

## House Committee on Ways and Means

Statement of The Honorable Mark W. Everson, Commissioner, Internal Revenue Service

Testimony Before the House Committee on Ways and Means

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### Introduction

Chairman Thomas, Ranking Member Rangel, and Members of the Committee, I appreciate the opportunity to appear before you this afternoon to discuss the impact of immigration issues on tax administration.

I would like to do three things this afternoon. First, I wish to try to frame the issues, at least from an IRS perspective. Second, I want to discuss in more detail how the IRS handles the mismatching of Social Security Numbers (SSN). And, third, I want to offer some comments on the pending legislation from the perspective of tax administration.

### Framing the Issues

Perhaps the most difficult part of these issues is framing them properly and understanding fully the different, yet sometimes complementary, roles performed by the Social Security Administration (SSA), the U.S. Department of Homeland Security (DHS), and the Internal Revenue Service (IRS).

We at the IRS support and appreciate the jobs being done at SSA in maintaining and protecting the Social Security Trust Funds and at DHS in enforcing our immigration laws, but our function is tax administration. Our job is to make sure that everyone who earns income within our borders pays the proper amount of taxes, whether that income is legally obtained and whether the individual is working here legally. If someone is working without authorization in this country, he/she is not absolved of tax liability. Instead of an SSN to file a tax return, that person frequently uses an Individual Taxpayer Identification Number (ITIN).

An ITIN is a tax processing number issued by the IRS. It is a nine-digit number that always begins with the number 9 and has a 7 or 8 in the fourth digit, e.g. 9XX-7X-XXXX.

IRS issues ITINs to foreign individuals who are required to have a U.S. taxpayer identification number but who do not have, and are not eligible for an SSN. ITINs are issued regardless of immigration status because non-citizens may have U.S. tax return and payment responsibilities under the Internal Revenue Code.

The Oversight and Social Security Subcommittees have held two hearings over the past three years on issues associated with ITINs and the mismatch of SSNs on W-2s. At those hearings, I talked about our ITIN program. It is important to understand that the ITIN program is bringing taxpayers into the system. Last year over 2.5 million tax returns were filed that included an ITIN for at least one person listed on the return. In calendar year 2006, so far we have received 1.6 million new applications for ITINs, up 25 percent from this time last year. Since 2004, to obtain an ITIN most applicants must attach a tax return to establish a return filing requirement.

We estimate that for tax periods 1996 to 2003 that the income tax liability for ITIN filers totaled almost \$50 billion.

Comprehensive immigration reform -- including border security, interior enforcement, and a temporary worker program -- is a top Administration priority. The Administration believes that worksite enforcement is critical to the success of immigration reform. Further, as immigration laws are enforced, the Administration believes that comprehensive immigration reform also requires us to improve those laws by creating a temporary worker program that rejects amnesty, relieves pressure on the border, and provides a legal means to match willing foreign workers with willing American employers to fill jobs Americans are not doing.

As the Commissioner of the IRS, it is not my role to advocate public policy changes. However, as a former Deputy Commissioner at Immigration and Naturalization Service, I am sensitive to the need for a system of immigration that functions effectively and I am particularly sensitive to the interaction between the immigration system and the tax system. I recognize that comprehensive immigration reform can have positive impacts on tax administration. For example, the creation of a temporary worker program will likely result in additional taxpayers entering the system.

### **IRS's Role in the Mismatch Program**

Each year, employers send their W-2s and W-3s to the SSA by February 28 (or March 31 if filed electronically). SSA processes the forms and then attempts to reconcile any mismatches. They then send the information to the IRS on a weekly basis. IRS culls out any unusable records as well as any W-2s that are not related to the current tax year. For Tax Year (TY) 2004, the resulting IRS file contained more than 231 million W-2s from the SSA.

This represents a decline of approximately 6.5 percent from the corresponding file for TY 2000. We are considering this and other employment-related trends as part of our ongoing study of the standards used to distinguish between employees and independent contractors. The decline in the number of W-2s has been accompanied by a corresponding decline in the number of mismatches that could not be reconciled.

