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Report to Congressional Committees

May 2022

COVID-19

IRS Implemented Tax Relief for Employers Quickly, but Could Strengthen Its Compliance Efforts

GAO-22-104280

GAO Highlights

Highlights of GAO-22-104280, a report to congressional committees

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IRS Implemented Tax Relief for Employers Quickly, but Could Strengthen Its Compliance Efforts

Why GAO Did This Study

The COVID-19 pandemic resulted in significant challenges to the U.S. economy, leading to business closures. The employment tax relief measures Congress passed to help businesses affected by the pandemic were estimated to result in about $237.8 billion in foregone revenue for fiscal years 2021-2031.

The CARES Act includes a provision for GAO to report on the federal government's response to the COVID-19 pandemic. This report describes IRS's efforts in implementing the employment tax provisions. The report also evaluates IRS's plans and actions to identify compliance risks for the provisions.

GAO reviewed federal laws and compared IRS's compliance plans and procedures with selected project management practices and with tax credit eligibility requirements. GAO analyzed IRS data from employment tax returns for 2020, including data on industry sector. GAO also interviewed IRS employees and officials.

What GAO Recommends

GAO is making five recommendations including that IRS develop a compliance plan consistent with project management principles, document compliance processes for adjusted returns and tax credits using restricted wages, and identify ineligible entities. IRS agreed with two of the recommendations and disagreed with three. IRS said its current processes are sufficient. GAO maintains that these recommendations remain warranted.

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What GAO Found

Starting in March 2020, Congress passed several laws, including the CARES Act, to provide employers with tax relief in response to the economic burden brought on by the COVID-19 pandemic. Provisions in these laws established the paid sick and family leave credits (leave credits), the Employee Retention Credit (ERC), and payroll tax deferrals. IRS implemented these provisions while facing delays caused by facility closures and other challenges. As new laws were enacted, IRS continued to revise employment tax returns and guidance.

Leave credits and ERCs for 2020 totaled about $20.7 billion. Payroll tax deferrals totaled about $123.6 billion, as shown in the table. In addition, preliminary data indicate 2021 usage of leave credits and ERCs likely exceed 2020 usage.

Data on Leave Credits, Employee Retention Credits, and Payroll Tax Deferrals, 2020

Provision	Number of employers using	Dollars in billions
Leave credits	1,509,611	9.8
Employee Retention Credits	119,834	10.9
Payroll tax deferrals	1,026,282	123.6

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Note: The tax credit dollar figures are as reported by taxpayers and are subject to taxpayer reporting error. Data are from employment and income tax returns, as of December 2021 and January 2022.

Several of the top industry sectors claiming leave credits and ERCs were sectors most affected by the pandemic that GAO identified in previous work. For example, Manufacturing claimed the second highest amounts of leave credit dollars (about 13 percent) and the Accommodation and Food Services sector claimed the highest amount of ERC dollars (about 15 percent).

IRS took some steps to identify and plan for compliance risks associated with the leave credits and the ERC. As IRS continues to plan for examinations of both credits—which expired in 2021 but will be subject to examination for several years after filing—GAO found IRS could strengthen these efforts by expanding its use of selected project management practices. For example, IRS developed objectives but the objectives did not evolve to reflect statutory changes made after the CARES Act, are not measurable, and do not include criteria to measure success. A comprehensive and cohesive compliance plan would help guide IRS efforts to ensure that it adequately identifies and addresses compliance risks.

IRS began creating new processes to research and address compliance risks associated with tax credits claimed on adjusted returns and employers who claimed multiple credits with wages that are restricted from use for more than one type of credit. However, IRS has not documented how it developed those processes or how it would implement them in practice. Documentation increases transparency and can inform future compliance efforts.

In preliminary data, GAO found 337 filings, totaling $100 million, from employers that were established in April 2020 or later, but then stopped filing employment tax returns. IRS screening filters flagged more than 65 percent of these filers for review. However, those controls may still overlook ineligible entities because they do not consider certain factors, such as refund amounts and employer establishment dates.

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Abbreviations

ARPA	American Rescue Plan Act of 2021
CAA, 2021	Consolidated Appropriations Act, 2021
EIN	Employer Identification Number
ERC	Employee Retention Credit
FFCRA	Families First Coronavirus Response Act
IIJA	Infrastructure Investment and Jobs Act
IRS	Internal Revenue Service
Leave credits	Sick and Family Leave Credits
NAICS	North American Industry Classification System
PMBOK® Guide	A Guide to the Project Management Body of Knowledge
PPP	Paycheck Protection Program
SBA	Small Business Administration
SB/SE	Small Business/Self-Employed division

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Congressional Committees

Congress has provided an estimated $4.6 trillion in emergency assistance and health care response for individuals, families, and businesses affected by COVID-19.[1] Stay-at-home orders, social distancing requirements, and reduced consumer demand early in the pandemic caused both temporary and permanent business closures, particularly among small businesses.

The laws providing this assistance included several tax provisions to help employers support and retain affected employees. This included the Employee Retention Credit (ERC), paid sick and family leave credits (leave credits), and payroll tax deferrals. The Joint Committee on Taxation estimated that these COVID-19-related tax provisions will result in about $237.8 billion in foregone revenue for the federal government for fiscal years 2021-2031.[2] The Internal Revenue Service (IRS) is responsible for implementing these tax provisions. Implementation of new initiatives has been a challenge for IRS as we have reported, including in our 2021 High-Risk Report.[3]

The CARES Act included a provision for us to monitor and oversee the federal government's efforts to prepare for, respond to, and recover from the COVID-19 pandemic. As part of our periodic government-wide

[1]The estimated $4.6 trillion is from the total budgetary resources reported to the Department of the Treasury's Governmentwide Treasury Account Symbol Adjusted Trial Balance System, as of November 20, 2021. The resources are for six COVID-19 relief laws providing comprehensive relief across federal agencies and programs. These six laws are the American Rescue Plan Act of 2021 (ARPA), Pub. L. No. 117-2, 135 Stat. 4; Consolidated Appropriations Act (CAA), 2021, Pub. L. No. 116-260, 134 Stat. 1182 (2020); Paycheck Protection Program and Health Care Enhancement Act, Pub. L. No. 116-139, 134 Stat. 620 (2020); CARES Act, Pub. L. No. 116-136, 134 Stat. 281 (2020); Families First Coronavirus Response Act (FFCRA), Pub. L. No. 116-127, 134 Stat. 178 (2020); and the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020, Pub. L. No. 116-123, 134 Stat. 146.

[2]This estimate includes FFCRA, the CARES Act, CAA, 2021, ARPA, and the Infrastructure, Investment and Jobs Act. The $237.8 billion estimate of foregone revenue cannot be compared with the $4.6 billion estimated total budgetary resources.

[3]GAO, *High-Risk Series: Dedicated Leadership Needed to Address Limited Progress in Most High-Risk Areas,* GAO-21-119SP (Washington D.C.: Mar. 2, 2021). Enforcement of tax laws has appeared on our High-Risk List since 1990.

reports, we previously discussed some aspects of IRS's implementation of these tax provisions. Specifically, we monitored IRS's release of guidance and tax forms, processing of tax credit refunds, and work with other federal agencies implementing related programs.[4]

In this report, we (1) describe IRS's implementation of the COVID-19-related employer tax provisions; (2) describe the characteristics of the employers leveraging these provisions and selected perspectives on their usefulness; and (3) evaluate IRS's plans and actions to identify and address taxpayer compliance risks.

To describe IRS's implementation of the leave credits, ERC, and payroll tax deferrals (collectively, "employer tax provisions"), we reviewed federal laws and our prior work.[5] We also reviewed agency actions to implement our prior recommendations. We monitored IRS's release of guidance and communications, including frequently asked questions and notices, and tips for tax preparers. We also reviewed revisions to employment tax forms and instructions. We analyzed IRS data, as of September 30, 2021, on Form 7200, *Advance Payment of Employer Credits Due to COVID-19*, processing and rejections. We also reviewed IRS internal guidance describing the implementation methods and procedures for the tax provisions. We interviewed representatives from three professional groups (two payroll and one tax group) to obtain feedback on their experiences with IRS's implementation of the employer tax provisions. We selected these groups because of their membership size and their members' role with filing employment tax returns. We also interviewed IRS officials to discuss implementation processes and statutory changes.

To describe the characteristics of employers leveraging the employer tax provisions, we analyzed IRS data from employment and income tax returns processed and in IRS's data systems. These data are in different systems updated at various times from November 2021 through January 2022. We also used IRS data on businesses, such as filing requirements and taxpayer reported data on sectors, based on the North American Industry Classification System. We assessed the reliability of IRS data by reviewing relevant documentation, interviewing knowledgeable IRS

[4]For example, GAO, *COVID-19: Continued Attention Needed to Enhance Federal Preparedness, Response, Service Delivery, and Program Integrity*, GAO-21-551 (Washington, D.C.: July 10, 2021); and *COVID-19: Sustained Federal Action Is Crucial as Pandemic Enters Its Second Year,* GAO-21-387 (Washington, D.C.: Mar. 31, 2021).

[5]GAO-21-387.

officials, and performing electronic testing. We determined that the data used in our analysis were sufficiently reliable for the purpose of describing employers using the tax credits and payroll tax deferrals. We obtained payroll tax deferral repayment data from IRS officials as of December 31, 2021.

To discuss experiences filing for the tax credits and the usefulness of the credits and deferrals, we interviewed employees and members from one tax preparation and two payroll professional groups. We selected these groups based on their size and the role of their professionals in filing employment tax returns. Additionally we interviewed representatives from 11 business groups and members from one other business group. We selected them because of the size and demographics of businesses they represent.[6] These statements are not representative or generalizable to all professionals or groups.

To evaluate IRS's plans and actions to identify and address taxpayer compliance risks, we analyzed various agency documents, such as compliance plans and procedures. We compared these documents with eligibility requirements for the tax credits and selected project management practices.[7] We also used IRS data, mentioned previously, to identify and analyze several areas of potential taxpayer compliance risk. Based on IRS documentation, we selected processes from different IRS divisions related to reviewing the tax credits to use as the basis of interviewing employees about their work. When necessary, we considered office locations and randomly selected employees to participate in interviews. We then used these interviews to help understand IRS's processes and to identify challenges.

To test controls over the ERC, leave credits, and related advance credits, we selected three generalizable random attribute samples of credits that

[6]For example, we met with groups that represent small businesses and self-employed individuals generally, and groups that represent women, Black, Hispanic, Asian, and Native American small business owners.

[7]Project management practices are from Project Management Institute, Inc., *A Guide to the Project Management Body of Knowledge* (PMBOK® Guide), Sixth Edition (Newtown Square, Pa.:2017). PMBOK is a trademark of Project Management Institute, Inc. The Project Management Institute is a not-for-profit association that provides global standards for, among other things, project and program management. We selected the practices based on their relevance to IRS's implementation of the laws.

IRS processed between April 16, 2020, and February 27, 2021.[8] For each sampled transaction, we reviewed IRS documentation such as account information and tax returns to determine whether the tax credit disbursements were accurate.

For all of our objectives, we interviewed IRS officials to discuss the implementation and compliance planning related to the COVID-19-related provisions.

We conducted this performance audit from April 2020 to May 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Overview of Employment Taxes

For federal tax purposes, employers generally are required to withhold and remit two types of taxes from their employees' salaries: federal income tax and Federal Insurance Contribution Act taxes, also referred to as "payroll taxes."[9] The payroll taxes include Old-Age, Survivors and Disability Insurance (Social Security) and hospital insurance (Medicare) taxes.[10] For 2021, Social Security taxes were 12.4 percent of taxable wages, and the Medicare tax rate was 2.9 percent. Half of each is to be withheld from employee pay (referred to as "employee share of payroll tax") and half of each is paid by the employer (referred to as the "employer share of payroll tax").[11] Self-employed individuals generally pay the Social Security tax at a 12.4 percent rate and the Medicare tax at a

[8]Certain employers could file for an advance payment of their leave credits or ERCs between employment tax return filings. Each sample was planned with a tolerable error of 5 percent and an expected error of 1 percent at a 95 percent confidence level.

[9]26 U.S.C. §§ 3402, 3102. Employers must also generally pay the federal unemployment insurance payroll tax. 26 U.S.C. § 3301. However, this is not withheld from employee wages and is reported separately from Federal Insurance Contributions Act taxes.

[10]26 U.S.C. §§ 3101, 3111.

[11]Social Security taxes are levied on earnings up to a maximum level set each year. Earnings beyond the threshold are not counted when calculating benefits. In 2020, the cap on taxable earnings was $137,700. The cap increased to $142,800 for 2021.

2.9 percent rate. Employers must deposit taxes daily, semiweekly or monthly, depending on their reported tax liability.

In general, employers must file their employment taxes and report taxable wages and other information. Most employers use Form 941, *Employer's Quarterly Federal Tax Return*, while employers meeting certain criteria may file annually on other forms. In fiscal year 2020, employers filed about 28 million employment tax returns, according to IRS data. Employers use employment tax returns to claim employer tax credits or to report payroll tax deferrals (see table 1).[12]

Table 1: Selected IRS Forms for Employment Tax Filing

IRS form number	Name	Purpose
941	*Employer's Quarterly Federal Tax Return*	Report federal income tax, Social Security tax and Medicare tax paid and withheld from employee wages.
943	*Employer's Annual Federal Tax Return for Agricultural Employees*	Report federal income tax, Social Security tax and Medicare tax paid and withheld from one or more farmworkers.
944	*Employer's Annual Federal Tax Return*	Report federal income tax, Social Security tax and Medicare tax paid and withheld from employee wages at small employers.[a]
941-X, 943-X and 944-X	Adjusted Employment Tax Returns	Report correction of errors on previously filed employment tax returns, including filing retroactive tax credit claims.
7200	*Advance Payment of Employer Credits Due to COVID-19*	Request an advance payment of the COVID-19-related employer tax credits if a credit exceeds reduced employment tax deposits.[b] This form is not a tax return and only certain employers may use it.

Source: GAO analysis of IRS forms and instructions. | GAO-22-104280

[a]Small employers are those whose annual liability for Social Security, Medicare, and withheld federal income taxes is $1,000 or less.

[b]Advance payments of the Employee Retention Credit for 2021 are limited to small eligible employers that averaged 500 or fewer full-time employees in 2019. For employers that were not in existence in 2019, advance payments are limited to small employers that averaged 500 or fewer full-time employees in 2020.

Employer Tax Relief Provisions in the CARES Act Relief Package and Other Legislation

The CARES Act, Families First Coronavirus Response Act (FFCRA), and other statutes created and modified COVID-19 employer tax relief provisions, mainly the ERC, leave credits, and the deferrals of tax payments for both the employee and employer's share of payroll tax. The Consolidated Appropriations Act, 2021 (CAA, 2021), and the American

[12]Self-employed individuals with employees claim paid sick and family leave equivalent tax credits on their income tax returns. With respect to their employees, self-employed individuals claim the leave credits on the relevant employment tax returns. Certain employers are ineligible for advance credits.

Rescue Plan Act of 2021 (ARPA) amended or modified key aspects of the implementation of these provisions (see table 2).

Table 2: Selected COVID-19-Related Employer Tax Provisions

Employer provision	Purpose	Authorities	Covered dates for eligible wages
Paid sick and family leave credits	To help certain small employers and certain government employers offset the cost of employee leave related to COVID-19, the employer can receive refundable credits for up to certain amounts per employee for health needs, or to care for a family member.	Families First Coronavirus Response Act (FFCRA) and CARES Act for 2020; Consolidated Appropriations Act, 2021 (CAA, 2021); and the American Rescue Plan Act of 2021 (ARPA) for 2021	Periods of leave between April 1, 2020 and March 31, 2021 (under FFCRA as amended and extended by the CAA, 2021); periods of leave between April 1, 2021, and September 30, 2021 (under ARPA)
Employee Retention Credit	To encourage employers to keep employees on their payroll. This refundable credit is for eligible employers whose trade or business was suspended by a government order due to COVID-19 or who were financially affected during calendar quarters in 2020 and 2021.	CARES Act for 2020; CAA, 2021; ARPA; and the Infrastructure and Investment in Jobs Act (IIJA) for 2021[a]	March 13, 2020, through September 30, 2021 (for most employers), and July 1, 2021, through December 31, 2021 (recovery startup businesses)[a]
Deferred payroll tax payments for employer share of Social Security	To allow employers to keep additional cash on hand. Employers could defer the deposit and payment of the 6.2 percent Social Security tax on wages and compensation.	CARES Act	March 27, 2020, through December 31, 2020
Deferred payroll tax payments for employee share of Social Security	To allow certain employees to keep additional cash on hand. Employers could defer the withholding, deposit and payment of the employee's 6.2 percent Social Security tax on wages and compensation paid. Only employees with wages under $4,000 in a biweekly period could defer.	Presidential Memorandum August 2020	September 1, 2020, through December 31, 2020

Source: GAO analysis of authorities. | GAO-22-104280.

