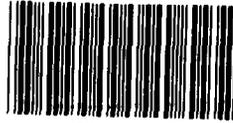




UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

HUMAN RESOURCES  
DIVISION



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Mr. John A. Svahn  
Commissioner of Social Security  
Department of Health and Human Services

Dear Mr. Svahn:

Subject: Social Security Should Correct Its Earnings Allocation  
Process For Self-Employed Taxpayers Whose Fiscal Year  
Ends In October and November (HRD-83-39)

We are currently reviewing the Social Security Administration's process for posting self-employment earnings. To determine the accuracy of postings, we are comparing the earnings information shown on individuals' IRS Schedule SE with that shown on their social security earnings records. We will apprise you of the results of our work when it is completed.

There is, however, one matter we would like to call to your attention now. As part of our review, we examined SSA's allocation of earnings for self-employed workers who file on a fiscal rather than calendar year basis. We found that those taxpayers whose fiscal year ended in October and November 1979 have not had their earnings allocated as required by law. Although only a relatively small number of people and amounts of earnings are affected, we are calling this matter to your attention so that their earnings records can be corrected.

For tax years beginning after 1977, the Social Security Act (42 U.S. Code 412) requires that fiscal year self-employed taxpayers have their earnings allocated proportionately on a monthly basis to the two calendar years comprising their fiscal year. For tax years which began before 1978, earnings were allocated proportionately on a quarterly basis to the two calendar years, and self-employed persons whose tax year ended in October or November were treated as calendar year taxpayers.

From a statistically valid sample of self-employed persons, we identified 71 whose fiscal year ended in October or November 1979 and found that their earnings were not allocated between the calendar years 1978 and 1979, but were credited entirely to 1979. We estimate there are about 640 such taxpayers nationwide. We believe these earnings were not allocated because the earnings posting system was not modified to allocate the earnings of October and November fiscal year taxpayers.

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All fiscal year taxpayers enjoy an advantage over calendar year taxpayers in that they pay taxes at the contribution rate in effect at the beginning of their fiscal year, regardless of how much of their earnings are made in the subsequent year. Consequently, in years of a tax rate increase, this results in a tax savings to them. Although they enjoy such an advantage they also experience a disadvantage which somewhat offsets the advantage. The disadvantage, according to SSA estimates, is that fiscal year taxpayers normally receive slightly lower social security benefit amounts at the time of retirement than their calendar year counterparts with equal earnings. This occurs because fiscal year taxpayers' final year earnings, after allocation, represent only a partial year for benefit computation purposes, since benefits are computed on a calendar year basis. However, those 640 October and November 1979 fiscal year taxpayers will not have a partial year in the final year of their benefit computation because no allocation of their earnings is now being made. Consequently, they may have the advantage of a lower tax rate without the disadvantage of a lower retirement benefit amount.

In view of the legal requirement involved, we recommend that SSA correct the earnings records of those 640 self-employed taxpayers whose fiscal year ended in October and November 1979 to properly reflect the allocation of earnings.

In addition, we recommend that SSA determine whether other self-employed taxpayers whose fiscal years ended in October or November of 1980 or subsequent years, have had their self-employment earnings recorded as if they were calendar year taxpayers. If so, these taxpayers' earnings records and the current system for allocating and recording earnings of self-employed October and November fiscal year taxpayers should be corrected.

We would appreciate being advised of any action you initiate on this matter. Copies of this letter are being sent to the Secretary, Health and Human Services, OIG Audit and your Office of Assessment.

Sincerely yours,



Peter J. McGough  
Associate Director