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IRS Tells Senators It Will Improve Service to Victims of Identity Theft

Testifying before the Senate Finance Committee on April 10, IRS Commissioner Douglas Shulman admitted that “The IRS is not where it needs to be” with regard to customer service for victims of identity theft. Only on the job three weeks, he faced considerable criticism and questioning from both senators and his fellow panelists. “We understand the devastation that a person feels when their identity has been stolen. We also understand that, when a victim of identity theft seeks assistance from a government agency, they have a right to expect that that agency will help them, not add to their problems,” Shulman said.

A video of the hearing, as well as the complete testimony and statements of the guests and senators, is available at <http://finance.senate.gov/sitepages/hearings.htm>.

Rebecca Spencer, Enrolled Agent. Rebecca Spencer, an Enrolled Agent with 6,500 clients in her home state of Montana, accused the IRS of doing just that when she related the story of a client whose identity was stolen. The thief filed a tax return electronically in her client’s name. Following a call to the IRS Criminal Investigation unit, Spencer and her client entered a limbo filled with interactive voice response phone systems, visits to local IRS offices, police reports, and forms to complete. To cap it all off, Spencer said, “10 days after the IRS had been notified that there was a problem, the Service released the refund to the fraudulent taxpayer.” Spencer managed to stop payment by working with the bank, but it was another four months before – with the help of the Taxpayer Advocate – her client received her refund.

Spencer recommended a number of tax policy changes to protect against identity theft. Two of these would impact the payroll profession:

- Require employers to submit Forms W-2 to the SSA one month before they are given to employees, rather than one month later.
- Have IRS, annually, provide each employer with a two-letter code to be included on each W-2, and require that code to be entered on the e-filed return, which would prevent thieves from using prior-years’ return information to file fraudulent returns.

J. Russell George, Inspector General, TIGTA. Senate Finance Committee Chairman Max Baucus (D-Mont.) accused the IRS of being part of the problem rather than the solution. “I am astonished that some IRS processes actually appear to

facilitate identity theft.” Specifically, the IRS processes returns for people using Individual Taxpayer Identification Numbers (ITINs) on returns with W-2s attached that have someone else’s SSN. Since ITIN holders usually cannot legally obtain an SSN, a return with an SSN and an ITIN should raise a red flag.

The Honorable J. Russell George, Treasury Inspector General for Tax Administration, continued this line of criticism as he explained that there are two types of identity theft related to tax administration. The first occurs when a person uses another’s name and SSN to file a false tax return. The second involves the fraudulent use of a person’s identity to obtain employment, which results in taxable income reported to the wrong taxpayer. George said that, in 2007, the Federal Trade Commission received more than 56,000 complaints from victims of these two crimes. *Note:* See **PAYROLL CURRENTLY, Issue No. 9, Vol. 16**, “TIGTA Issues Report Critical of IRS Efforts to Address Employment-Related and Tax Fraud Identity Theft.”

“Internal Revenue Code confidentiality and disclosure provisions restrict IRS’s ability to share employee information with the victim’s employer,” George said. “However, there are exceptions in the IRC that allow disclosure of tax information to other federal agencies with jurisdiction over certain non-tax criminal matters.” George believes that the IRS should use these exceptions “to the fullest extent possible” and clarify policy as needed.

George said that IRS system modernization has not been undertaken with sufficient security precautions in place. The Service is “deploying several new systems that lack detection capabilities. Without audit trail logs, the IRS does not know what configuration changes are made or who makes them. Intruders or ill-intentioned IRS employees who have access to these components could steal taxpayer information with little chance of detection.”

Further, George said, the IRS Criminal Investigation unit will only investigate identity theft if it is in conjunction with another crime having a large tax effect. The IRS claims, he says, that it doesn’t have the resources and that the taxes are so small that it is not worth the effort. “With this strategy, there is no deterrent.”

Douglas Shulman, IRS Commissioner. Following this withering testimony, Senator Ken Salazar (D-Colo.) asked Commissioner Shulman what the IRS intends to do to protect taxpayers. Shulman replied that the IRS is actually implementing some of the ideas that the Senate and the Taxpayer Advocate have recommended. By the fall of 2008, Shulman said, the

IRS will have people specially trained to handle identity theft complaints. "The overall goal is to allow taxpayers to reach a knowledgeable person who can resolve a complaint promptly and permanently." In direct response to criticism, the IRS will also begin to notify taxpayers when others appear to be using their SSNs. Shulman pledged to issue a comprehensive plan to the Senate Finance Committee within 90 days.