Notes: We analyzed the following provisions: FFCRA; the CARES Act; CAA, 2021; ARPA; and IIJA, and Deferring Payroll Tax Obligations in Light of the Ongoing COVID-19 Disaster. Pub. L. No. 116-127, §§ 7001–7004, 134 Stat. 178, 210–219 (2020); Pub. L. No. 116-136, §§ 2301, 2302, 3606, 134 Stat. 281, 347–352, 411–412 (2020); Pub. L. No. 116-260, div. N, § 286, div. EE, §§ 206, 207, 134 Stat. 1182, 1989, 3059–3064 (2020); Pub. L. No. 117-2, §§ 9641, 9651, 135 Stat. 4, 161–172, 176–182 (2021); Pub. L. No. 117-58, § 80604, 135 Stat. 429, 1341 (2021); 85 Fed. Reg. 49587 (Aug. 13, 2020).

[a]IIJA retroactively terminated the ERC for wages paid after September 30, 2021, for employers other than recovery startup businesses. Pub. L. No. 117-58, § 80604, 135 Stat. 429, 1341 (2021). A recovery startup business is an employer (1) that began carrying on any trade or business after February 15, 2020; and (2) for which the average annual gross receipts did not exceed $1 million over a certain 3-taxable-year period. Pub. L. No. 117–2, § 9651(a), 135 Stat. at 179; as amended by Pub. L. No. 117–58, § 80604(a), 135 Stat. at 1341; codified at 26 U.S.C. § 3134(c)(5).

Although they have similar purposes to provide tax relief, the credits and deferrals have different eligibility criteria and other requirements.

Leave Credits. Under FFCRA, businesses and tax-exempt organizations with fewer than 500 employees were eligible for refundable tax credits for sick and family leave.[13] Qualifying paid sick leave includes leave taken to comply with quarantine or isolation orders (or to care for someone under orders), to seek a COVID-19 diagnosis, or to provide child care under certain circumstances.[14] Qualifying paid family leave includes childcare when school or other care is unavailable due to COVID-19. Certain self-employed persons in similar circumstances are allowed equivalent credits. Among other things, ARPA expanded eligibility to state and local governments, and expanded qualifying paid leave definitions to include COVID-19 vaccinations or time spent waiting for test results.[15]

Employee Retention Credit. Under the CARES Act as amended by the CAA, 2021, and ARPA, eligible employers of any size—including tax-exempt entities, eligible governmental entities, and self-employed individuals with employees—can claim the ERC.[16] The credit amount is based on qualified wages paid to employees, including certain health care expenses.[17] Qualified leave wages used to claim the leave credits cannot

[13]Pub. L. No. 116-127, §§ 7001–7004, 134 Stat. 178, 210–219 (2020). The CARES Act provided for advance refunds of the credits and CAA, 2021, extended the credits to apply to wages paid before March 31, 2021. Pub. L. No. 116-136, § 3606, 134 Stat. at 411–412; Pub. L. No. 116-260, § 286, 134 Stat. at 1989 Full- and part-time employees are counted. Both credits have maximum payouts.

[14]The tax credits under FFCRA, as amended and extended by the CAA, 2021, for leave taken from April 1, 2020, through March 31, 2021, are equal to qualified leave wages paid to employees, plus the employer share of Medicare taxes paid with respect to qualified wages and allocable health plan expenses.

[15]Pub. L. No. 117-2, § 9641, 135 Stat. at 161–172, APRA added the credits to the Internal Revenue Code. 26 U.S.C. §§ 3131–3133.

[16]Pub. L. No. 116-136, § 2301, 134 Stat. at 347–351; Pub. L. No. 116-260, div. EE, §§ 206, 207 134 Stat. at 3059–3065; Pub. L. No. 117-2, § 9651, 135 Stat. at 176–182. Eligible government entities include tribal governments, tribal entities, and state- or locally-run colleges, universities, and organizations providing medical or hospital care.

[17]For eligible large employers (that averaged more than 100 employees during 2019), qualified wages are those paid to an employee not providing services during periods of full or partial suspension of operation due to a governmental order or a significant decline in gross receipts. For eligible small employers (that averaged 100 or fewer employees during 2019), qualified wages are wages paid to an employee during the same periods.

be used as qualified wages to claim the ERC.[18] In 2020, an employer was considered eligible to claim the ERC when it experienced either: (1) full or partial suspension of operations due to governmental orders during any quarter, or (2) a significant decline in gross receipts, more than 50 percent for the same quarter in 2019.[19]

CAA, 2021, amended aspects of the ERC for credits in 2021, including increased credit maximums, a lower gross receipts threshold, and extending eligibility to employers who received a forgiven Paycheck Protection Program (PPP) loan, who had been previously ineligible.[20] ARPA and the Infrastructure Investment and Jobs Act (IIJA) made additional amendments.[21]

Deferred Payroll Tax Payments for Employer and Employee Share of Social Security. The CARES Act granted all employers the option to defer deposits and payments of the employer share of the Social Security portion of the Federal Insurance Contributions Act tax and the employer's share of the Social Security portion of the Railroad Retirement Tax Act tax. These would otherwise be required to make during the period beginning March 27 through December 31, 2020.[22] Self-employed individuals could defer half of their Social Security taxes imposed on net earnings from self-employment during the same period. Deferred deposits

[18]There are other wages for which an employer may not claim the ERC, as discussed later in this report.

[19]Employers are no longer eligible in the first quarter after the one in which gross receipts are more than 80 percent of the same quarter in the previous calendar year.

[20]Pub. L. No. 116-260, §§ 206, 207, 134 Stat. 3059–3064. PPP loans are made by lenders to small businesses, guaranteed 100 percent by the Small Business Administration, low interest, and fully forgivable if certain conditions are met. The eligibility change for PPP borrowers was retroactive to 2020. Thus, employers could file adjusted employment tax returns in 2021 to claim ERCs for qualifying wages paid in 2020.

[21]ARPA granted eligibility to “recovery startup businesses” who otherwise would not meet eligibility criteria to claim the credit, among other changes. Pub. L. No. 117-2, § 9651, 135 Stat. at 176–182. IIJA retroactively terminated the ERC for wages paid after September 30, 2021, for employers other than recovery startup businesses. Pub. L. No. 117-58, § 80604, 135 Stat. 429, 1341 (2021).

[22]Pub. L. No. 116-136, § 2302, 134 Stat. at 351–352, as amended by the Paycheck Protection Program Flexibility Act, Pub. L. No. 116-142, § 4, 134 Stat. 641, 643 (2020). To be considered timely, deferred payments of 50 percent of tax are to be made by December 31, 2021, with the remainder due December 31, 2022. The employer share of Social Security tax is 6.2 percent of taxable earnings up to the Social Security wage base cap on taxable income.

and payments were to be reported on employment tax returns or income tax returns for self-employed individuals.

On August 8, 2020, a Presidential Memorandum directed the Secretary of the Treasury to allow the deferral of withholding, deposit, and payment of the employee share of certain employment taxes imposed on wages or compensation paid from September 1, 2020, through December 31, 2020.[23] This applied if an employee's wages or compensation are generally less than $4,000 during any biweekly pay period on a pretax basis, or the equivalent amount with respect to other pay cycles. The CAA, 2021, and Notice 2021-11 extended the time period during which employers may withhold and pay the deferred employment taxes until December 31, 2021.[24]

IRS Rapidly Implemented Employment Tax Provisions and Worked to Address Return Processing Challenges

IRS Developed and Revised Guidance and Tax Forms under Tight Time Frames

IRS worked quickly to implement the new laws that changed aspects of federal employment tax to provide relief to employers. IRS created a team led by the Small Business/Self-Employed division to develop and issue guidance, conduct communications and outreach, revise forms and instructions, and implement system changes. The team included members from examination and collection, and other divisions, such as Counsel, Communications and Liaison and Research, Analysis and Statistics. The team also led coordination and development in areas such as information technology (i.e., establishing an electronic fax line to

[23] 85 Fed. Reg. 49587 (Aug. 13, 2020).

[24] Pub. L. No. 116-260, div. N, § 274, 134 Stat. at 1978; IRS Notice 2021-11, 2021-6 I.R.B 827 (Feb. 8, 2021). The guidance directs employers to ratably withhold and pay the deferred taxes, meaning, in general, equally apportioned across the period.

receive Form 7200), communication with taxpayers, and personnel management (i.e., training staff on the new provisions).

IRS began releasing guidance and revising forms just days after FFCRA was enacted on March 18, 2020, and the CARES Act on March 27, 2020. The forms included Form 7200, the *Advance Payment of Employer Credits Due to COVID-19*, and its instructions released on April 1, 2020. This form allowed employers to request an advance payment of the tax credits rather than waiting to claim them on their employment tax return.

As new statutes modified the tax credits, IRS continued to revise and update guidance—that included, but was not limited to issuing multiple notices and frequently asked questions—and update the public via its website. For example, in August 2021, IRS released guidance on the ERC for the third and fourth quarters of 2021.[25] IRS also revised Form 941 and its instructions four times—twice in 2020 and twice in 2021—to reflect legislative and other changes. On December 6, 2021, IRS issued guidance regarding the termination of the ERC for employers other than recovery startup businesses that are still eligible for the credit for the fourth quarter of 2021.[26] Employers other than recovery startup businesses that received advance payments for fourth quarter wages of 2021 are instructed to repay the amounts by the due dates of their employment tax returns.

Despite Disruptions, IRS Completed 2020 Employment Tax Return Processing and Resolved Some Tax Credit Implementation Issues

The COVID-19 Pandemic Disrupted Returns Processing

According to IRS officials, the agency completed processing of 2020 employment tax returns (Forms 941, 943, and 944) on December 14, 2021. The officials said processing took longer than previous years because of systemic, procedural, and operational changes IRS made in

[25] IRS Notice 2021-49, 2021-34 I.R.B. 316 (Aug. 23, 2021), available online at: https://www.irs.gov/irb/2021-34_IRB, accessed January 28, 2022.

[26] IRS Notice 2021-65, 2021-51 I.R.B. 880 (Dec. 20, 2021), available online at: https://www.irs.gov/irb/2021-51_IRB, accessed January 28, 2022.

response to the COVID-19 pandemic.[27] For example, IRS closed certain processing facilities and made staffing changes, such as reassigning personnel from other divisions and training of personnel, according to IRS officials. As a result, IRS was delayed in opening and processing paper returns and employers received refunds later than they otherwise would have. Over time, IRS began reopening facilities at partial capacity to accommodate social distancing measures, according to IRS officials. To mitigate the backlog, IRS rerouted returns and taxpayer correspondence to locations where more employees were available, according to information on the IRS website.

IRS also encountered other challenges in processing adjusted employment tax returns.[28] For example, IRS received 127 percent more Forms 941-X, *Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund*, in calendar year 2021 than in 2019.[29] The increase was due, in part, to ERC claimants who were PPP borrowers with forgiven loans that became retroactively eligible for the credit, according to IRS officials.[30] These returns can only be filed on paper. Thus, processing them requires more manual steps than processing electronic forms,

[27]In March and July 2021 and April 2022, we reported on how COVID-19 affected IRS's operations during the filing season. GAO, *Tax Filing: 2021 Performance Underscores Need for IRS to Address Persistent Challenges*, GAO-22-104938 (Washington, D.C.: Apr 11, 2022); *COVID-19: Continued Attention Needed to Enhance Federal Preparedness, Response, Service Delivery, and Program Integrity*, GAO-21-551 (Washington, D.C.: July 10, 2021); and *Tax Filing: Actions Needed to Address Processing Delays and Risks to the 2021 Filing Season*, GAO-21-251 (Washington, D.C.: Mar. 1 2021).

[28]An employer may submit an adjusted return to correct an error, or claim a previously unclaimed tax credit.

[29]We did not compare with 2020 because of pandemic-related disruptions. Because of adjusted returns resulting from CAA, 2021, changes would not have been received in 2020. The 2021 data are as of November 22, 2021, and are incomplete with receipts still being entered into the data system.

[30]In the draft for our July 2021 report enclosure, we recommended that IRS and the Small Business Administration (SBA) work together to disseminate information to PPP loan forgiveness applicants on the tax implications of payroll cost allocations when they apply for loan forgiveness. In response, in June 2021, SBA published guidance on its website that included an explanation of the potential tax implications associated with how an employer decides to allocate eligible payroll costs on a loan forgiveness application. It also linked to IRS's detailed guidance on the ERC. As a result of the guidance, we did not make a recommendation in our final report. The guidance SBA issued could help employers maximize the benefits of both the PPP and ERC. See GAO-21-551, enclosure on "Employer Tax Relief."

making it resource intensive. As of January 19, 2022, IRS had approximately 440,000 unprocessed Forms 941-X.

IRS Was Delayed in Processing Forms 7200 and More Than Half Were Rejected

To quickly receive and process advance credit claims, IRS developed an electronic fax system for receiving Form 7200 filings for the advance payment of employer credits. Incoming forms were stored electronically for review, which helped IRS bypass mail-related delays. However, as we previously reported, IRS still experienced significant delays in processing and paying credit refunds.[31]

In July 2021, we reported these forms had a rejection rate of about 60 percent (based on data through May 2021). As of September 30, 2021, IRS had designated almost 72 percent (63,562 of 87,915) of Form 7200 submissions it received as "rejected," according to IRS officials. IRS most often rejected forms because the filer provided an unauthorized signature or filed a Form 7200 after submitting a Form 941 for the same quarter or after the due date of the Form 941 for the quarter.

IRS received a higher volume of Form 7200 filings after statutory changes in the CAA, 2021, made PPP borrowers eligible for employer credits. IRS officials said that they received a higher volume of Forms 7200 from January to March 2021, compared with November and December 2020. This delayed processing. IRS officials said the PPP borrowers who submitted Forms 7200 in January 2021 sometimes used the wrong form, which resulted in rejections. These filers should have used a Form 941-X instead because the original return for the quarter in question was already filed or processed, or the deadline to file Form 7200 for the quarter had already passed.

Six of 10 payroll and tax professionals we spoke with in April and May 2021 said the employers for whom they file employment tax returns were frustrated with the Form 7200 response, and in some cases were using Form 941 instead because the Form 7200 filings were not resulting in payments during the expected 7-week time frame.

To reduce rejection rates, IRS issued a "tax tip" in April 2020 outlining common errors on Form 7200 and emailed reminders to payroll professionals in June 2021. Common errors that taxpayers should watch for included missing or inaccurate employer identification numbers—

[31]GAO-21-551.

indicating more than one calendar quarter—and math errors. Also, IRS officials said that as of September 30, 2021, IRS had mailed 56,118 letters to employers whose Form 7200 claims were rejected. The last remaining credit on the form expired on December 31, 2021.[32]

Employers Claimed $20.7 Billion in Tax Credits and Deferred $123.6 Billion in Payroll Taxes for 2020, but Use Varied

Self-Employed Individuals Accounted for More Than Two-Thirds of Leave Credit Filings; Five Industry Sectors Accounted for More Than 70 Percent of Claim Dollars

Employers claimed more than 1.8 million leave credits totaling almost $10 billion for 2020 (see table 3).[33]

Table 3: Number and Dollars of Sick and Family Leave Credits Claimed, 2020

Number of credits claimed[a]	Number of employers claiming[b]	Dollars claimed (dollars in billions)	Average credit per employer, quarterly filers (dollars)[c]	Average credit per employer, annual filers (dollars)[d]
1,818,676	1,509,611	9.8	15,450	1,902

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: The dollar figures we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The table includes: 2020 Forms 941 (second through fourth quarters

[32]IRS's website stated that the last day to file Form 7200 to request an advance payment for the fourth quarter of 2021 was January 31, 2022. Employers may still file a request for an advance for leave credits if it involves wages paid for leave taken prior to October 1, 2021.

[33]Our definition of "employers" here includes employment tax return filers and self-employed individuals (who may not have employees), who report leave credits and deferrals on Form 1040, Schedule 3.

2020), 943, and 944, data as of January 2022, and sick and family leave credits for self-employed individuals reported on 2020 income tax returns, data as of December 2021.

