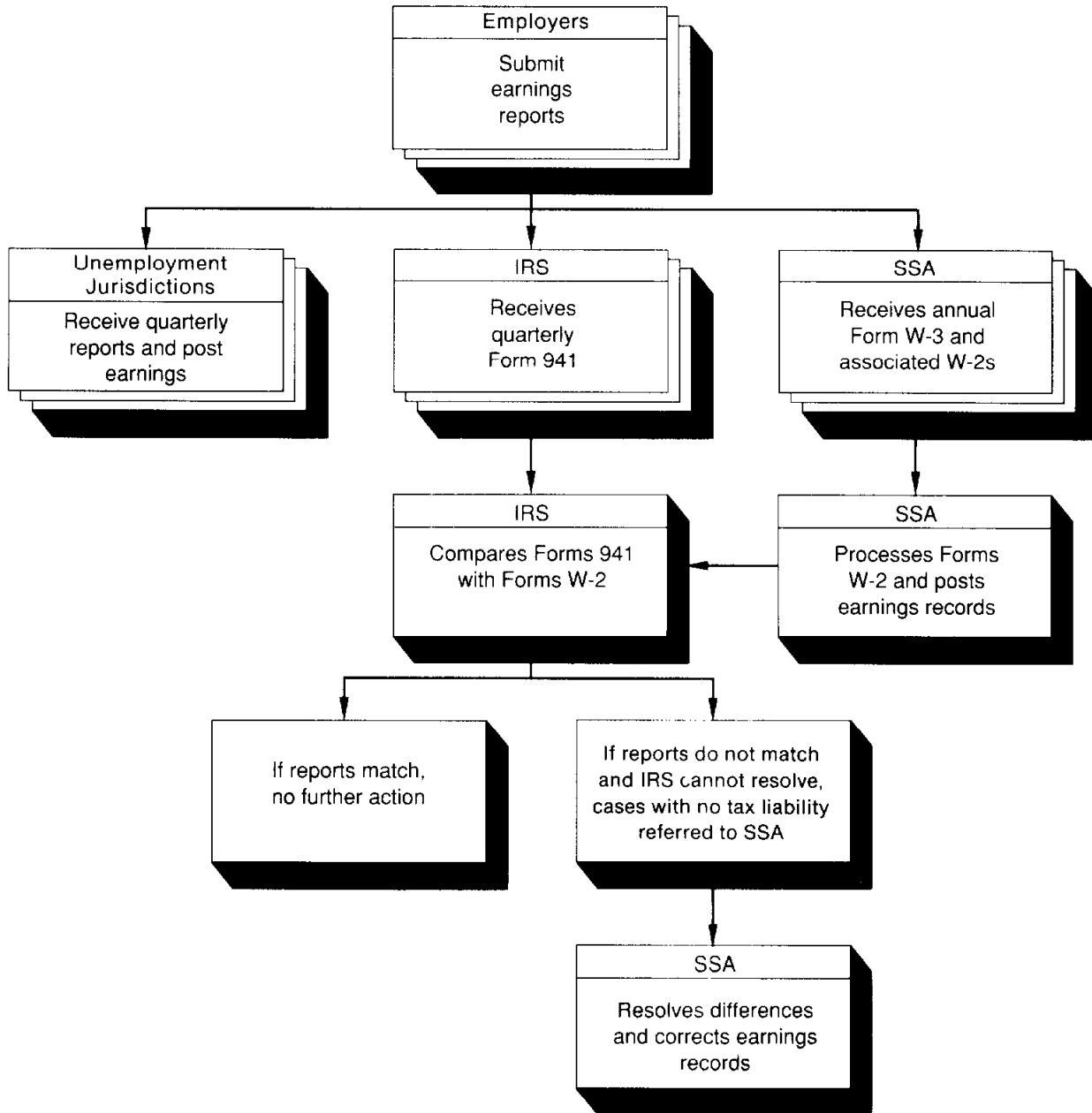
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<sup>2</sup>Tax Administration: IRS' Combined Annual Wage Reporting Reconciliation Program (GAO/GGD-89-21, Dec. 14, 1988).



