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# PAYROLL CURRENTLY

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## Employers May Scan and Shred Returned Forms W-2

Employers may fulfill the regulatory requirement to keep undeliverable Forms W-2, such as those that are returned in the mail, by scanning the IRS and employee copies (copies B and C) and shredding the originals, IRS Chief Counsel tells APA. This is supported by Revenue Procedure 97-22, *Guidance on Electronic Records*. This victory was spearheaded by APA member Sam Kerch, CPP, CPA, our representative on IRS's Information Reporting Program Advisory Committee.

Implementing this practice can significantly decrease an employer's burden for storage and shuffling through paper if an employee requests the returned W-2. Just as importantly, this increases data privacy and security, because W-2s with employee names, addresses, and social security numbers (the perfect tools for identity theft) won't be available for anyone with access to the boxes or file drawers where forms are kept.

A best practice might be to also scan the envelope in which the W-2 was mailed, so the postmark and address will be preserved as proof of mailing. Of course, for employees who have consented to electronic delivery of their W-2s in place of paper, you don't need to scan or store any returned paper W-2s.

### Background

Treasury Regulation §31.6051-1(a)(3) provides as follows: "Undelivered statements for employees. The Internal Revenue Service copy and the employee's copy of each withholding statement for the calendar year which the employer is required to furnish to the employee and which after reasonable effort he is unable to deliver to the employee shall be retained by the employer for the 4-year period prescribed in paragraph (e)(2) of §31.6001-1."

The "4-year period" means that employers must "maintain such records for at least four years after the due date of such tax for the return period to which the records relate." For a 2007 W-2, the due date for the tax is April 15, 2008. Four years after that is April 15, 2012. It's easy to see how files of undelivered W-2s would build up in the payroll department.

### APA: the regulation is outdated

APA was concerned about the storage burden, and we asked IRS about the applicability of a regulation probably written before photocopiers were so commonplace, let alone payroll software to easily reprint W-2s and company Intranets where employers can post W-2s for employees to access at any time. In other words, if an employee contacts an employer for his or her W-2, there are probably easier ways of providing it than digging through the files of returned W-2s.

If the purpose of the regulation is to provide proof that an

attempt was made to provide the original W-2, we're still not sure the regulation is effective. Some mailed W-2s just get lost in the mail and aren't returned to the employer. So, it's not as if the returned W-2s represent all the forms that never got to employees.

In addition, we explained to IRS the threat to data security and the risk of identity theft that would be eliminated if returned W-2s could just be shredded.

### IRS: the regulation stands, but ...

IRS Chief Counsel responded that, until IRS reviews and re-proposes the regulation, it is still in effect. However, they said that, "Rev. Proc. 97-22 authorizes the use of an electronic storage system to maintain records for purposes of the Internal Revenue Code." They quoted a section of the revenue procedure that gives examples of such systems, including "electronically imaging hardcopy documents to an electronic storage media." In addition, they pointed out another section of the revenue procedure that supports the destruction of the scanned material: "This revenue procedure permits the destruction of the original hardcopy books and records." IRS concluded by saying, "Consequently, the W-2s could be scanned and destroyed if there is compliance with Rev. Proc. 97-22."

*Note:* The revenue procedure includes requirements applicable to an electronic storage system, such as reasonable controls to ensure its integrity, regular evaluations of the system, and periodic checks of the stored data. For more information, see *The Payroll Source*®, beginning at p. 10-5.

### APA asked for clarification

We took the opportunity to ask the IRS what it meant when it said that "the W-2s could be scanned and destroyed." Does this mean that employers must scan (a) the envelope in which the W-2 was mailed, (b) the W-2 itself, or (c) both?

IRS said that "[the regulation] only requires the withholding statement to be kept (or scanned). There is no regulatory requirement to scan the envelope, although it probably is a best practice to do so, since the proof of nondelivery is probably the returned envelope. However, this would be another paperwork burden for the employer. If a W-2 is undelivered or lost, it is important that the employer produce it later if and when the employee finally contacts the employer about it and wants a copy in order to do his or her return. That is probably why we have the rule we have in the regulations."

### Further analysis

Interestingly, the IRS's emphasis is on the ability to provide a W-2 to an employee who needs it to file a tax return, as

opposed to the ability to prove that the original W-2 was mailed. That may support our going back to them to ask that the regulation itself be revised to eliminate the requirement for an employer to store (via paper or electronic media) any undeliverable W-2s, so long as it can provide a replacement for

an undelivered W-2 by making a photocopy of the employer copy, by printing a W-2 via its payroll software, by directing the employee to the company Intranet, or by whatever other means future technologies may present. ■

## APA, NPRC Ward Off 'FICA Tax Holiday' as Means of Economic Stimulus

Earlier this year, representatives from APA and the National Payroll Reporting Consortium (NPRC) met with the staff of the U.S. Congress Joint Committee on Taxation (JCT) to discuss various options for putting cash in the hands of U.S. taxpayers to implement an economic stimulus.