[a]Each employer claiming the credit in a single quarter is counted as claiming the credit once regardless of the number of employees, but separately counting self-employed individuals as described below. The total number of credits claimed is across multiple quarters of 2020; employers claiming the credit in more than one quarter count as a credit for each quarter it is claimed.

[b]The count of employers includes self-employed individuals filing on Form 1040 for a tax credit for their own COVID-19 related leave. These individuals may have also claimed a credit on an employment tax return for their employees' leave. We did not conduct analysis to link Form 1040 filers with employment tax returns. There were 514,456 employers claiming credits on Forms 941, 943 and 944 that could also be part of the Form 1040 filing population.

[c]Form 941 filers.

[d]Forms 943, 944, and 1040 filers.

Based on partial data from Form 941 filings available in January 2022, employers claimed more than 360,000 leave credits, totaling almost $8.9 billion for 2021.[34] When comparing filing patterns, 2021 leave credit usage in dollars is likely to surpass 2020 amounts. This is likely because of changes to the credit from ARPA, such as:

- expanding eligibility to include state and local governments and certain tax exempt federal entities,[35]
- increasing the per employee family leave credit limit from $10,000 to $12,000, and
- expanding the definition of qualifying paid leave to include vaccinations and waiting for COVID-19 test results.

We did not calculate a take-up rate—the percentage of eligible employers who claimed a credit—because eligibility cannot be determined based solely on filed return data. Payroll records or other information are needed to confirm an employer was eligible for the credits.[36] For example, data are unavailable on the number of employees who were granted paid

[34]These data are mostly from e-filed Forms 941, as IRS continues to process paper 2021 Forms 941, as of March 2022. Annual return data were unavailable in time for our analysis. The e-file data includes some Forms 941 from the first three quarters of 2021. In the 2020 data, employers claimed 818,680 credits on Form 941, totaling $7.9 billion. The remaining million credits are from other filers, mostly Forms 1040.

[35]Based on 2020 Bureau of Labor Statistics data, state and local governments had almost 19 million employees.

[36]We have ongoing work which includes an estimate of differences in usage of ERC, leave credits, and payroll tax deferrals by small business owners by race, ethnicity, and sex.

sick and family leave related to COVID-19, according to Department of Labor officials.[37]

A large number of self-employed individuals who file on annual income tax returns drove the difference in average credit size.[38] Specifically, about 66 percent of employers claiming leave credits did so on income tax returns.[39] The average credits these filers received were smaller ($1,865), compared with other employers ($15,393 average). Corporations were about 23 percent of leave credit claimants.[40]

Employers from five sectors claimed about 71 percent of leave credit dollars for 2020.[41] Professional, Scientific, and Technical Services (about $2.5 billion) and Manufacturing (about $1 billion) claimed the highest

[37]We identified one research paper that used tax data and modeling to estimate the share of employers claiming the credits for 2020 and 2021. The paper found the following 2020 take-up rates for employers: leave credits, between 3.7 and 6.8 percent; ERC, between 0.7 and 1.3 percent; and payroll tax deferrals, 3 percent. See Goodman, Lucas, *Take-up of Payroll Tax-Based Subsidies During the COVID-19 Pandemic* (Washington D.C.: Nov. 8, 2021).

[38]"Self-employed individuals" are considered to be employers for purposes of the credits, even if they do not have employees. They include filers of Forms 941, 943, or 944, who are also required to file certain individual tax returns or who IRS data identified as sole proprietors. They also include individuals who file Form 1040, *Schedule H, Household Employment Taxes,* or Schedule SE, *Self-Employment Tax*.

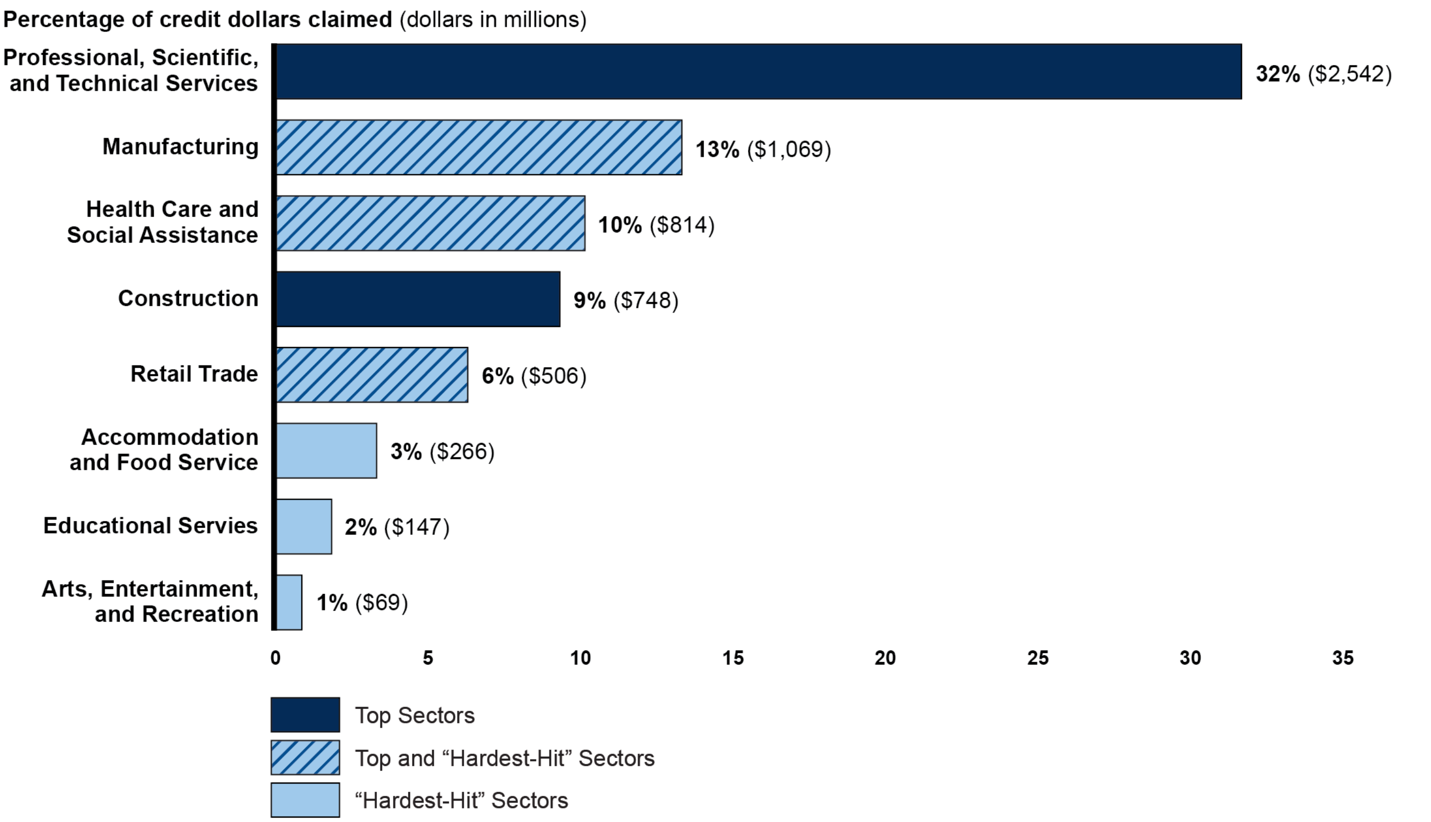
[39]Self-employed individuals who could not work due to COVID-19 and household employers claim leave credits on their annual income tax returns, and therefore would have counted as one credit for 2020, similar to filers of Forms 943 and 944. Form 941 filers could have filed for leave credits for up to three quarters in 2020. Self-employed individuals could also claim leave credits on their employment tax return for their employees' COVID-19 related leave, which would be counted separately as another credit. We did not conduct analysis to link Form 1040 filers with employment tax returns. There were 514,456 employers claiming credits on Forms 941, 943 and 944 that could also be part of the Form 1040 filing population.

[40]We categorized employers based on filing requirements and other IRS data. We made certain assumptions to categorize employers that had more than one filing requirement and those with complex structures. See appendix I for more details. Partnerships made about 5 percent of the leave credit employer claims, and tax-exempt organizations (including churches) made about 2 percent. Non-corporate claimants of the credits, such as partnerships, may be related to a corporation. Employers with missing data and other entities, such as estates and trusts, made up the remaining 3.4 percent. Governments and certain political subdivisions, agencies, or instrumentalities were ineligible for the leave credits for 2020 wages.

[41]These sectors are: Professional, Scientific and Technical Services; Manufacturing; Health Care and Social Assistance; Construction; and Retail Trade. There are a total of 20 sectors.

dollars of leave credits. In prior work, we used information from the 2020 Bureau of Labor Statistics' Business Response Survey to identify six "hardest-hit" sectors, or sectors that were most likely to experience adverse effects to business operations as a result of the pandemic.[42] Three of these sectors are among the top five leave credit claimants; figure 1 also shows the three other "hardest-hit" sectors, which claimed much smaller dollar amounts.

Figure 1: Sick and Family Leave Credit Dollars Claimed by Top Five and "Hardest-Hit" Sectors, 2020



Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (second

[42]These six sectors are (1) Accommodation and Food Services; (2) Arts, Entertainment, and Recreation; (3) Educational Services; (4) Health Care; (5) Manufacturing; and (6) Retail Trade. See GAO, *Paycheck Protection Program: Program Changes Increased Lending to the Smallest Businesses and Underserved Locations,* GAO-21-601 (Washington D.C.; Sept. 21, 2021).

through fourth quarters 2020), 943, and 944, data as of January 2022. Sectors are based on the North American Industry Classification System. In prior work, we used information from the 2020 Bureau of Labor Statistics' Business Response Survey to identify six "hardest-hit" sectors, or sectors that were most likely to experience adverse effects to business operations as a result of the pandemic. See GAO-21-601.

Overall, the average credit amount per employer across all sectors was $15,629, as shown in table 4. See appendix II for data on all 20 sectors and appendix III for more detailed data on selected sectors.

Table 4: Top Average Sick and Family Leave Credit Amounts per Employer, by Sector, 2020

Industry sector	Average credit amount, dollars
Professional, Scientific, and Technical Services	47,712
Public Administration	22,952
Mining, Quarrying, and Oil and Gas Extraction	22,118
Manufacturing	21,148
Utilities	19,633
All 20 sectors	15,629

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The table includes: 2020 Forms 941 (second through fourth quarters 2020), 943, and 944, data as of January 2022. Sectors are based on the North American Industry Classification System.

Corporations Were about 62 percent of Employers Claiming ERC for 2020

Employers claimed 168,918 ERCs totaling about $10.9 billion for 2020, as shown in table 5.

Table 5: Number and Dollars of Employee Retention Credits Claimed, 2020

Number of credits claimed[a]	Number of employers claiming	Dollars claimed (dollars in billions)	Average credit per employer, quarterly filers (dollars)[b]	Average credit amount, annual filers (dollars)[c]
168,918	119,834	10.9	92,182	19,278

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The table includes: 2020 Forms 941 (data on first through fourth quarters 2020) 943, and 944, data as of January 2022.

[a]Each employer claiming the credit in a single quarter is counted as claiming the credit once. The total number of credits claimed is across multiple quarters of 2020; employers claiming the credit in more than one quarter count as a credit for each quarter it is claimed.

[b]Form 941 filers.

[c]Forms 943 and 944.

In addition, employers claimed 367,285 ERCs totaling about $32 billion for 2021 based on partial Form 941 data available in January 2022.[43] The increased number of credits and dollars claimed is likely because CAA, 2021, expanded eligibility to PPP borrowers with forgiven loans and other entities, such as colleges and universities. It also increased credit maximums from $5,000 per employee for all quarters in 2020, to $7,000 per quarter in 2021. Further, it increased the definition of large employer from 100 to 500 employees and redefined “decline in gross receipts,” which further widened the population of eligible employers.

We also found 8,564 Forms 941-X filed after December 31, 2020, claimed about $470.5 million of ERCs.[44]

Looking at ERCs by employer type, we found that about 62 percent of the employers claiming the ERC for 2020 were corporations. Partnerships and tax-exempt organizations (including churches) were each about 9 percent of claimants, followed by self-employed individuals (about 8 percent).[45]

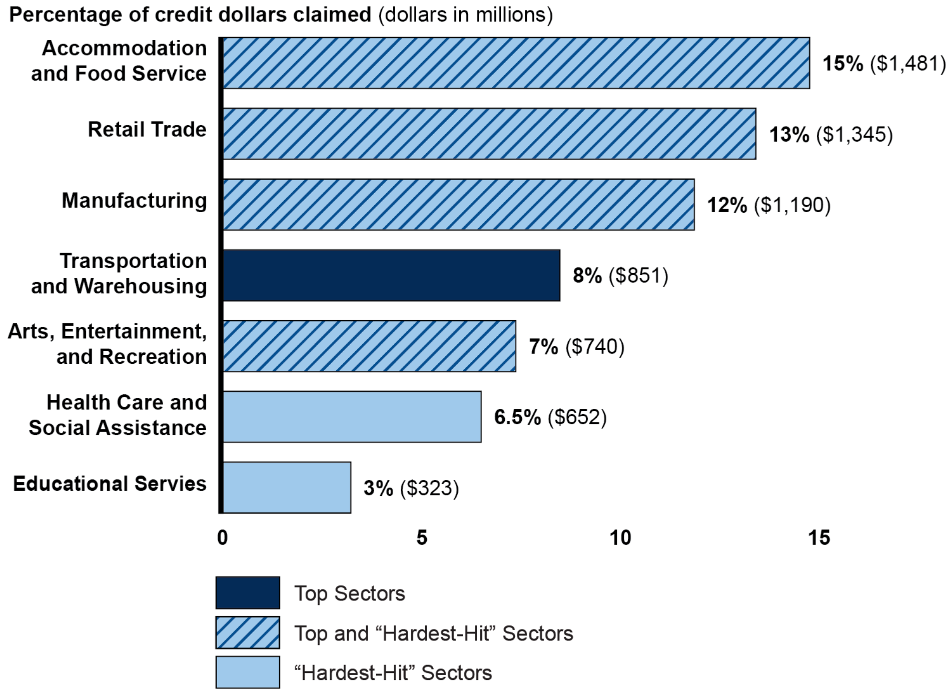
We also analyzed ERC claims by sector. Unlike the distribution of leave credits, where one sector claimed almost a third of credit dollars, ERC amounts were more widely distributed among several sectors. The Accommodation and Food Service sector claimed the highest percentage (15 percent) of ERCs in 2020. Two other “hardest-hit” sectors, Retail Trade and Manufacturing, followed closely behind at 13 and 12 percent respectively. See figure 2.

[43]These data are on e-filed Forms 941 and include incomplete data for three quarters of 2021. Also, as of March 2022, IRS continues to process 2021 Forms 941. Annual return data were unavailable in time for our analysis.

[44]These credits are likely to be retroactive 2020 ERC’s. Data are as of November 25, 2021.

[45]Among self-employed individuals, ERC could only be claimed for those with employees. We had insufficient data to categorize about 12 percent of the employer claimants. The remaining employers were other entities, such as estates and trusts and state and local agencies.

Figure 2: Employee Retention Credits by Top Five Dollars Claimed and "Hardest-Hit" Sectors, 2020



Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022. Sectors are based on the North American Industry Classification System. In prior work we used information from the 2020 Bureau of Labor Statistics' Business Response Survey to identify six "hardest-hit" sectors, or sectors that were most likely to experience adverse effects to business operations as a result of the pandemic. See GAO-21-601.

Although the Accommodation and Food Service sector claimed the highest percentage of credits, the sector's average credit size, per employer, of $90,298 was not among the top averages. Other sectors, shown in table 6, had higher average credit amounts.

Table 6: Top Average Employee Retention Credit Amounts per Employer, by Sector, 2020

Industry sector	Average credit amount, dollars
Management of companies and enterprises	353,509
Transportation and warehousing	272,095
Manufacturing	250,440
Information	209,789
Utilities	175,458
All 20 sectors	83,876

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The table includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022. Sectors are based on the North American Industry Classification System.