The IRS does not know the scope of tax-related identity

theft. Although the IRS is able to track double use of an SSN, it has not kept track of whether such a situation is related to identity theft. When questioned about how the IRS would know how many identity theft specialists to train in light of this situation, Shulman said that the Service would "overstaff." Many employees will be trained to resolve these complaints, and they will also be capable of other tasks when not engaged in problem resolution. ■

Compromises Considered on Multi-State Withholding Bill

Proposed federal legislation calling for a 60-day threshold before states or localities could impose their income taxes on nonresidents would cost New York \$100 million or more in annual tax revenue, according to Federation of Tax Administrators (FTA) Executive Director Harley Duncan.

Duncan made the comment at the Tax Executives Institute's midyear conference in Washington in April, arguing that the 60-day threshold provided in H.R. 3359 – the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007 – would result in too much revenue shifting between states. The FTA represents the tax collection agencies of the 50 states, the District of Columbia, Puerto Rico, and New York City, and its opinion carries great weight with members of the House of Representatives who want to protect their states' revenues.

In response, leaders of the Council on State Taxation (COST) are offering compromises on the threshold, hoping to save the legislation, which would significantly reduce the multi-state withholding burden for payroll departments. The suggested compromises include reducing the number of days for the threshold and/or establishing thresholds of fewer days specifically for high-earning employees, whose taxes would constitute the most significant losses for states like New York. In addition, to allow states and taxpayers to prepare for the change, COST is proposing an effective date of January 1, 2010. These compromises have been discussed with APA's Government Relations office.

What would H.R. 3359 do?

Under this legislation, wages paid to an employee who performs duties in more than one state or locality would be subject to the income tax laws of the state or locality of the employee's residence and any state or locality in which the employee is physically present and performing duties for more than 60 days during the calendar year. Professional athletes, professional entertainers, and nationally prominent public figures would not be covered.

APA contends that it would be much easier to comply with a single standard across all states and localities compared with the patchwork of laws in the 41 states and thousands of localities with income tax withholding. Employers would be able to avoid the expensive process of withholding taxes and filing Forms W-2 for multiple states in which an employee spends only a short amount of time. In addition, employees would be saved from filing nonresident income tax returns for those states.

Compromise idea #1: reduce the number of days for the threshold

Asked whether the FTA had a specific day-threshold it could support, Duncan replied, "We haven't put one down on paper, but 60 is too high."

COST and APA agree that a threshold based on a number of work-days within a jurisdiction is generally the easiest type of threshold to administer (compared to one based on earnings – see below), and we might be willing to drop the threshold to 45 or 30 workdays if it would induce more parties to support the legislation.

Compromise idea #2: establish a lower threshold for high-earners

Duncan has often said that the FTA would be more likely to support the bill if it also included a dollar threshold, so as to protect states from tax losses on nonresidents with significant income. The FTA has suggested that a state's income tax should apply to anyone who either spends more than a certain number of days in the state or earns more than a certain amount of money in the state.

APA and COST feel that this approach would be too difficult to administer, requiring constant checking of the amount of compensation earned in a particular state, which is a big part of what we are trying to avoid. In addition, states and other taxing jurisdictions vary widely in how they measure taxable wages.

As a compromise, APA and COST are considering a proposal under which a shorter threshold period – for example, 20 days – would apply to a company's top earners. However, we would want that group of employees to be determinable before the beginning of the year, based on the prior year's wages, so as to avoid the possibility of an employee becoming subject to the lower threshold at some point in the year because of a sudden increase in his or her earnings.

Why not just one, low threshold?

Some employers might prefer to have just one threshold for all employees – even at the very low 20 days suggested in compromise #2 above – rather than one threshold for some employees and another, lower one for high earners. However, certain very large employers in COST prefer the double threshold approach because the number of lower-earning employees who would be saved by the higher threshold would be so significant.

What has APA done and what can you do?

The APA has supported this legislation from the beginning. You can read about APA's efforts and take action yourself by visiting www.payroll.org/login.cfm?nextpage=/i4a/pages/index.cfm?pageid=151. We urge you to send a letter to your representative in the House, asking him or her to co-sponsor the bill. Everything you need is on the APA website, including a link to identify your representative, a sample letter, a one-page description of the problem, the solution under H.R. 3359, and a list of the House members who have already signed on as co-sponsors. ■