The JCT proposed some methods that would have had employers front the money on behalf of the U.S. Treasury, but APA and NPRC explained the burden and potential for abuse as well as the difficulty of getting all six million U.S. employers on board with any such idea.

As we now know, the economic stimulus will be provided via tax rebate checks issued by the IRS after taxpayers file their income tax returns.

### Have employers issue the tax rebates?

One idea was to have employers refund a flat dollar amount or a percentage of the year-to-date social security and Medicare taxes already withheld and deposited. One issue with the flat dollar rebate was the inequity between a taxpayer with multiple employers and a taxpayer with just one employer. While this proposal would have included a reconciliation on the personal income tax return, the JCT was considering that such a reconciliation would never require a taxpayer to return any amounts that had been "over-rebated." If there were a reconciliation process, it might have required a new field on Forms W-2, 941, and 1040.

The biggest problem with having employers issue rebates would have been the impact on employers' cash flow. Any amount an employer rebated to its employees could have been taken as a credit against its employment tax liability. However, a number of items could have caused an employer to have at least a temporary negative cash impact. For example, what about the time between when the employer rebates the taxes and when its next tax deposit is due (for a small employer, that might be a month or even a quarter). And what if an employer's employees are low-wage-earners who are only subject to social security and Medicare taxes? It could have taken a number of payroll periods until the tax liability exceeded the credit.

### Temporarily reduce social security tax?

Another proposal was to reduce the 6.2% rate for social security tax to 2.2% retroactively or prospectively, but only for a

short period of time. APA and NPRC explained that the only way to successfully accomplish a rate reduction would be to change it for the entire year.

Employers are required by law to withhold, remit, and report social security tax at a strict 6.2%. This has to be accurate to within pennies, as there is no other reconciliation process for this tax the way there is for income tax withholding, for which employees file personal income tax returns. Because employers are held to such a tight standard, almost every payroll system has a built-in "self-adjust" feature that constantly looks at the year-to-date social security wages of each employee and makes sure that the corresponding year-to-date tax has been withheld at the correct percentage. If the year-to-date withholding for an employee is not correct in relation to the wages, the system will withhold or refund the difference the next time the employee is paid.

To implement a holiday from the social security tax for a particular period of time, the rate would have to be set to zero for that time period, and then reset after the period ended. This would be a programming hurdle. Software developers would need to program the "off" and "on" dates, once they were determined, test the software, and then distribute the software to customers. Beyond that, however, would be the issue of the self-adjust feature. Once the rate was set back to 6.2%, payroll systems, as explained previously, would attempt to retroactively collect tax on the wages paid during the holiday period.

To avoid this, there would have to be special wage and tax accumulators for the period of the holiday. This is actually a radical departure for payroll systems, which currently track items by "current," "quarter-to-date," and "year-to-date," and would involve lots of additional programming for employers, service providers, and software developers.

We also explained the inherent inequities in reducing the tax rate for a particular period of time. Someone who is employed during that part of the year would get a tax break. Someone who is only employed outside of the period of the rate reduction would not see any benefit. We also explained that there might be attempts by employees (and employers, who match social security tax withholding) to shift wage payments into the holiday period, whether by delaying or accelerating payments, to take advantage of the tax break. ■

## Submit Your Payroll Questions for the 2008 Federal Forum

One of the most popular workshops at the APA's Annual Congress is the *Forum on Federal Payroll Issues*, which features a panel of representatives from six federal agencies answering challenging payroll questions posed by our members. The questions are provided to the panelists about a month in advance, so they can do any necessary research and deliver complete answers.

If you have a question about a federal payroll law or regulation, or how it should be applied in your particular setting, please send it by March 14 to [smezistrano@americanpayroll.org](mailto:smezistrano@americanpayroll.org). You may pose a question to the Internal Revenue Service,

the Social Security Administration, the Office of Child Support Enforcement, the Department of Labor, U.S. Citizenship and Immigration Services, or Immigration and Customs Enforcement.

In addition to being presented at the Congress workshop, many of the questions and answers will be transcribed for publication in future issues of *PAYROLL CURRENTLY*. Last year's Congress Q&A appeared in Issue Nos. 13, 14, and 15 (Vol. 15).

APA's 26th Annual Congress will be held May 13-17 in Austin, Texas. For more information, visit [www.americanpayroll.org/congress](http://www.americanpayroll.org/congress). ■