Employers across Industry Sectors Deferred Payroll Taxes

Employers deferred almost $124 billion of payroll tax in 2020 (see table 7). About 99 percent of that amount was for the employer share of payroll tax. The dollar amount of payroll tax deferrals was much larger than leave credits and ERC. Only about 3 percent of employers deferred payroll taxes in 2020.[46] The payroll tax deferral period ended on December 31, 2020. As of December 31, 2021, there were 89,376 employers (other than self-employed individuals) with an unpaid employer or employee share deferral amount, according to IRS officials.[47] These unpaid amounts total almost $20 billion.[48]

[46]This calculation is based on the total number of deferrals reported by an employer with a unique employee identification number on Forms 941, 943, and 944, and the total number of filers of these forms. We did not calculate a percentage with self-employed individuals because of challenges defining the population of self-employed individuals.

[47]According to IRS officials, there may be some deposits or payments made close to or after the due date that were not yet captured in these counts. This count only includes employment tax return filers. IRS officials said they sent letters to employers with unpaid deferrals in October and November 2021. After the December 31, 2021, deadline, employers with payments remaining will receive a notice with possible penalties, according to the officials.

[48]The unpaid deferrals are about 16 percent of the $123.6 billion of deferrals made on employment tax returns in our analysis.

Table 7: Number and Amount of Payroll Tax Deferrals for 2020

Number of deferrals[a]	Number of employers using deferrals	Dollars deferred (dollars in billions)	Average deferral per employer, quarterly filers (dollars)[b]	Average deferral, annual filers (dollars)[c]
1,280,543	1,026,282	123.6	623,530	1,237

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. The table includes 2020 Forms 941 (data on first through fourth quarter 2020), 943, and 944, data as of January 2022, and deferrals for self-employed individuals reported on 2020 income tax returns, as of December 2021.

[a]Each employer making a deferral in a single quarter is counted as a making one deferral. The total number of deferrals is across multiple quarters of 2020; employers deferring tax in more than 1 quarter count as a deferral for each quarter.

[b]Form 941 filers.

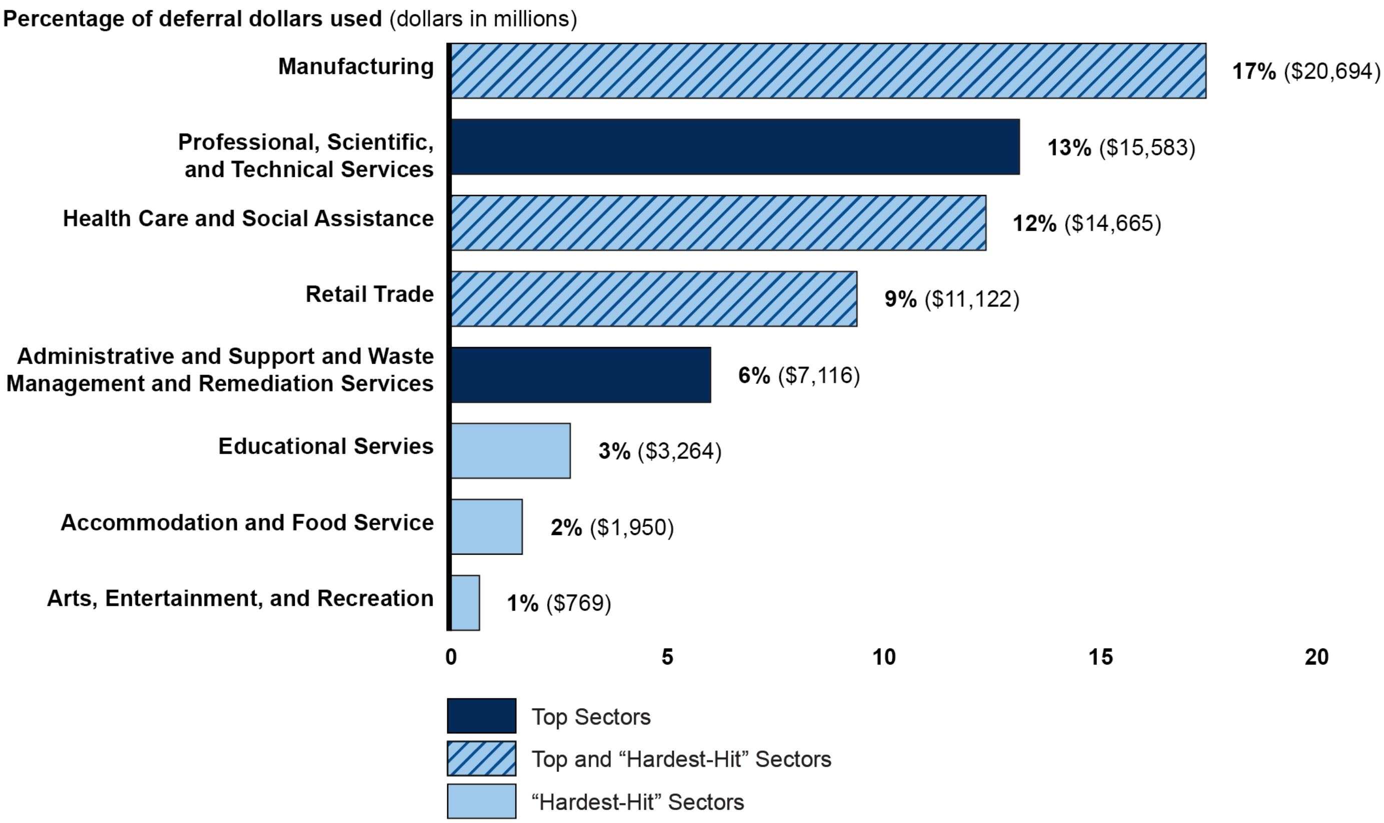
[c]Forms 943, 944, and 1040 filers.

Many self-employed individuals deferred payroll tax but in relatively small amounts. About 82 percent of employers deferring payroll tax were self-employed individuals. About 11 percent of employers deferring payroll tax were corporations.[49]

By sector, the Manufacturing and Professional, Scientific, and Technical Services sectors had the highest dollars of taxes deferred, about 17 and 13 percent of credit dollars respectively. Of the top five sectors using deferrals, three are also “hardest-hit” sectors: Manufacturing, Health Care and Social Assistance, and Retail Trade. The other three “hardest-hit” sectors each were responsible for less than 3 percent of the total deferral dollars (see fig. 3).

[49]About 3 percent of employers using deferrals were partnerships. The remaining 4 percent of deferral dollars were claimed by other entities—such as state and local entities—or did not have data to allow us to categorize them.

Figure 3: Payroll Tax Deferrals Used by Top Five Dollars Claimed and "Hardest-Hit" Sectors, 2020



Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022. Sectors are based on the North American Industry Classification System. In prior work we used information from the 2020 Bureau of Labor Statistics' Business Response Survey to identify six "hardest-hit" sectors, or sectors that were most likely to experience adverse effects to business operations as a result of the pandemic. See GAO-21-601.

Two sectors—Public Administration and Utilities—have significantly higher deferral averages, as shown in table 8. The high average for Public Administration is driven by the relatively few unique employer identification numbers reporting deferral usage.

Table 8: Top Average Payroll Tax Deferral Amounts per Employer, by Sector, 2020

Industry sector	Average deferral amount, dollars
Public administration	42,618,173
Utilities	2,812,770
Manufacturing	1,161,930
Transportation and warehousing	1,082,708
Educational services	1,051,881
All 20 sectors	602,923

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. The table includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022. Sectors are based on the North American Industry Classification System.

Industry Representatives Had Mixed Views on the Usefulness of the COVID-19 Tax Relief Provisions for Employers

In interviews, representatives from the payroll and tax preparer industries and business groups recognized some benefits of each of the employment tax provisions. The leave credits, ERC, and deferrals provided some helpful financial assistance to employers. However, challenges with employers' awareness of the leave credits and deferrals and with timing of relief for the ERC may have limited their financial effectiveness.[50]

Leave credits. The leave credits helped some employers with employee retention and general finances, according to a business representative and some payroll and tax professionals. The leave credits were particularly helpful during 2020 when paid sick and family leave was mandated for COVID-19-related absences, according to a business group representative and a tax professional. However, according to two business group representatives, the use of leave credits may have been limited since some employers lacked awareness of the credits.[51] Further, some businesses were confused about filing requirements or did not want to use resources or professional support to file for the leave credits,

[50]The industry groups we contacted for interviews were selected due to their large size and representation of businesses, or professionals with employer clients, that may be eligible for the tax credits. These statements are not generalizable to all employers. See appendix I. We are continuing to gather information about small businesses' use of these provisions as part of our work on tax policy effects on small businesses by race, ethnicity, and sex. We expect to report the results later in 2022.

[51]We previously reported that employers and employees were not always aware of, or did not always understand, Families First Coronavirus Response Act paid sick and family leave provisions. See GAO-21-551.

according to representatives from five business groups. Four payroll professionals said their clients either have not needed to use the leave credits or used them minimally.

ERC benefits. While the ERC was helpful to many employers, representatives we spoke with questioned its true effectiveness. The ERC was less favored in 2020, compared with the more generous dollar amounts available from the Paycheck Protection Program (PPP), according to two business group representatives and several payroll professionals. Once the ERC eligibility opened to PPP borrowers, many employers decided it was worthwhile to claim the credit retroactively, according to eight of the 11 tax and payroll professionals we interviewed. However, retroactive filing requirements combined with processing delays likely reduced the benefit, and therefore the usefulness of the credits for many of these employers, according to several of the professionals. The delayed processing of refunds meant that businesses could not benefit or were strained waiting for money, according to some of the payroll professionals. One tax professional said some companies had already let go of their employees if they were unable to pay them during 2020.[52]

Payroll tax deferrals. Based on our analysis, overall use of the payroll tax deferrals was low per employer. However, representatives who said their clients did take advantage of the deferrals found them useful. In April and May 2021, all 10 of the payroll and tax professionals from two groups we spoke with said the employer share deferral was the most widely used of the tax-related COVID-19 relief provisions for employee retention among their clients. According to one of these professionals, the deferrals functioned like an interest free loan. Three business group representatives told us that the deferrals helped provide cash flow. However, two representatives said some employers were unaware of the deferrals. Two other representatives said the deferrals were difficult to navigate or employers did not have the resources to access the relief. One other business group representative said many of their members did not see the deferral as valuable. For this business group and a payroll professional, smaller businesses were less likely to use the deferrals.

Professionals from a tax preparer group and two payroll groups highlighted reasons why the employee share of payroll tax deferrals were

[52]According to our analysis, ERC dollars claimed for 2021 are higher than dollars claimed for 2020 ERCs.

used more widely.[53] For example, some representatives believe the deferrals put employees in a poor position when withholding of the deferred payroll taxes resumed. One payroll professional said the deferral is deceiving because employees may think they are getting a tax break. According to some payroll professionals, employers feared liability for the taxes if an employee departs.

IRS Could Improve Its Approach to Mitigating Taxpayer Compliance Risks

Prior to the pandemic, few tax credits were claimed on employment tax returns. Accordingly, IRS compliance efforts focused more on other areas, such as wage reporting. From 2010 to March 2020, IRS only administered three credits on the Form 941 and one credit on the Form 941-X.[54] Historically, issues for employment tax noncompliance were typically related to the reporting of taxable wages, specifically regarding worker classification, fringe benefits, and payment recharacterization.[55] The unusual nature of the COVID-19-related credits, the rapid implementation, and multiple changes to the credits created a unique compliance risk environment. While IRS is addressing some of these risks, we found opportunities for IRS to strengthen its compliance planning to better manage risks.

IRS Would Benefit from Following Project Management Practices to Guide Taxpayer Compliance Efforts

IRS's plans to address potential noncompliance for ERC and leave credit claimants partially demonstrated relevant project management practices we selected for review, but could benefit from expanded use of these practices.[56] IRS quickly developed an initial compliance plan for the tax credits in May 2020. As the pandemic and legislation continued to develop, IRS updated this plan in six more documents, with the first two in August and November 2020, and again in February, May, September,

[53]According to our analysis, the employee share of payroll tax deferrals was only about 1 percent of all deferred payroll taxes.

[54]We reviewed past credits on the Form 941 and Form 941-X back to tax year 2010. The advanced payment of Earned Income Credit was administered on the Form 941 for 2010. The COBRA premium assistance credit was administered on the Form 941 for 2010 to 2013 and then on the Form 941-X for 2014 to 2020. The Qualified Small Business Payroll tax credit was administered on the Form 941 for 2017 to 2021 (the latest form available).

[55]GAO, *Employment Taxes: Timely Use of National Research Program Results Would Help IRS Improve Compliance and Tax Gap Estimates,* GAO-17-371 (Washington D.C.: Apr. 18, 2017).

[56]Project management practices are from Project Management Institute, Inc., *A Guide to the Project Management Body of Knowledge* (PMBOK® Guide), Sixth Edition (Newtown Square, Pa.: 2017). PMBOK is a trademark of Project Management Institute, Inc. The Project Management Institute is a not-for-profit association that provides global standards for, among other things, project and program management. See appendix I for more details on our selection and evaluation of IRS's application of the practices in this audit.

and November 2021. IRS's COVID-19-related compliance planning efforts consist principally of these seven planning documents. Additionally, IRS developed a project plan with expected and actual completion dates for the overall implementation of the credits, and the project plan included a subset of compliance activities.

IRS's Small Business/Self Employed division (SB/SE) also develops an annual examination work plan that includes employment tax, which estimates numbers of examinations and numbers of examination staff. Although SB/SE officials said the draft fiscal year 2022-2023 examination work plan includes examinations on the COVID-19 tax credits, those credits listed under "other issues."

IRS would benefit from leveraging key project management practices to guide its plans and to systematically identify and prioritize compliance risks and effectively deploy resources to address those risks. The Project Management Body of Knowledge (PMBOK® Guide) includes proven traditional practices that are widely applied as well as innovative practices that are emerging in the field of project management.[57] We examined the PMBOK® Guide and determined that three sections contained the most relevant criteria for assessing IRS's compliance planning documents: Project Integration Management, Project Schedule Management, and Project Stakeholder Management.[58]

Project integration management. (Partially met.) This includes the processes and activities to identify, define, combine, unify, and coordinate the various processes and project management activities. Relevant subsections of project integration management include: developing a project charter, developing a project management plan, directing and

[57]Given the temporary nature of the COVID-19 credits, PMBOK® Guide's definition of a project—a temporary endeavor undertaken to create a unique product, service, or result—is relevant for IRS's compliance efforts in this area. IRS compliance planning documents do not include the COVID-19-related employer deferrals within their scope. According to IRS officials, IRS plans to use its established processes for deferral compliance.

[58]We reviewed the PMBOK® Guide and determined that these sections were relevant based on the context of evaluating our objective. Each of these sections contain different subsections against which we evaluated IRS's practices. We included a breakdown of the subsections for the Project Integration Management section because they were distinct and relevant to our analysis. For more details, see appendix I.

managing project work and knowledge, performing integrated change controls, and monitoring and reviewing performance.[59]

- **Develop a project charter.** According to the PMBOK® Guide, a project charter formally authorizes the existence of a project, provides the project manager with the authority to apply organizational resources to project activities, and provides a direct link between the project and the strategic objectives of the organization. The PMBOK® Guide states that these objectives should be measurable and contain related success criteria. IRS has components of a project charter in its compliance planning documents.[60] For example, the May 2020 plan notes that IRS's responsibilities to ensure compliance with the COVID-19 legislation support IRS's strategic goal to protect the integrity of the tax system by encouraging compliance through administering and enforcing the tax code. This plan includes three objectives; they are not measurable and do not include criteria to measure success. For example, one objective focuses on risk mitigation goals and information technology tools, business rules, controls, and guidance to prevent known and potential compliance risks. However, this cannot be easily measured because there are no criteria to measure whether or not the tools and business rules sufficiently mitigate risks. Additionally, the objectives do not appear in the six subsequent planning documents, and were not otherwise updated to reflect subsequent changes in the law.
- **Develop a project management plan.** The PMBOK® Guide defines a project management plan as a comprehensive document that defines the basis of all project work and how the work will be performed. This includes defining, preparing, and coordinating all plan components and consolidating them into an integrated project management plan. IRS does not have a comprehensive document that explains all relevant project components. IRS officials stated that all seven plans are valid. Therefore, they do not supersede each other. However, in the plans, IRS does not track progress occurring between them. In addition, the structures of the plans differ. The plans exclude some compliance activities. IRS officials described—and we

[59]Developing a project management plan starts with developing a project charter, and then defining, preparing, and coordinating all plan components and consolidating them into an integrated project management plan. The key benefit of this process is the production of a comprehensive document that defines the basis of all project work and how the work will be performed.