Of the 231 million W-2s in IRS's TY 2004 file, approximately 223 million had matching names and SSNs. Some of these matches resulted from SSA's successful use of techniques for resolving mismatches. For the balance of approximately 8 million TY 2004 W-2s for which there was no valid match, IRS used several additional methods to match the numbers. We were able to match approximately 60,000 more names with SSNs, leaving about 7.9 million W-2s where there is no valid name and SSN match.

To help correct SSN mismatches, the SSA sends letters to employers, employees and self-employed individuals asking that they take steps to match the names with the SSNs. These letters go only to certain employers. First, letters are sent to employers who submit a wage report containing more than 10 Forms W-2 that SSA cannot process. In addition, employers who file more than 2200 W-2's, more than one-half of one percent (1/2 percent) of which represents mismatched forms, also receive the letters. In TY 03, the SSA sent over 121,000 such letters to employers, inquiring about 7.2 million invalid W-2s. There is no letter sent to the employers for the other 0.7 million mismatches

There are two interesting aspects to the data on mismatches. The first is geographical. Over 50 percent of the mismatches are found in four states, California, Texas, Florida and Illinois. California has by far the greatest number of mismatches totaling nearly 2.3 million, or approximately 29 percent of the mismatch total.

The second is economic. Based on IRS' own analysis, about 75 percent of all mismatched W-2s report wages of less than \$10,000. If we focus only on those mismatched W-2s with no withholding, the percentage increases to 90 percent. Only about 2 percent of all W-2s with invalid SSNs report wages greater than \$30,000. In fact, the average wage for all mismatches is only about \$7,000 annually. Bear in mind, that many employees receive more than one W-2 in a tax year, so these numbers may not reflect an individual's gross income.

From a tax administration perspective, we know that for TY 2004 there were approximately \$53 billion in wages reported on W-2s with invalid SSNs, with about a quarter of that amount, or \$13.3 billion, on W-2s with no withholding. About 56 percent of the \$53 billion came from W-2s reporting wages between \$10,000 and \$30,000.

On the high end, only about 1 percent of the wages (\$0.5B) were reported on mismatched W-2s showing wages in excess of \$100,000. Thus, this analysis shows that the worker population causing W-2 mismatches represents the lowest wage earners who likely have little or no tax liability.

### **Legal Requirements for Employers**

It is important to point out that SSA has no enforcement power and cannot impose penalties on employers for failure to correct SSN mismatches. IRS, however, does have enforcement power and can assess penalties. Therefore, it might be helpful if I walk you through our current legal authority.

Under section 6041 and 6011 of the Internal Revenue Code (IRC) employers and other payors must include correct SSNs or Taxpayer Identification Numbers (TINs) on form W-2 reporting wages or salaries paid to employees.

Under section 6721, we may impose a \$50 penalty on an employer for each W-2 or 1099 that omits or includes an inaccurate SSN/TIN unless the filer (employer, other payor, etc.) shows reasonable cause for the omission or inaccuracy. The maximum penalty for any employer or payor in a calendar year is \$250,000. If the violation is deemed to be willful, the fine is the greater of \$100 or 10 percent of the unreported amount per violation, with no maximum.

From a tax compliance perspective, violations of these provisions are generally identified as part of an overall employment tax examination. We would not ordinarily initiate an examination against an employer solely on the basis that he/she had reported a high number of mismatches. This is a function of both resources, and the fact that the employer can easily demonstrate that he/she has performed the due diligence required under the law.

Specifically, Section 6109 places the burden on the employee or the payee to provide the employer or payor with an accurate SSN or TIN. This is an important distinction because the employer can have any penalty imposed for failing to include an accurate SSN or TIN on the return abated, if the employer made an initial and, if necessary, annual request that the payee provide an accurate SSN/TIN. He can also have the penalty abated if he establishes that due diligence was otherwise used, such as by obtaining a statement from the employee under penalties of perjury that the SSN or TIN is accurate.