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Figure I.6: Combined Annual Wage Reporting

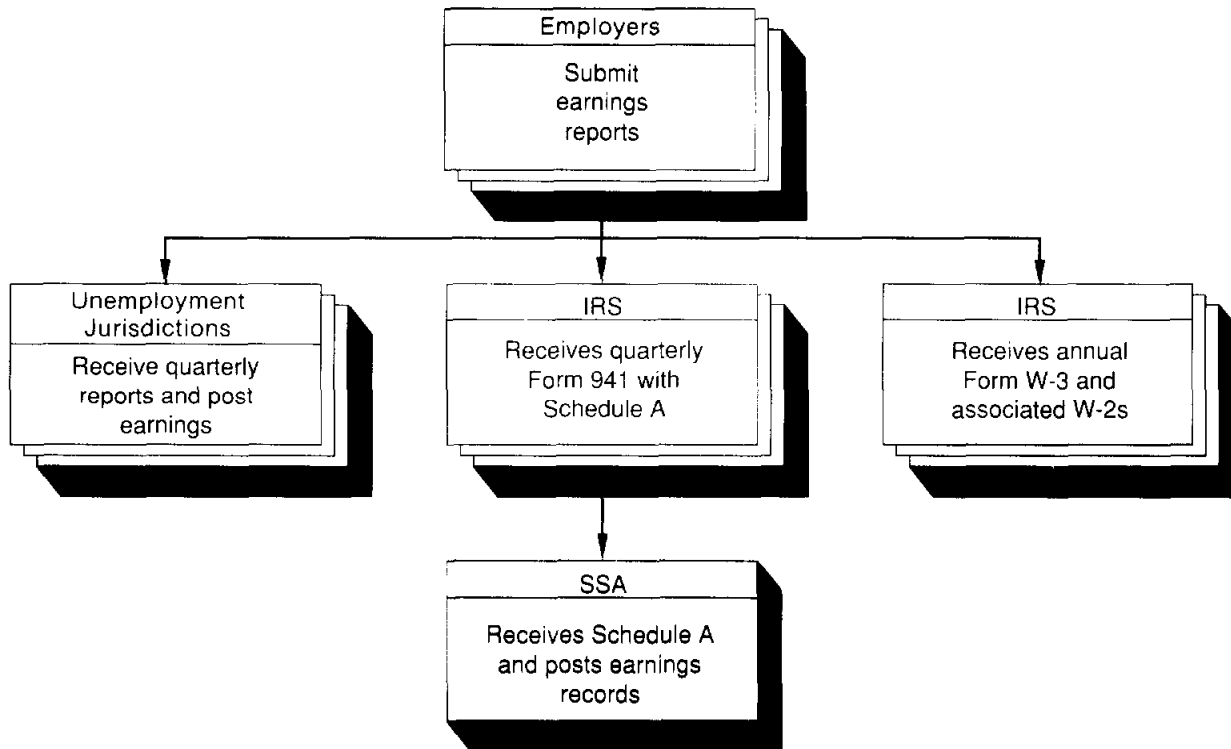


Under the current system, employers still submit the quarterly Form 941 to IRS, but without Schedule A. IRS uses the employer reported total wage and tax information for comparison with employers' tax deposits.

## Wage Reporting Before 1978

Before 1978, employers were required by law to file quarterly and annual reports with IRS. The resulting five reports provided aggregate tax and wage data for employers and quarterly and annual data on each worker. At the same time, many employers also filed quarterly reports with unemployment compensation jurisdictions detailing the wages paid to each employee covered by unemployment insurance. This basic system of quarterly wage reporting is depicted in figure I.5.

Figure I.5: Quarterly Wage Reporting



Shortly after the end of each calendar quarter, employers reported total aggregate earnings and taxes that they withheld from all their employees to IRS on Form 941. Similar information was itemized for each employee on Schedule A. IRS compared the employer-reported totals on Form 941 with the sum of individual earnings reported on the attachment. If in agreement, IRS later compared the reported taxes withheld with each employer's actual deposit of taxes to the Federal Reserve. If not in agreement, IRS was responsible for resolving the difference.

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**Department of Labor**

The Department of Labor oversees the administration of the unemployment compensation program. Under this program, most states collect quarterly wage information from employers to aid in determining a person's eligibility and benefits for unemployment compensation. This data base, however, includes information only on workers covered by the unemployment insurance program. States determine which employees and employers participate in the program. Consequently, the self-employed and certain employers (e.g., nonprofit, religious, agricultural, domestic) are generally not part of the system. Further, wage information is kept for a limited time period (16 quarters) because unemployment benefits are based on recent rather than lifetime earnings. Figure I.4 depicts an example of one state's quarterly employment report.