[60]Federal law, including the Families First Coronavirus Response Act and the CARES Act, authorizes IRS to implement the COVID-19 tax provisions, and therefore acts as an inherent component of a charter.

identified in other documentation—several processes related to tax credit compliance that were not mentioned in the planning documents. For example, the planning documents do not mention that SB/SE's Office of Fraud Enforcement is reviewing certain Forms 7200 containing information that indicate potential fraud.

- **Direct and manage project work and knowledge.** According to the PMBOK® Guide, managing the project work and knowledge includes performing the work defined in the plan, using existing knowledge, and learning to achieve the project's objectives. IRS has started executing some planned project activities and has used some existing institutional knowledge to start the compliance process.[61] However, it has also begun other work that is not mentioned in the planning documentation. For example, according to IRS officials, some specific compliance activities have been developed, but this information is neither included nor described within the planning documentation. Thus, it is unclear whether this information contributes to achieving the project's objectives.
- **Perform integrated change control.** The PMBOK® Guide defines this as the process of reviewing all change requests, approving changes, and managing changes to deliverables, project documents, and the project management plan. It also includes communicating the decisions. Documented changes within a project should be considered in an integrated manner, which addresses overall project risk. We found that IRS did not have consistent communication of activities and changes in its planning documents or in actual project implementation. For example, according to IRS officials, IRS revised the scope and timing of certain exam and review activities, but the plans do not discuss the change, therefore not addressing the approval and rationale for the change.
- **Monitor and control project work.** The PMBOK® Guide outlines this step as the process of tracking, reviewing, and reporting the overall progress to meet the performance objectives defined in the project management plan. As noted above, IRS does not have measurable objectives for the projects and IRS's compliance planning documents do not discuss measuring, monitoring, or evaluating components for the performance of the project.

Project schedule management. (Partially met.) According to the PMBOK® Guide, project schedule management is an integral part of the project planning process. It includes the processes required to manage

[61]For example, IRS used senior employees who had experience reviewing IRS forms as revenue officers and agents to review the new Form 7200, according to IRS officials.

the timely completion of the project by defining and sequencing activities. Project schedules should identify and document specific actions to be performed and establish an understanding of the relationships between project activities.

IRS's compliance planning documents list activities at a high level but the documents do not comprehensively identify specific planned actions or identify any interdependencies or sequencing of activities. For example, the November 2021 compliance plan references the general timing of actions for specific credit claimant populations, such as employers who claimed both the ERC and had a forgiven Small Business Administration PPP loan. However, there are no specific tasks in the compliance planning documents, and it is unclear how or if the actions are related, or whether a specific sequence is needed to ensure timely completion of the project.

IRS's project plan lists different topic areas and tracks task progress. Although these lists include tasks that are related to compliance, the document does not include many items that IRS said it is developing—such as examination selection criteria and filters. A schedule that identifies all activities and their interdependencies and sequencing would help IRS keep its efforts on track for timely completion.

Project stakeholder management. (Partially met.) According to the PMBOK® Guide, stakeholder management includes the processes required to identify the people, groups, or organizations that could affect or be affected by the project, to analyze stakeholder expectations and their effect on the project, and to develop appropriate management strategies for effectively engaging stakeholders. Plans that are comprehensive and list all relevant entities, processes, decisions, and risks, can clarify responsibilities and reduce potential confusion. IRS's efforts in this area were inconsistent and incomplete. For example, IRS's May 2020 compliance planning document states that the Specialty Tax COVID Team will develop a service-wide approach to address compliance. However, subsequent planning documents are limited in their discussion of the roles and responsibilities of other entities within IRS, such as Accounts Management processing adjusted returns, and there are no mentions of SB/SE's Office of Fraud Enforcement, which is involved in reviewing credits.

According to compliance planning documents, the processing delays of 2020 tax returns negatively affected the timing of compliance planning. IRS officials stated that they did not want to develop components of the compliance plans while processing returns because they needed to study the entire population of returns. An official also stated that, historically, compliance plans do not list all functions supporting the processing or reviewing of credits.

According to IRS officials, as of December 2021, IRS had transcribed 2020 employment tax returns and was developing examination selection criteria that they expect to be implemented by October 2022. As IRS prepares to increase compliance activities, the agency would benefit from developing a comprehensive and cohesive project plan to guide this effort that is based on established project management practices. This would help ensure that compliance risks are adequately identified and addressed and that resources are maximized.

IRS Has Not Documented New Processes to Address Some Compliance Risks

IRS has begun creating new processes to address compliance risks, including risks with adjusted returns. IRS is also researching the population of employers who have claimed multiple credits with restricted wages. Wage restrictions generally prohibit an employer from counting certain wages toward multiple tax credits. However, these efforts are not included in IRS's compliance documentation.

Adjusted returns. The CAA, 2021, further expanded ERC eligibility to include PPP borrowers, among others, and allowed for the credit to be claimed retroactively, for 2020, on adjusted returns. In calendar year 2021, IRS received 738,422 Forms 941-X, a 127 percent increase compared to 2019.[62] Adjusted returns can only be filed on paper, and have not historically been subject to the same controls as regular employment tax returns. IRS employees manually process adjusted returns prior to making account adjustments and issuing refunds. If a claim meets a certain dollar threshold and other criteria, it may be referred to SB/SE for examination consideration.[63]

[62]We did not compare with 2020 because of pandemic-related disruptions and because adjusted returns resulting from CAA, 2021, changes would not have been received in 2020. The 2021 data are as of November 22, 2021, and are incomplete with receipts still being entered into the data system. Aside from ERC claims there are other reasons that could cause an employer to file an adjusted return, such as correcting an error.

[63]These criteria are referred to as "Category-A" and they are intended to identify high-dollar amounts and other possible compliance issues. SB/SE employees examining these claims are instructed to review credit maximums and research information in IRS systems that affect credit calculations, such as the number of employees and wages and PPP loan forgiveness.

An IRS official stated that in March 2021, SB/SE started discussing computer programming to check the COVID-19 credits claimed on adjusted returns against eligibility requirements. The official said SB/SE plans to use the same filters that are under development to check for potential noncompliance on Form 941 filings.[64] Implementing these filters could potentially help IRS address compliance risks posed by adjusted returns. However, IRS's plans for developing and using the filters are not mentioned in IRS's compliance planning documents. An SB/SE official said the compliance plan is an overarching document, but the compliance review process for adjusted returns is specific to one unit within SB/SE.

In April 2022, as part of IRS's review of a draft of this report, the agency provided a document listing filters for tax credit eligibility that would be applied to employment tax data, including adjusted return information. The document provided information on data sources and thresholds for review for possible examination. However, it does not discuss how and when the filters will be implemented, including how processing backlogs for adjusted returns may affect 2020 account information. Therefore, it is unclear whether the filters can be run on complete 2020 return data, which includes retroactive ERC's filed on adjusted returns. The project plan and compliance plans that IRS provided did not discuss timeframes for these steps and sequencing of collecting return data and running filters. Not documenting the development, methodology, and next steps creates risks to continuity of operations and potentially limits transparency and oversight of these activities.

Tax credits with wage restrictions. For the second through fourth quarters 2020, we found an average of 7,026 employers that claimed both a leave credit and ERC per quarter, and therefore potentially claimed credits on the same wages for these two credits.[65] Employers cannot

[64]When processing adjusted returns, IRS reconciles the original return with the adjusted return, according to an IRS official. Although adjusted returns are not transcribed, the reconciled changes are transcribed and will be what the filters are run against, according to the official.

[65]These data are taxpayer reported credits on Form 941, and may contain taxpayer errors. Data are as of January 2022.

claim the ERC for wages taken into account for purposes of the leave credits and five other tax credits.[66]

In May 2020, IRS performed a risk assessment that included the wage restrictions on the ERC and the leave credits. IRS identified the restrictions against using the same wages for purposes of the ERC, leave credits, and Work Opportunity Tax Credit as "high risk" and stated that the risk would be handled through postfiling compliance activities. In April 2022, IRS provided research results on four of the non-COVID related credits that indicated a very small number of employers had claimed credits with potential restricted wages.[67] As a result, IRS officials said they determined the risk was not an issue and they would re-evaluate this risk when they begin working with 2021 returns. However, IRS's research did not address potential use of restricted wages between ERC and leave credit claimants. In its compliance plans, IRS also did not address how it would specifically address this risk during postfiling compliance activities.

Internal control standards state that effective documentation establishes and communicates the who, what, when, where, and why of internal control execution.[68] Documentation provides a means to communicate the knowledge that may be limited to a few personnel to both internal and external stakeholders. Without documentation on the adjusted return and restricted wage compliance processes, the timeline for completion and expected outcomes of the processes are unclear. Additionally, undocumented changes in the internal control system can affect efforts to monitor and evaluate internal control issues. Documenting the processes could help inform efforts for future tax credits with similar rules.

[66]The other tax credits are the Work Opportunity Tax Credit, and—for calendar quarters beginning after December 31, 2020—the Qualified Small Business Research Credit, Active Duty Members Credit, Indian Employment Credit, and the Empowerment Zone Employment Credit. CARES Act Pub. L. No. 116-136, § 2301(c)(3)(A)(ii), (h)(2), 134 Stat. 349, 350; CAA, 2021, Pub. L. No. 116-260, § 207(f)(1), 134 Stat. at 3063. Employers also cannot claim sick and family leave credits for wages taken into account for the Work Opportunity Tax Credit. FFCRA Pub. L. No. 116-127, § 7001(e)(1), 134 Stat. at 211.

[67]According to IRS officials, IRS does not plan to monitor compliance for the Indian Employment Credit with wage restrictions on ERC and leave credits. Restrictions would generally only apply to nontribal businesses with an employee and service performed substantially on a reservation since certain tribal-owned businesses are not subject to federal income tax and the Indian Employment Credit is used to offset those taxes.

[68]GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: Sept. 10, 2014).

Screening Filters Flagged Many Possible Ineligible Entities, but Additional Screening Could Be Beneficial

IRS's employment tax return screening flagged more than 65 percent of the employer identification numbers (EIN) that we identified as possible entities who may be ineligible for the leave credits or ERC.[69] Specifically, in preliminary data we found 337 EINs from employers who established their EINs in April 2020 or later, and filed for an employment tax credit on Form 941 in second quarter 2020, but then never filed an employment tax return again.[70] These returns claimed more than $100 million in leave credits and ERC. Of the 337 EINs, IRS held refunds and reviewed 196 EINs for possible identity theft. Approximately 30 other EINs were reviewed as potential fabricated entities.[71] The remaining EINs did not meet IRS's criteria for reviews, based on the screening filters, according to IRS officials.

There could be legitimate reasons for the credits—such as a newly created business that failed in a short period. However, some of these filers may not actually be employers or may be using a fabricated EIN, which relies on stolen information, to complete and file employment tax returns. Fabricated EINs and entities that are not actual employers are ineligible for leave credits or the ERC.[72]

In January 2020, we found IRS's application system for new EINs had control weaknesses, which can fail to identify fabricated EINs.[73] We recommended that IRS conduct a fraud risk assessment to help IRS establish a risk tolerance for the EIN application process and determine if

[69]Employment tax return screening involves using filters with criteria, prior to refund issuance, to look for potential identity theft. Staff are responsible for resolving those cases to both prevent IRS from paying out fraudulent refunds and ensure that legitimate taxpayers' returns are released for processing.

[70]Data were from August and September 2021, which we shared with IRS in December 2021 and January 2022. In an analysis based on January 2022 data, we found 438 filings for employers established April 2020 or later that filed for a tax credit for second quarter 2020 and then never filed again. Due to lags with updating IRS's databases, it is possible that some Forms 941 data were unavailable in time for our analysis and therefore may appear as an employer who stopped filing.

[71]To protect taxpayer privacy, IRS did not provide us with the exact number of EINs for reporting, since counts were below 10 for certain filers.

[72]Under the Families First Coronavirus Response Act, only eligible employers engaged in or affecting commerce are eligible to receive leave credits. Pub. L. No. 116-127, § 5110(2)(A)(ii), (B)(i)(I), 134 Stat. at 198–199. Under the CARES Act, only eligible employers carrying on a trade or business during calendar year 2020 can receive the ERC. Pub. L. No. 116-136, § 2301(c)(2)(A)(i), 134 Stat. at 348.

[73] GAO, *Identity Theft: IRS Needs to Better Assess the Risks of Refund Fraud of Business-Related Returns*, GAO-20-174 (Washington, D.C.: Jan. 30, 2020).

existing fraud controls are sufficient to address the vulnerabilities inherent to this process. While IRS agreed with this recommendation, as of February 2022, it had not provided evidence of any action to identify and assess other inherent fraud risks to business identity theft, such as the EIN application process. IRS had taken steps to assess fraud risk for 35 business-related tax forms, however.

Although the employment tax return screening flagged many of the returns we identified with potentially ineligible credit claims, it is possible some returns from fabricated EINs may have passed the filters and received refunds. For example, annual employment tax returns are subject to fewer filters. Also, none of the filters contain specific criteria to identify entities established after the enactment of FFCRA and the CARES Act. The control weaknesses in the EIN application system make back end checks—such as filtering through already processed 2020 and 2021 returns—an important complement to the screening filters.

SB/SE officials shared a list of compliance areas that are under consideration for using computerized filters to identify potential noncompliance specific to the tax credits. These areas are still under development, according to an SB/SE official, and they did not have any further information in the most recent compliance plan.[74] IRS could bolster its controls by using dates from the relevant legislation, refund amount and filing data, the establishment date for the employer, and other variables in filters to help identify tax credit recipients that may be ineligible employers.

Control Weaknesses Resulted in Invalid Tax Credits

IRS's internal controls did not reasonably assure that the ERC and leave credits claimed on Form 941 were valid and accurate before refunds were issued. Internal control standards indicate that management should design control activities to achieve objectives and respond to risks, such as designing appropriate types of control activities over information processing, the proper execution of transactions, and that all transactions are completely and accurately recorded.

To test controls over each program, we selected three generalizable random attribute samples. Each sample contained 93 transactions.[75] We

[74]The compliance areas did not contain specific information. Only one area, "no prior annual filing history," relates to filing patterns that could suggest a fabricated entity.

[75]Each sample of 93 transactions was planned using a 5 percent tolerable error and a 1 percent expected error at a 95 percent confidence level.

also reviewed 100 percent of the ERC and leave credits outliers that consist of transactions greater than $10 million and $7 million, respectively.

From our generalizable sample, we found that IRS disbursed two ERC and seven leave credits that the taxpayers did not claim on their Forms 941. We also found that IRS incorrectly posted a deferral of payroll taxes of about $16 million that the employer claimed as a leave credit.

Further, we found inaccuracies in three ERC and four leave credits claimed on Form 941. When we calculated the ERC or leave credit amount using the Form 941 worksheet 1, *Credit for Qualified Sick and Family Leave Wages and the Employee Retention Credit'*, and the taxpayer's information reported on Form 941, these credit amounts were substantively different than the credit amounts that were claimed by the taxpayer and disbursed by IRS.[76] IRS does not require the taxpayer to provide worksheet 1 and does not validate the accuracy of the credits before disbursement.

We identified six ERC errors out of the 93 randomly selected transactions. Based on the results of ERC control testing, we estimate at a 95 percent confidence level that 12.33 percent (a one-sided upper error limit) of the population of ERC transactions are in error. We also identified 11 leave credit errors out of 93 randomly selected transactions. Based on the results of leave credit control testing, we estimate at a 95 percent confidence level that 18.81 percent (a one-sided upper error limit) of the population of leave credits are in error. Further, we identified one ERC outlier error and one outlier leave credit error.

To provide relief to taxpayers quickly, IRS decided to limit internal controls that would have prevented invalid refunds related to the ERC and leave credits claimed on Form 941. Since these credits expired on or before December 31, 2021, IRS is not in the position to design and implement these controls to address future refund claims related to ERC and leave credits. However, IRS can continue to take action as part of its

[76]For the ERC and leave credits calculations on the Form 941 Worksheet 1, *Credit for Qualified Sick and Family Leave Wages and the Employee Retention Credit,* we used the information the taxpayer claimed on the Form 941 and the supporting documentation IRS provided. However, because Worksheet 1 was unavailable and the information was not on the taxpayer's account for line 1g (related to Section 3121 (q) Notice and Demand) and line 1j (related to Form 5884-C, *Work Opportunity Credit for Qualified Tax- Exempt Organizations Hiring Qualified Veterans),* we assumed a zero dollar amount for these lines in our calculation for the ERC and leave credits.

postfiling compliance or examination activities to address potential invalid or inaccurate employer credit refund claims. In doing so, IRS would help ensure taxpayers receive the appropriate tax treatment and that transactions are recorded accurately.

Conclusions

In response to the COVID-19 pandemic and its effects on the economy, the ERC, sick and family leave credits, and payroll tax deferrals provided billions of dollars of tax relief that could help employers maintain payroll and address the health-related leave needs of employees. IRS implemented these provisions—which were modified several times during 2020 and 2021—while it managed its own staffing and capacity challenges related to the pandemic. The large dollar amount of this relief, combined with IRS's relatively limited experience administering credits on employment tax returns, introduced a high level of risk for revenue loss.

Soon after the enactment of the CARES Act in March 2020, IRS began documenting plans to address compliance related challenges with the tax credits. As IRS moves toward selecting 2020 returns for examination and other compliance actions in 2022, IRS could better address compliance risks by using established project management practices to improve its planning efforts. Such practices would help IRS systematically identify and prioritize compliance risks and effectively deploy resources to address those risks.

IRS's compliance efforts would also benefit from documentation of compliance-related processes that are already underway. IRS can help ensure accountability and transparency with these processes by documenting the steps being taken to check eligibility for credit claims on adjusted returns and to ensure that tax credits are not claimed using restricted wages. Further, developing filters to identify tax credits potentially refunded to fabricated employers can help mitigate risks with IRS's EIN application system.

IRS's decision to limit controls prior to disbursing refunds—to help employers receive funds more quickly—contributed to the issuance of some invalid tax credit refunds. IRS could use postfiling compliance or examination activities to address already-issued tax credit refunds that may have been in error or otherwise were invalid.

Recommendations for Executive Action

We are making the following five recommendations to IRS:

The Commissioner of Internal Revenue should develop an integrated project management plan for the COVID-19 credits to improve IRS's ability to manage and plan compliance efforts related to these credits. The plan should include

- measurable objectives;
- key activities to support accomplishment of objectives, including documenting stakeholder involvement, knowledge sharing, and integrated change control; and
- details surrounding measuring, tracking, or reviewing the performance of the project, such as steps to verify if the actions of the plan were successful at mitigating compliance risks IRS identified. (Recommendation 1)

The Commissioner of Internal Revenue should document the processes being used to address compliance risks associated with Employee Retention Credit and leave credit claims on adjusted employment tax returns. (Recommendation 2)

The Commissioner of Internal Revenue should document the processes being used to address compliance risks associated with the Employee Retention Credit and leave credits that rely on wages that cannot be used for other tax credits. (Recommendation 3)

The Commissioner of Internal Revenue should implement additional controls to help identify tax credit recipients who may be ineligible employers. (Recommendation 4)

The Commissioner of Internal Revenue should update and implement postfiling compliance or examination activities to address potentially invalid or inaccurate employer credit refund claims that were not prevented by internal controls. (Recommendation 5)

Agency Comments and Our Evaluation

We provided a draft of this report to IRS and the Department of the Treasury for review and comment. IRS provided written comments, which are summarized below and reproduced in appendix IV. IRS and Treasury also provided technical comments, which we incorporated as appropriate.

In its written comments, IRS agreed with two recommendations and disagreed with three. Specifically, IRS agreed with the recommendations to document compliance risks associated with ERC and leave credit claims on adjusted employment tax returns (recommendation 2), and to document processes being used to address compliance risks associated with ERC and leave credits that rely on wages that cannot be used for other tax credits (recommendation 3).

IRS disagreed with the recommendation to develop an integrated project management plan for the credits (recommendation 1). In its letter, IRS said that it uses project management techniques. Its project plan includes details to implement the project, including compliance. IRS's compliance plan helps identify compliance risks and maintain a broad, overarching approach. IRS stated that post-processing compliance, in the form of examinations that consider taxpayer documents, is its next step. IRS also noted that the credits are temporary and the compliance efforts are now a work stream for examinations. Thus, it says a project management plan is no longer needed.

We acknowledge that IRS partially demonstrated the project management practices from the PMBOK® Guide. However, without measurable objectives, comprehensive planning documents and schedule management, and other practices, IRS is not fully prepared to move forward with compliance activities for the tax credits.

We also maintain that the temporary and unique nature of the credits makes project management practices, including an integrated and comprehensive plan, an important foundation for SB/SE's compliance efforts in this area. Releasing multiple versions of a compliance plan that accumulate rather than supersede each other, and additional documents—such as the project plan and the work plan—that are not unified and do not show evidence of coordination, run counter to practices such as those in the PMBOK® Guide.

IRS also disagreed with the recommendation to implement additional controls to help identify tax credit recipients that may be ineligible employers (recommendation 4). In its letter, IRS said there are existing work streams to address these credits. IRS mentioned the Office of Fraud Enforcement's Potential Fabricated Entities Review Project. This project targets fraud related to the credits and includes coordination with Criminal Investigation. As we mention in the report, the Office of Fraud Enforcement's responsibilities related to the tax credits are not mentioned in SB/SE's planning documents. Therefore, although the Potential Fabricated Entities Review Project may provide beneficial work on this issue, its omission from planning documents underscores the need for comprehensive planning and continued project management that includes all relevant resources, processes and stakeholders.

Moreover, despite IRS's disagreement with this recommendation, in April 2022, it provided documentation of a filter for employment tax return screening that may help identify ineligible employers, such as fabricated entities. We find this action encouraging and think it could help address some of the compliance risks we identified. However, it remains unclear how and when this filter will be integrated into IRS's compliance activities, particularly the examination work plan. The project plan does not include tasks such as filters and examination selection criteria.

IRS also disagreed with the recommendation to update and implement postfiling compliance or examination activities to address potentially invalid or inaccurate employer credit refund claims that were not prevented by internal controls (recommendation 5). We acknowledge the challenge of balancing compliance activities with the need to assist taxpayers, and the limitations of identifying invalid or inaccurate employer credit refund claims prior to disbursing the refund. Thus our focus with this recommendation is on the need for IRS to update and implement postfiling examination and compliance activities to assess the validity and accuracy of refund credits paid.

We are sending copies to the appropriate congressional committees, the Commissioner of Internal Revenue, and other interested parties. In addition, this report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff has any questions about this report, please contact us at (202) 512-3406 (clarkce@gao.gov) or (202) 512-6806 (lucasjudyj@gao.gov). Contact points for our offices of Congressional

Relations and Public Affairs are on the last page of this report. GAO staff members who made major contributions to this report are listed in appendix V.

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Appendix I: Objectives, Scope, and Methodology

This report (1) describes the Internal Revenue Service's (IRS) implementation of COVID-19-related employer tax provisions; (2) describes the characteristics of the employers leveraging these provisions and selected perspectives on their usefulness; and (3) evaluates IRS's plans and actions to identify and address taxpayer compliance risks.

Objective 1

To describe IRS' implementation of the sick and family leave credits (leave credits), the Employee Retention Credit (ERC), and payroll tax deferrals (collectively, "employer tax provisions"), we reviewed federal laws and our prior work, including reviewing the status of actions to address our prior on recommendations.[1] We monitored IRS's release of guidance (including frequently asked questions and notices) and other communications to taxpayers and their representatives (such as IRS.gov and tips for tax preparers). We also reviewed revisions to employment tax forms and instructions.

We analyzed IRS data, as of September and October 2021, on Form 7200, *Advance Payment of Employer Credits Due to COVID-19*, processing and rejections. We also reviewed IRS internal guidance describing the implementation methods and procedures for the tax provisions. We interviewed representatives from two payroll and one tax professional group to obtain feedback on their experiences with IRS's implementation of the employer tax provisions. We selected these groups because of their membership sizes and their members' roles with filing employment tax returns. We also interviewed IRS officials to discuss implementation processes and statutory changes.

Objective 2

Characteristics of Credit Claimants and Deferral Users

To describe the credit claimants, we analyzed IRS data from Form 941, *Employer's Quarterly Federal Tax Return*; Form 943, Employer's Annual Federal Tax Return for Agricultural Employees; Form 944, Employer's Annual Federal Tax Return, adjusted employment tax returns; and Form

[1]See GAO, *COVID-19: Continued Attention Needed to Enhance Federal Preparedness, Response, Service Delivery, and Program Integrity*, GAO-21-551 (Washington, D.C.: July 10, 2021); *COVID-19: Sustained Federal Action Is Crucial as Pandemic Enters Its Second Year,* GAO-21-387 (Washington, D.C.: Mar. 31, 2021); *Urgent Actions Needed to Better Ensure an Effective Federal Response*, GAO-21-191 (Washington, D.C.: Nov. 30, 2020); *Opportunities to Improve Federal Response and Recovery Efforts*, GAO-20-625 (Washington, D.C.: June 25, 2020).

1040, Individual Income Tax Return, Schedule 3.[2] Third-party payers, such as payroll companies filing returns on behalf of many clients, use Schedule R, 941)

Allocation Schedule for Aggregate Form 941 Filers, to allocate their clients' dollar amounts for each line on Form 941 or 943. We included data on the individual employers listed on Schedule R, with the exception of the paper Schedule Rs submitted by Form 943 filers, as those lines are not keyed into IRS's data systems.[3]

An IRS official said the agency finished entering information from Forms 941, 943, and 944 for 2020 into IRS's data systems on December 14, 2021. IRS stores each form's data in a different system. Thus, the dates covered are different for each form (see table 9). We include 2021 employment tax return data, reported separately, for the returns that were in IRS's systems as of January 2022.

Table 9: Tax Returns Analyzed

	Date of data	
Return	**E-file**	**Paper**
Form 941	January 15, 2022	January 9, 2022
Schedule R	January 15, 2022	January 18, 2022
Form 943	January 9, 2022	January 9, 2022
Form 944	January 9, 2022	January 9, 2022
Form 1040, Schedule 3	December 30, 2021	December 30, 2021
Adjusted returns Forms 941-X	N/A, all returns are paper	November 25, 2021

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

The dollar figures we are reporting are subject to taxpayer reporting error. We report what was filed without adjustments. So, these figures may differ from figures reported by IRS. For data from adjusted returns, such as Form 941-X, we analyzed account transaction codes and credit reference numbers to identify employers that received an ERC. Unlike

[2]Self-employed individuals file for their leave credits and report payroll tax deferrals on their income tax return. Certain employers also claim COVID-19-related credits on Form CT-1, *Employer's Annual Railroad Retirement Tax Form*. We did not include these filers in our review.

[3]Only 15 Forms 943 in our data that had an accompanying Schedule R.

taxpayer-provided data on employment tax returns, these codes reflect actions on the employer's account.

We obtained additional descriptive information on employers by matching employer identification numbers with data in IRS's Business Master File. We identified the industry sectors associated with the employers through the North American Industry Classification System (NAICS) codes that employers reported on returns.[4] The NAICS has a hierarchical structure and the codes contain six digits. The first two digits designate the NAICS sectors—such as Manufacturing or Construction—that represent general categories of economic activities. NAICS classifies all economic activities into 20 sectors. The third digit represents the subsector.

The total values, by provision, in our analyses of NAICS sectors and subsectors may be less than the totals we present for all credits and deferrals for a sector. Our summary totals for the provisions include the following items which are not included in our NAICS analyses:

- Leave credit and deferral data from self-employed individuals, which would require additional analysis using Social Security numbers.
- Counts that were too small to analyze because of taxpayer privacy considerations.

Taxpayers report NAICS codes and therefore they are subject to error, as identified in previous IRS research.[5] Of the employers who used the ERC, leave credits, or payroll tax deferrals, between about 4.5 and 8 percent had neither a NAICS code on file nor a valid number. The blank codes could be from new employers that had yet to file income tax returns with a code. Blank codes could also be taxpayer errors.

In prior work we used information from the 2020 Bureau of Labor Statistics' Business Response Survey to identify six "hardest-hit" sectors, or sectors that were most likely to experience adverse effects to business

[4]NAICS is the standard used by federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy. On corporate income tax returns, taxpayers are instructed to determine from a provided list which business activity from which the company derives the largest percentage of its total receipts. This list is based on the NAICS.

[5]For example, in 2019 IRS summarized its research on NAICS error rates and how well business descriptions from tax returns matched NAICS code descriptions.

operations as a result of the pandemic.[6] These six sectors are (1) Accommodation and Food Services; (2) Arts, Entertainment, and Recreation; (3) Educational Services; (4) Health Care; (5) Manufacturing; and (6) Retail Trade.

To identify these six, we ranked sectors based on the following four adverse effects to business operations, expressed in survey responses, of resulting from the pandemic: (1) shortage of supplies or inputs, (2) decrease in demand for products or services, (3) difficulty in moving or shipping goods, and (4) government-mandated closure of a business location. Of those four, we consider a decrease in demand for products or services and a government-mandated closure of a business location as adverse effects that are more likely to affect employment. We also used the Bureau of Labor Statistics' data on employee numbers by sector for 2019 and 2020 (not seasonally adjusted) from the Current Employment Statistics Survey.

We also used Business Master File data on filing requirements and employment codes to categorize employers by type.[7] Filing requirements indicate which type of tax returns the employer is responsible for filing. They also indicate whether an employer is a corporation or tax-exempt organization. Employment codes identify other entities—such as state and local government agencies—which do not have income tax filing requirements. To categorize the employers, we had to make certain assumptions which make the analysis imperfect. We consulted with IRS about how to best categorize employers with more than one filing requirement. For example, for employers with a filing requirement for both a corporate income tax form and a tax-exempt organization information return, we categorized the employers as tax-exempt organizations.

We obtained payroll tax deferral repayment data from IRS officials as of December 31, 2021.

We also reviewed a research paper that used Form 941 data to estimate usage and take-up rates from 2020 and 2021 for each of the provisions,

[6]See GAO, *Paycheck Protection Program: Program Changes Increased Lending to the Smallest Businesses and Underserved Locations,* GAO-21-601 (Washington D.C.: Sept. 21, 2021).

[7]We analyzed account data for the employer identification numbers of employment tax return filers, we did not match information on employment tax returns with other forms.

including an analysis of NAICS sectors. [8] When considering differences in our methodologies and forms included in the analysis, we found that our analyses were generally in agreement.[9] We assessed the reliability of employment tax, Form 1040, and Business Master File data by reviewing relevant documentation, reviewing written responses from knowledgeable IRS officials, and electronically testing the data to identify obvious errors or outliers. We determined that the data used in our analysis were sufficiently reliable for the purpose of describing employers using the tax credits and payroll tax deferrals.

Employer Experience with the Credits and Deferrals

We interviewed representatives and members from tax preparation and payroll industry groups and representatives from business groups to discuss their experiences filing for the tax credits, and the usefulness of the credits and deferrals in retaining employees and continuing operations. We selected one tax preparer and two payroll professional groups based on their size and the role of their professionals in filing employment tax returns. We met with group representatives and professional members of the groups.[10] Two of these groups also provided us with email feedback from some of their members that work with employment tax issues. We selected business groups that represent small businesses and certain demographic groups. We met with representatives from 11 business groups and members from one other business group. The interviews and emails provided anecdotal information that is not representative or generalizable to all professionals or groups.

Objective 3

IRS Compliance Planning

To evaluate IRS's plans and actions to identify compliance risks we analyzed a variety of agency documents. These documents include compliance and implementation plans, Internal Revenue Manual sections, desk guides and other procedures, and draft filters. We compared IRS

[8]Goodman, Lucas, *Take-up of Payroll Tax-Based Subsidies During the COVID-19 Pandemic,* (Washington, D.C.: Nov. 8, 2021).

[9]The research paper estimated values for paper returns that are still in processing and did not include annual returns. For 2020 data, our data on ERC and deferral dollars were slightly lower given the methodology in the paper. Our data on leave credits were slightly higher, which we attributed to how the paper's modeling may have treated outlier values.

[10]For example, we met with groups that represent small businesses and self-employed individuals generally, and groups that represent women, Black, Hispanic, Asian, and Native American small business owners.

documents with eligibility requirements for the tax credits, found in legislation, and with selected project management practices.[11] For the selected project management practices, we reviewed *A Guide to the Project Management Body of Knowledge* (PMBOK® Guide), which consists of 13 sections. We determined that there are three sections containing a total of 13 subsections that are relevant. The three relevant sections include project integration management, project schedule management, and project stakeholder management. We selected the practices based on their relevance to IRS's identified compliance risks for employer tax credits. We discussed IRS's procedures and plans with IRS officials in interviews.

We also used Business Master File and employment tax data to analyze employers that may have been newly created to claim invalid tax credit refunds. We reviewed employers that were established in or after April 2020, filed for a credit refund in second quarter 2020, and then stopped filing a Form 941.