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**Figure I.2: Form W-2 Wage and Tax Statement**

<b>1</b> Control number		OMB No. 1545-0008					
<b>2</b> Employer's name, address, and ZIP code				<b>3</b> Employer's identification number		<b>4</b> Employer's state I.D. number	
				<b>5</b> Statutory employee <input type="checkbox"/> Deceased <input type="checkbox"/> Pension plan <input type="checkbox"/> Legal rep. <input type="checkbox"/>		<b>942 emp.</b> <input type="checkbox"/> Subtotal <input type="checkbox"/> Deferred compensation <input type="checkbox"/> Void <input type="checkbox"/>	
				<b>6</b> Allocated tips		<b>7</b> Advance EIC payment	
<b>8</b> Employee's social security number		<b>9</b> Federal income tax withheld		<b>10</b> Wages, tips, other compensation		<b>11</b> Social security tax withheld	
<b>12</b> Employee's name, address, and ZIP code				<b>13</b> Social security wages		<b>14</b> Social security tips	
				<b>16</b>		<b>16a</b> Fringe benefits incl. in Box 10	
				<b>17</b> State income tax		<b>18</b> State wages, tips, etc.	
				<b>19</b> Name of state			
				<b>20</b> Local income tax		<b>21</b> Local wages, tips, etc.	
				<b>22</b> Name of locality			

**Form W-2 Wage and Tax Statement 1989**  
Employee's and employer's copy compared

**Copy 1 For State, City, or Local Tax Department**

**Internal Revenue Service**

To effectively administer the collection of taxes from employers and employees, IRS needs accurate and current wage information. Employers withhold taxes from employees and deposit these taxes with the Federal Reserve or approved commercial bank. IRS needs to know the total wages paid by each employer to verify the proper deposit of withheld taxes by employers. Employers currently submit this summary wage information on Form 941 (Employer's Quarterly Federal Tax Return) directly to IRS each quarter (see fig. I.3). IRS also needs details on wages paid to each employee to verify wages reported on individual tax returns. IRS now receives this detailed information on magnetic tape from SSA after SSA processes Form W-2 data.

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# Wage Reporting: Its Importance, History, and Alternative Strategies

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This appendix discusses why wage reports are needed, the history of wage reporting, the impact of a major 1976 change and its associated problems, and the advantages and disadvantages of three wage-reporting alternatives.

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## Why Wage Reports Are Needed

To administer various programs, federal and state governments need information on the wages employers pay their workers. However, because of differences in programs and operating needs, employers must report wages to different government agencies, in different formats, and at different times. These differences are briefly described below for the government agencies who use wage information extensively.

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## Social Security Administration

SSA needs a record of wage information to administer its social security programs. Eligibility and benefits for social security entitlement programs (Retirement, Survivors and Disability Insurance) are based generally on the average lifetime wages of covered workers. Benefits payable under its needs-based program (Supplemental Security Income) are linked to a person's current level of income and resources. Annually, SSA receives employee wage information from employers on Forms W-3 (Transmittal of Income and Tax Statements) and W-2 (Wage and Tax Statement). (See figures I.1 and I.2.) Earnings information for self-employed persons is derived from the tax returns they filed with IRS. IRS aggregates self-employed earnings information on magnetic tape and sends it to SSA.

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theorized for each alternative were similarly developed. The alternatives represent an array of concepts that could appreciably improve the effectiveness of the wage-reporting process. The alternatives and their pros and cons are discussed in appendix I. Appendix II presents a fuller discussion of our scope and methodology.

We analyzed and are reporting on three different concepts. The first modified the existing system by making IRS rather than SSA responsible for receiving and processing earnings reports. At present, SSA receives earnings reports, processes them, and sends them to IRS. The second concept makes use of the unemployment compensation earnings file, now the responsibility of the Department of Labor and the states, to check wage data submitted to IRS and SSA. The third concept revamps the existing process by setting up a new wage-reporting entity that would receive and process wage data for IRS, SSA, and the states.

After reviewing the alternatives, we conclude that though there are advantages to each alternative, none are compelling enough to warrant a change to the existing process in the near term. The changes being made by IRS and SSA to the current process are a start in the right direction. They address known causes of reporting problems but the results of these changes will not be known before 1990 because of time lags associated with the reporting, processing, and reconciliation of wage information.

What may be the most significant initiative affecting the accuracy of SSA's earnings files in the future is SSA's new Personal Earnings and Benefit Estimate Statements (PEBES). In 1988, SSA began sending these statements to workers who requested a statement of their earnings. The statements provide a yearly listing of their recorded wages beginning with tax year 1951 and an estimate of various Social Security benefits.<sup>2</sup> Though this innovation is separate from the current wage-reporting system, it gives workers the opportunity to review earnings posted to their Social Security account and to clear up discrepancies. Currently, 3 percent of the PEBES' requests result in workers questioning the accuracy of their earnings records. SSA and the Congress are considering whether earnings statements should be periodically sent to all workers. In the long run, these earnings statements could be as effective in correcting errors in SSA's files as the options considered in this report.

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<sup>2</sup>Earnings for tax years 1937-50 are summarized.