We interviewed IRS employees to discuss their experience with implementing compliance procedures related to the COVID-19-related provisions. Based on IRS documentation, we selected five processes from different IRS divisions related to reviewing the ERC and leave credits. When necessary, we considered office locations and randomly selected employees to participate in interviews to discuss their work, IRS guidance and training, compliance issues, and other topics. We used these interviews to understand IRS's processes and to identify challenges.

Testing IRS Controls on Credit Disbursements

To test controls over ERC, leave credit, and related advance credit transactions, we selected three generalizable random attribute samples of credits that IRS processed between April 16, 2020, and February 27, 2021. Each sample was planned with a tolerable error of 5 percent and an expected error of 1 percent at a 95 percent confidence level. Additionally, we tested all outlier transactions related to the ERC, leave credits, and advance credits. The outliers consisted of dollar amounts greater than $10 million and $7 million respectively (see table 10).

[11]Project management practices are from Project Management Institute, Inc., *A Guide to the Project Management Body of Knowledge* (PMBOK® Guide), Sixth Edition (Newtown Square, PA: 2017). PMBOK is a trademark of Project Management Institute, Inc. The Project Management Institute is a not-for-profit association that provides global standards for, among other things, project and program management.

Table 10: Population, Sample Size, and Outliers Selected for Review

COVID-19 employer credit type	Population transaction count	Population dollar amount	Sample size
Sample and population sizes			
Employee Retention Credit	70,185	$2,274,805,883.19	93
Paid Sick and Family Medical Leave Credit	50,893	$939,367,336.17	93
Advanced Credit	10,476	$380,051,114.87	93
Outliers identified for review			
Employee Retention Credit Outliers	18	$500,427,630.72	18
Sick and Family Leave Credit Outliers[a]	-----	-----	-----
Advance Credits Outliers	10	$159,494,675.02	10

Source: GAO. | GAO-22-104280

[a]We are not reporting the number and amount of outliers for the sick and family leave credits because the small cell counts could constitute a disclosure of taxpayer information.

To determine whether IRS designed and implemented internal controls related to the disbursement of the COVID-19 employer credits, we obtained and reviewed IRS internal documentation for each sample transaction to determine whether

- each COVID-19 tax credit was accurately recorded to the taxpayers' module;
- duplicate credits were issued;
- the employer credits were offset to outstanding liability before the refund was disbursed; and
- IRS reconciled any advance credits claimed on Form 7200 with the taxpayer's filed Form 941.

We also obtained and reviewed external documentation such as tax returns related to each sample transaction to determine whether: (1) the information from the tax return matched the taxpayer's module records;

(2) the COVID-19 tax credits were calculated correctly; and (3) the taxpayers were eligible to receive the tax credit.[12]

We conducted this performance audit from April 2020 to May 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[12]The tax returns included copies of 2020 Form 7200, *Advance Payment of Employer Credits Due to COVID-19* and Form 941. For employer credits' claimed on Form 941 we computed the COVID-19 tax credit using the Worksheet 1, *Credit for Qualified Sick and Family Leave Wages and the Employee Retention Credit*, and the information reported on the taxpayer's return. The leave credits had limitations on the number of employees the employer can have (less than 500 employees). The ERC had limitations on the dollar amount per employee for which a credit could be claimed. However, we were only able to determine the eligibility of leave credits for advance credits claimed on Form 7200 using the number of employees the taxpayer reported on the tax return.

Appendix II: COVID-19-Related Tax Credits and Payroll Tax Deferrals by Industry Sector

The tables below show industry sector data for the paid sick and family leave credits (leave credits), Employee Retention Credit (ERC), and payroll tax deferrals for 2020. The tables include the 20 sectors identified in the North American Industry Classification System (NAICS). See appendix I for details on our methodology.

The total values, by provision, in our analyses of NAICS sectors are less than the totals we present in the report for all credits and deferrals. Our summary totals in the report include the following items which are not included in our NAICS analyses:

- Leave credit and deferral data from self-employed individuals reported on income tax returns, as this would require additional analysis using Social Security numbers.
- Counts that were too small to analyze because of taxpayer privacy considerations.

Table 11: Paid Sick and Family Leave Credits, by Industry Sector, 2020

North American Industry Classification System sector	Amount claimed (dollars in millions)	Average credit per employer (dollars)	Number of employers claiming[a]	"Hardest-hit" sector (check for yes)
Professional, Scientific, and Technical Services	2,542	47,712	53,285	
Manufacturing	1,069	21,148	50,561	☑
Health Care and Social Assistance	814	10,355	78,615	☑
Construction	748	13,653	54,772	
Retail Trade	506	9,710	52,101	☑
Wholesale Trade	313	13,257	23,576	
Other Services (except Public Administration)	294	8,412	34,982	
Invalid	275	11,879	23,172	
Accommodation and Food Services	266	6,420	41,441	☑
Administrative and Support and Waste Management and Remediation Services	248	12,174	20,347	
Finance and Insurance	177	13,040	13,541	
Real Estate and Rental and Leasing	170	9,174	18,536	
Transportation and Warehousing	153	10,925	14,042	
Educational Services	147	14,009	10,529	☑
Agriculture, Forestry, Fishing and Hunting	80	10,383	7,707	
Arts, Entertainment, and Recreation	69	10,152	6,775	☑
Information	56	11,790	4,719	
Mining, Quarrying, and Oil and Gas Extraction	42	22,118	1,920	

North American Industry Classification System sector	Amount claimed (dollars in millions)	Average credit per employer (dollars)	Number of employers claiming[a]	"Hardest-hit" sector (check for yes)
Management of Companies and Enterprises	42	19,099	2,195	
Utilities	11	19,633	552	
Public Administration	4	22,952	183	
Total	**8,027**	**15,629**	**513,619**	

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The table includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944 data as of January 2022. We did not include leave credits for self-employed individuals in this analysis. Sectors are based on the North American Industry Classification System. In prior work we used information from the 2020 Bureau of Labor Statistics' Business Response Survey to identify six "hardest-hit" sectors, or sectors that were most likely to experience adverse effects to business operations as a result of the pandemic. See GAO-21-601.

[a]This column shows the number of unique employers who claimed a credit. Employers claiming credits on more than one Form 941 are counted once. The numbers in this column do not equal the total because we had to exclude some data from the sector rows to protect taxpayer privacy.

Table 12: Employee Retention Credits, by Industry Sector, 2020

North American Industry Classification System sector	Amount claimed (dollars in millions)	Average credit per employer (dollars)	Number of employers claiming[a]	"Hardest-hit" sector (check for yes)
Accommodation and Food Services	1,481	90,298	16,398	☑
Retail Trade	1,345	117,827	11,412	☑
Manufacturing	1,190	250,440	4,751	☑
Transportation and Warehousing	851	272,095	3,126	
Arts, Entertainment, and Recreation	740	157,608	4,692	☑
Professional, Scientific, and Technical Services	737	56,708	13,000	
Health Care and Social Assistance	652	62,224	10,480	☑
Administrative and Support and Waste Management and Remediation Services	527	130,008	4,057	
Other Services (except Public Administration)	345	26,149	13,195	
Information	327	209,789	1,558	
Educational Services	323	135,148	2,392	☑
Wholesale Trade	294	75,013	3,924	
Invalid	294	31,484	9,343	
Construction	235	22,980	10,221	
Finance and Insurance	229	94,359	2,422	
Management of Companies and Enterprises	191	353,509	541	

North American Industry Classification System sector	Amount claimed (dollars in millions)	Average credit per employer (dollars)	Number of employers claiming[a]	"Hardest-hit" sector (check for yes)
Real Estate and Rental and Leasing	164	31,884	5,152	
Agriculture, Forestry, Fishing and Hunting	51	22,032	2,323	
Mining, Quarrying, and Oil and Gas Extraction	39	88,688	436	
Utilities	13	175,458	72	
Public Administration	0	0	0	
Total	**10,029**	**83,876**	**119,573**	

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The table includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944 data as of January 2022. Sectors are based on the North American Industry Classification System. In prior work we used information from the 2020 Bureau of Labor Statistics' Business Response Survey to identify six "hardest-hit" sectors, or sectors that were most likely to experience adverse effects to business operations as a result of the pandemic. See GAO-21-601.

[a]This column shows the number of unique employers who claimed a credit. Employers claiming credits on more than one Form 941 are counted once. The numbers in this column do not equal the total because we had to exclude some data from the sector rows to protect taxpayer privacy.

Table 13: Payroll Tax Deferrals, by Industry Sector, 2020

North American Industry Classification System sector	Payroll tax deferred (dollars in billions)	Average deferral per employer (dollars)	Percentage of employers using[a]	"Hardest-hit" sector (check for yes)
Manufacturing	20.7	1,161,930	6.8	☑
Professional, Scientific, and Technical Services	15.6	530,546	3.2	
Health Care and Social Assistance	14.7	517,892	4.3	☑
Retail Trade	11.1	837,771	1.9	☑
Invalid	7.5	481,887	3.8	
Administrative and Support and Waste Management and Remediation Services	7.1	784,739	3.1	
Transportation and Warehousing	5.6	1,082,708	2.3	
Finance and Insurance	5.1	740,530	2.9	
Information	5.1	882,906	6.1	
Wholesale Trade	4.5	547,329	3.2	
Construction	3.7	330,213	1.4	
Other Services (except Public Administration)	3.5	319,428	1.4	
Educational Services	3.3	1,051,881	3.1	☑

North American Industry Classification System sector	Payroll tax deferred (dollars in billions)	Average deferral per employer (dollars)	Percentage of employers using[a]	"Hardest-hit" sector (check for yes)
Management of Companies and Enterprises	2.3	835,711	13.9	
Accommodation and Food Services	2.0	136,501	2.7	☑
Real Estate and Rental and Leasing	1.9	246,452	2.0	
Public Administration	1.9	42,618,173	1.3	
Utilities	1.4	2,812,770	7.9	
Arts, Entertainment, and Recreation	0.8	181,592	2.7	☑
Mining, Quarrying, and Oil and Gas Extraction	0.8	715,647	4.5	
Agriculture, Forestry, Fishing and Hunting	0.3	216,879	0.8	
Total	**118.7**	**602,923**	**2.8**	

Source: GAO analysis of Internal Revenue Service data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. The table includes: 2020 Forms 941 (data first through fourth quarters 2020), 943, and 944 data as of January 2022. We did not include deferrals for self-employed individuals in this analysis. Sectors are based on the North American Industry Classification System. In prior work we used information from the 2020 Bureau of Labor Statistics' Business Response Survey to identify six "hardest-hit" sectors, or sectors that were most likely to experience adverse effects to business operations as a result of the pandemic. See GAO-21-601.

[a]This calculation is based on the total number of deferrals reported by an employer with a unique employer identification number on Forms 941, 943, and 944, and the total number of filers of these forms, by sector.

Appendix III: COVID-19-Related Tax Credits and Payroll Tax Deferral, Additional Data for Selected Sectors

The figures below show the usage of the sick and family leave credits (leave credits), Employee Retention Credit, and payroll tax deferrals for the six "hardest-hit" sectors, and other sectors that appear in the top five highest users, in dollars, for any of the three provisions.[1] For the sectors that have subsectors in the North American Industry Classification System (NAICS), we show usage for all or top subsectors.

The total values, by provision, in our analyses of NAICS subsectors may be less than the totals we present for all credits and deferrals for a sector. Our summary totals for the provisions include the following items which are not included in our NAICS analyses:

- Leave credit and deferral data from self-employed individuals reported on income tax returns, as this would require additional analysis using Social Security numbers.
- Counts that were too small to analyze because of taxpayer privacy considerations.

Figure 4: Accommodation and Food Service Sector Employee Retention Credits, Leave Credits and Payroll Tax Deferrals, 2020

Accommodation and Food Service

Establishments providing customers with lodging and/or preparing meals, snacks, and beverages for immediate consumption.

Employers	Wages and compensation	Percent change in employment, 2019 to 2020
537,805	$145 billion	-18

	Dollars (millions)	Percent of all dollars claimed/deferred	Number of employers using	Percent of all dollars claimed/deferred, by subsector	
				Accommodation	Food services and drinking places
Tax credits					
Employee Retention Credit	$1,481	15%	16,398	20%	79%
Leave credits	$266	3%	41,441	17%	83%
Payroll tax deferrals	$1,950	2%	14,289	20%	80%

Source: GAO analysis of Internal Revenue Service and U.S. Bureau of Labor Statistics data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022; and Form 1040 data for self-

[1]These six sectors are (1) Accommodation and Food services; (2) Arts, Entertainment, and Recreation; (3) Educational services; (4) Health Care; (5) Manufacturing; and (6) Retail Trade. See appendix I for more information and GAO, *Paycheck Protection Program: Program Changes Increased Lending to the Smallest Businesses and Underserved Locations,* GAO-21-601 (Washington D.C.: Sept. 21, 2021).

employed individuals, data from December 2021. The percentages by subsector may not total 100 due to rounding and exclusions of subsector data that were too small to protect taxpayer privacy. Sectors are based on the North American Industry Classification System.

Figure 5: Administrative and Support and Waste Management and Remediation Services Sector Employee Retention Credits, Leave Credits and Payroll Tax Deferrals, 2020

Administrative and Support and Waste Management and Remediation Services

Establishments performing routine support activities for the day-to-day operations of other organizations.
These essential activities are often undertaken in house by establishments in many sectors of the economy.

Employers	Wages and compensation	Percent change in employment, 2019 to 2020
292,015	$294 billion	-8

	Dollars (millions)	Percent of all dollars claimed/ deferred	Number of employers using	Percent of all dollars claimed/deferred, by subsector	
				Administrative and support	Waste management and remediation
Tax credits					
Employee Retention Credit	$527	5%	4,057	96%	2%
Leave credits	$248	3%	20,347	92%	8%
Payroll tax deferrals	$7,116	3%	9,068	95%	5%

Source: GAO analysis of Internal Revenue Service and U.S. Bureau of Labor Statistics data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022; and Form 1040 data for self-employed individuals, data from December 2021. The percentages by subsector may not total 100 due to rounding and exclusions of subsector data that were too small to protect taxpayer privacy. Sectors are based on the North American Industry Classification System.

Figure 6: Arts, Entertainment, and Recreation Sector Employee Retention Credits, Leave Credits and Payroll Tax Deferrals, 2020

Arts, Entertainment, and Recreation

Establishments that operate facilities or provide services to meet varied cultural, entertainment, and recreational interests of their patrons. This sector comprises establishments that: produce, promote, or participate in live performances, events, or exhibits; preserve and exhibit objects and sites of interest; and enable patrons to participate in recreational activities or pursue interests.

Employers	Wages and compensation	Percent change in employment, 2019 to 2020
157,905	$63 billion	-27

	Dollars (millions)	Percent of all dollars claimed/ deferred	Number of employers using	Percent of all dollars claimed/deferred, by subsector		
				Performing arts, sports and related	Museums, historical sites	Amusement, gambling and recreation
Tax credits						
Employee Retention Credit	$740	7%	4,692	20%	3%	74%
Leave credits	$69	1%	6,775	17%	12%	68%
Payroll tax deferrals	$769	1%	4,236	26%	12%	60%

Source: GAO analysis of Internal Revenue Service and U.S. Bureau of Labor Statistics data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022; and Form 1040 data for self-employed individuals, data from December 2021. The percentages by subsector may not total 100 due to rounding and exclusions of subsector data that were too small to protect taxpayer privacy. Sectors are based on the North American Industry Classification System.

Figure 7: Construction Sector Employee Retention Credits, Leave Credits, and Payroll Tax Deferrals, 2020

Construction

Establishments primarily engaged in the construction of buildings or engineering projects. Establishments inlude those primarily engaged in the preparation of sites for new construction and those primarily engaged in subdividing land as building sites. Work may include new work, additions, alterations, or maintenance and repairs.

Employers	Wages and compensation	Percent change in employment, 2019 to 2020
774,355	$348 billion	-3

	Dollars (millions)	Percent of all dollars claimed/ deferred	Number of employers using	Percent of all dollars claimed/deferred, by subsector		
				Buildings	Heavy and civil engineering	Specialty trade contractors
Tax credits						
Employee Retention Credit	$235	2%	10,221	28%	8%	58%
Leave credits	$748	9%	54,772	17%	10%	69%
Payroll tax deferrals	$3,658	3%	11,078	18%	23%	53%

Source: GAO analysis of Internal Revenue Service and U.S. Bureau of Labor Statistics data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022; and Form 1040 data for self-employed individuals, data from December 2021. The percentages by subsector may not total 100 due to rounding and exclusions of subsector data that were too small to protect taxpayer privacy. Sectors are based on the North American Industry Classification System.

Figure 8: Educational Services Sector Employee Retention Credits, Leave Credits, and Payroll Tax Deferrals, 2020

Educational Services

Establishments that provide instruction and training in a wide variety of subjects. This instruction and training is provided by specialized establishments, such as schools, colleges, universities, and training centers. Includes establishments privately owned and operated for profit or not for profit, or publicly owned and operated.

Employers	Wages and compensation	Percent change in employment, 2019 to 2020
100,960	$163 billion	-8

	Dollars (millions)	Percent of all dollars claimed/ deferred	Number of employers using
Tax credits			
Employee Retention Credit	$323	3%	2,392
Leave credits	$147	2%	10,529
Payroll tax deferrals	$3,264	3%	3,103

Source: GAO analysis of Internal Revenue Service and U.S. Bureau of Labor Statistics data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022; and Form 1040 data for self-employed individuals, data from December 2021. The percentages by subsector may not total 100 due to rounding and exclusions of subsector data that were too small to protect taxpayer privacy. Sectors are based on the North American Industry Classification System.

Figure 9: Health Care and Social Assistance Sector Employee Retention Credits, Leave Credits, and Payroll Tax Deferrals, 2020

Health Care and Social Assistance

Establishments providing health care and social assistance for individuals. All industries in the sector rely on labor inputs of health practitioners or social workers with the requisite expertise.

Employers	Wages and compensation	Percent change in employment, 2019 to 2020
664,521	$656 billion	-3

	Dollars (millions)	Percent of all dollars claimed/ deferred	Number of employers using	Percent of all dollars claimed/deferred, by subsector			
				Ambulatory health care	Hospitals	Nursing and residential care facilities	Social assistance
Tax credits							
Employee Retention Credit	$652	7%	10,480	38%	40%	5%	14%
Leave credits	$814	10%	78,615	60%	5%	14%	20%
Payroll tax deferrals	$14,665	12%	28,316	34%	51%	8%	3%

Source: GAO analysis of Internal Revenue Service and U.S. Bureau of Labor Statistics data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022; and Form 1040 data for self-employed individuals, data from December 2021. The percentages by subsector may not total 100 due to rounding and exclusions of subsector data that were too small to protect taxpayer privacy. Sectors are based on the North American Industry Classification System.

Figure 10: Manufacturing Sector Employee Retention Credits, Leave Credits, and Payroll Tax Deferrals, 2020

Manufacturing

Establishments engaged in the mechanical, physical, or chemical transformation of materials, substances, or components into new products. Establishments are often described as plants, factories, or mills and use power-driven machines and material handling equipment.

Employers	Wages and compensation	Percent change in employment, 2019 to 2020
263,271	$711 billion	-5

	Dollars (millions)	Percent of all dollars claimed/ deferred	Number of employers using	Percent of all dollars claimed/deferred, by subsector (top 3)					
				Fabricated metal	Misc.	Food	Transportation equipment	Computer and electronic	All others
Tax credits									
Employee Retention Credit	$1,190	12%	4,751			13%	33%	18%	34%
Leave credits	$1,069	13%	50,561	20%	13%	9%			55%
Payroll tax deferrals	$20,694	17%	17,810		12%		16%	14%	55%

Source: GAO analysis of Internal Revenue Service and U.S. Bureau of Labor Statistics data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022; and Form 1040 data for self-employed individuals, data from December 2021. Percentages by subsector may not total 100 due to rounding and exclusions of subsector data that were too small to protect taxpayer privacy. Sectors are based on the North American Industry Classification System.

Figure 11: Professional, Scientific, and Technical Services Sector Employee Retention Credits, Leave Credits, and Payroll Tax Deferrals, 2020

Professional, Scientific, and Technical Services

Establishments that specialize according to expertise and provide services to clients. Activities include: legal; accounting, bookkeeping, and payroll; architectural and engineering; computer services; consulting; research; advertising; photography; and veterinary.

Employers	Wages and compensation	Percent change in employment, 2019 to 2020
918,290	$785 billion	-1

	Dollars (millions)	Percent of all dollars claimed/ deferred	Number of employers using
Tax credits			
Employee Retention Credit	$737	7%	13,000
Leave credits	$2,542	32%	53,285
Payroll tax deferrals	$15,583	13%	29,371

Source: GAO analysis of Internal Revenue Service and U.S. Bureau of Labor Statistics data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022; and Form 1040 data for self-employed individuals, data from December 2021. The percentages by subsector may not total 100 due to rounding and exclusions of subsector data that were too small to protect taxpayer privacy. Sectors are based on the North American Industry Classification System.

Figure 12: Retail Trade Employee Retention Credits, Leave Credits, and Payroll Tax Deferrals, 2020

Retail Trade

Establishments engaged in retailing merchandise, generally without transformation, and rendering services incidental to the sale of merchandise. Retail is the final step in the distribution of merchandise; retailers sell in small quantities to the general public.

Employers	Wages and compensation	Percent change in employment, 2019 to 2020
687,992	$535 billion	-5

	Dollars (millions)	Percent of all dollars claimed/ deferred	Number of employers using	Percent of all dollars claimed/deferred, by subsector (top 3)						
				Food and beverage stores	Motor vehicle and parts dealers	Nonstore retailers	Electronics and appliance stores	Clothing and clothing accessories stores	General merchandise	All others
Tax credits										
Employee Retention Credit	$1,345	13%	11,412	19%			7%	35%		38%
Leave credits	$506	6%	52,101	14%	41%	9%				35%
Payroll tax deferrals	$11,122	9%	13,276	26%		18%			14%	41%

Source: GAO analysis of Internal Revenue Service and U.S. Bureau of Labor Statistics data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022; and Form 1040 data for self-employed individuals, data from December 2021. The percentages by subsector may not total 100 due to rounding and exclusions of subsector data that were too small to protect taxpayer privacy. Sectors are based on the North American Industry Classification System.

Figure 13: Transportation and Warehousing Sector Employee Retention Credits, Leave Credits, and Payroll Tax Deferrals, 2020

Transportation and Warehousing

Includes industries providing transportation of passengers and cargo, warehousing and storage for goods, scenic and sightseeing transportation, and related support activities. Establishments in these industries use transportation equipment or transportation related facilities as a productive asset.

Employers	Wages and compensation	Percent change in employment, 2019 to 2020
222,399	$187 billion	-2

	Dollars (millions)	Percent of all dollars claimed/ deferred	Number of employers using	Percent of all dollars claimed/deferred, by subsector (top 3)						
				Air	Truck	Couriers and messengers	Warehousing and storage	Support activities	Transit and ground passenger	All others
Tax credits										
Employee Retention Credit	$851	8%	3,126	73%	4%				13%	8%
Leave credits	$153	2%	14,042		43%		14%	18%		20%
Payroll tax deferrals	$5,620	5%	5,191	28%	28%	18%				24%

Source: GAO analysis of Internal Revenue Service and U.S. Bureau of Labor Statistics data. | GAO-22-104280

Notes: Dollar figures and sector information we are reporting are as reported by taxpayers and are subject to taxpayer reporting error. These figures may differ from IRS's reported figures because we are reporting what was filed without adjustments. The figure includes: 2020 Forms 941 (data on first through fourth quarters 2020), 943, and 944, data as of January 2022; and Form 1040 data for self-employed individuals, data from December 2021. The percentages by subsector may not total 100 due to rounding and exclusions of subsector data that were too small to protect taxpayer privacy. Sectors are based on the North American Industry Classification System.

Appendix IV: Comments from the Internal Revenue Service

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

OFFICE OF THE
CHIEF RISK OFFICER

April 28, 2022

Jessica Lucas-Judy
Director, Tax Issues, Strategic Issues

Cheryl E. Clark
Director, Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Lucas-Judy and Ms. Clark,

Thank you for the opportunity to review and comment on your draft report titled: *COVID-19: IRS Implemented Tax Relief for Employers Quickly, but Could Strengthen Its Compliance Efforts* (Job Code 104280). This audit presented unique challenges, as GAO conducted this audit in real time, while we were implementing fast changing and sometimes retroactively changing legislation.

The Families First Coronavirus Response Act (FFCRA) and Coronavirus Aid, Relief, and Economic Security (CARES) Act were enacted in March 2020. These new provisions established the Paid Sick & Family Leave Credit, Employee Retention Credit (ERC), an ability to receive an advance payment of these amounts, and the payroll tax deferral. Subsequent legislation in December 2020, March 2021 and November 2021 extended and/or modified limitations and qualifications for these credits.

These last two years have been unprecedented, and we are proud of the significant actions we expeditiously took to implement extensive legislative tax changes. While maintaining the balance of providing relief to American employers and ensuring compliance we quickly, fairly and equitably processed billions of dollars in credits and deferrals while simultaneously addressing the pandemic's impact on our own workforce and operations.

Within one month of enactment, we delivered strategic communication, designed the new Form 7200, *Advance Payment of Employer Credits due to COVID-19*; developed processes and procedures to enable employers to submit these requests; and established and trained multiple teams to manually review 100% of all submitted Forms 7200 prior to processing, to include a referral process for suspicious requests through the Office of Fraud Enforcement (OFE). Shortly after, we published revised employment tax forms and their accompanying instructions (e.g. Forms 941, 943, 944, CT-1) to allow for reporting of credits; established business rules for processing of revised employment tax forms and credits; developed processes to reconcile advances received by clients of third party payers and designated resources for this new manual reconciliation; and began compliance development efforts.

Within months, we implemented manual review processes for large, unusual, and questionable credit filings; implemented at filing filters to prevent fabricated entities from obtaining invalid refunds; and began discussion and/or development of processes to reverse or address credits reported by potentially ineligible entities. With each legislative change, each of these steps was repeated, began anew, or evolved.

Finally, as we look back on all that we've accomplished, but again towards increased post-filing compliance efforts, this draft report has afforded us the additional opportunity to highlight any processing concerns or errors that might contribute to the need for additional compliance efforts. We are proud to learn that the errors GAO identified supports the efficacy of our internal control efforts as the nine cases cited involving credits erroneously posted to returns totaled less than $29, an amount that falls below our tolerance level for consideration.

Responses to your specific recommendations are enclosed. If you have any questions, please contact me, or a member of your staff may contact Sammi Shultz, at (307) 823-6832.

Sincerely,

Mark E. Pursley

Mark E. Pursley
IRS Chief Risk Officer

Enclosure

Enclosure

GAO Recommendations and IRS Responses to GAO Draft Report COVID-19: IRS Implemented Tax Relief for Employers Quickly, but Could Strengthen Its Compliance Efforts (Job Code 104280)

Recommendation 1: The Commissioner of the Internal Revenue should develop an integrated project management plan for the COVID-19 credits to improve the IRS's ability to manage and plan compliance efforts related to these credits.

COMMENT: We disagree.
We used standard project management techniques to timely and effectively carry out implementation. Our project management strategies included: project schedule management, risk and issue management, stakeholder engagement management, communications management, and change management for system and form changes. We created both an Implementation Master Project Plan and a Compliance Plan shortly. The Project Plan we created includes details to implement the project as a whole as well as compliance, while the Compliance Plan serves to assist with the identification of compliance risks related to the COVID provisions and maintains a broad overarching approach.

As the implementation phase is winding down, the compliance phase is ramping up. In addition to the pre-processing compliance efforts put in place, we also plan to carry out post-processing compliance efforts. These post-processing efforts must be taken because proper credit and eligibility determination relies on information that is not housed or displayed on the face of the employment tax return, but rather the taxpayer's credit worksheets and internal payroll data. Rejection of the credits at filing based on the limited data contained on an employment tax return, absent the information discussed (i.e. taxpayer interaction) would have resulted in rejection of valid, otherwise qualifying entities entitled to the credits, credit miscalculations, and the addition of significant burden to the potentially already struggling taxpayer. As a result, the draft FY22 and FY23 work plans include examination of employer credits. To facilitate this, COVID Credits training material was developed, and virtual classroom instruction has begun.

The credits are temporary, compliance efforts have been implemented, and it is now a workstream. Based on these facts, a project management plan is no longer needed. These credits are following the same processes that are followed for other workstreams, which are detailed in the Employment Workload Selection IRM (4.23.23).

Recommendation 2: The Commissioner of the Internal Revenue should document the processes being used to address compliance risks associated with Employee Retention Credit and paid sick and family leave credit claims on adjusted employment tax returns.

2

CORRECTIVE ACTION: We agree. We will document the processes being used to address compliance risks associated with Employee Retention Credit and paid sick and family leave credit claims on adjusted employment tax returns.

Recommendation 3: The Commissioner of the Internal Revenue should document these processes being used to address compliance risks associated with the Employee Retention Credit and paid sick and family leave credits that rely on wages that cannot be used for other tax credits.

CORRECTIVE ACTION: We agree. We will document the processes being used to address compliance risks associated with the Employee Retention Credit and paid sick and family leave credits that rely on wages that cannot be used for other tax credits.

Recommendation 4: The Commissioner of the Internal Revenue should implement additional controls to help identify tax credit recipients that may not be eligible employers.

COMMENT: We disagree. There are existing workstreams to address invalid or inaccurate employer credit refund claims including a Government Entity workstream. We have referral procedures in place when a return with an invalid/inaccurate employer claims a credit refund.

Additionally, OFE's Emerging Threats Mitigation Team (ETM) developed, coordinated, and implemented its **Potential Fabricated Entities Review Project** to address both cogent fraud indicators and non-compliance noted related to CARES Act-based credits reported on employment tax returns. The project is achieving four (4) goals:

1. ***Referrals to the Office of Promoter Investigations (OPI)*** of tax return preparers/promoters who are engaging in potentially abusive tax schemes involving CARES Act provisions.
2. ***Coordination with the Criminal Investigation (CI)*** to address fabricated entities who fraudulently obtained CARES Act-related refunds.
3. ***Prevention of the issuance of refunds*** to fabricated entities after they failed to demonstrate legitimacy.
4. ***Referrals to the Employment Tax Exam Case Selection*** program to address non-compliance by entities that were not deemed fabricated at the time of EMT's review.

Recommendation 5: The Commissioner of the Internal Revenue should update and implement post-filing compliance or examination activities to address potentially invalid or inaccurate employer credit refund claims that were not prevented by internal controls.

3

COMMENT: We disagree with GAO's position that the accuracy of credits can be determined based simply on the data reflected on a filed employment tax return.

Worksheets were created for employers to compute refundable and non-refundable credits. These worksheets utilize payroll data, some of which is not available on the corresponding employment tax return. These worksheets are not required to be filed with the employment tax return. Additionally, eligibility for the credits is based on factors not reported on the employment tax return or worksheets. For example, whether an employee is entitled to paid sick or family leave or whether an employer has experienced a decline in gross receipts are items that will need to be substantiated as part of an examination. GAO has made assumptions about taxpayer payroll information to reach conclusions that, unfortunately, cannot be determined without taxpayer contact. To appropriately determine the accuracy of a credit, review of books and records used to complete the worksheets is integral. GAO appears to suggest that IRS could have used systemic, at-filing processes to reject these credits.

If IRS had implemented systemic programming based on this premise, that is, to reject credits claimed by taxpayers based on assumptions, IRS would have rejected valid, otherwise qualifying, entities entitled to the credits. This could have unintentionally harmed taxpayers erroneously and required taxpayers to contact the IRS to rectify the issue, delaying a refund or credit to which they were entitled and further increasing taxpayer burden. Due to these limitations, IRS can only use post-filing compliance to help ensure the substantive accuracy and validity of COVID Employer credits claimed by and paid to taxpayers. The post-processing approach more appropriately balances compliance with the need to assist taxpayers during a pandemic.

Appendix V: GAO Contacts and Acknowledgments

GAO Contacts

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In addition to the contacts named above, Brian K. James (Assistant Director), Nina E. Crocker (Assistant Director), Lindsay Swenson (Analyst-in-Charge), Austin Barvin, Michael Bechetti, Garry Blum, Kareen Borhaug, Sharon Byrd, Allison Channell, Liliam Coronado, Alejandro Coste Sanchez, Sara Daleski, David Dornisch, Steven Flint, Robert Gebhart, Shelby Kain, Michael Kany, Yoki Moody Wong, Edward Nannenhorn, Sonya Phillips, Samantha Piercy, Julie Scarano, Andrew J. Stephens, and Monasha Thompson made key contributions to this report.

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