As you can see, what is important here is that the employer or payor makes a request, or repeats a request, for an accurate SSN or TIN. If the employer does, he/she has performed due diligence and has reasonable cause to believe the SSN or TIN is correct. Because the reasonable cause and due diligence standard in section 6724 is relatively easy for employers to meet, it has been virtually impossible to sustain a penalty assessed against an employer under section 6721.

When I testified last February before your Oversight and Social Security Subcommittees, there were some questions as to whether we were utilizing our enforcement authority. I indicated then that we had surveyed nearly 300 companies with high mismatch rates. I also indicated that we intended to look more carefully at 48 of those companies that failed to respond to that survey.

We have now begun those investigations and I can tell you that what we have found thus far is consistent with what we found from our survey. The companies tend to be from three industries: Agriculture, janitorial and temporary workers. The employees are low wage earners, and we have found no other employment tax violations in 90 percent of the companies we have examined. From a tax administration standpoint, these companies do not constitute a target rich environment.

### **Pending Legislation**

We are well aware that both the Senate and House have adopted bills that take different approaches to addressing the immigration issue. It is neither my role nor my desire to express a preference for either version. I merely wish to offer some observations and concerns about how each of the bills would affect tax administration.

Having a strong immigration policy that includes border security, interior enforcement, and a temporary worker program is critical to our future.

As I indicated earlier, many illegal aliens, utilizing ITINs, have been reporting tax liability to the tune of almost \$50 billion from 1996 to 2003. In TY 2004, we had 2.5 million ITINs filed with nearly \$5 billion in tax liability. That is why comprehensive reform is so necessary. It will allow these taxpayers as well as others who are not currently filing to become a more active part of our economic system. Failure to enact comprehensive reform could have negative consequences for tax administration if procedures are imposed on employers and employees that have the effect of driving certain economic activities "underground".

The one common approach in both the House and Senate immigration bills is the requirement that employers verify the work eligibility of potential employees with DHS from information provided by the Social Security Administration. The Senate version of the bill does this by requiring DHS to create a verification system with the cooperation of SSA. The House bill essentially takes the discretionary process that is already in place under the Basic Pilot Program, which is administered by DHS with the help of SSA, and makes it mandatory.

The Senate bill goes much further. It amends Section 6103 of the Internal Revenue Code relating to the privacy of taxpayer information and requires SSA to send to DHS the identities of employers who, among other things, have a significant number of employee/SSN mismatches. The bill restricts disclosure only for the purposes of establishing and enforcing participation in the system and complying with various laws.

The Senate bill, under what it calls the "Earned Adjustment" program, also allows aliens unlawfully present in the U.S. to adjust their status to legal permanent resident status if they meet certain criteria, including continuous residence in the U.S. during the previous 5 years, employment in 3 of those 5 years, and employment for at least the next 6 years. It appears that, the Earned Adjustment applicants would not be allowed to adjust status until they had demonstrated "the payment" of any liability for Federal taxes owed during the required pre- and post-enactment periods of employment. The IRS is mandated to cooperate with aliens by providing documentation "to establish the payment of all [Federal] taxes required".

We are continuing to study the provisions of the Senate bill, but based on what we see thus far, we do have some concerns. For example, to the extent that applicants for earned adjustment will make requests for prior tax payments from IRS, that will require IRS to divert resources from current functions.

In addition, it is important to consider that while we can, upon request, currently provide any taxpayer, including those who have filed using ITINs, a transcript of their tax return records, we do not verify the accuracy of their tax returns or the information the taxpayer has submitted. Accordingly, we are not now equipped to provide any taxpayer, including aliens, with documentation to establish payment of all Federal taxes.

In addition, if the alien has filed using multiple SSNs that were not assigned to him and later with an ITIN, it is possible that a single alien could request multiple transcripts. From a disclosure perspective, we would be reluctant to provide a single taxpayer with multiple taxpayer records upon request.

We have other administrative concerns with provisions of the Senate bill, but we are confident that as we progress toward the goal of comprehensive reform that we can iron those out.

### **Conclusions**

We appreciate Mr. Chairman, the tough policy choices that you and other members of Congress must make on the tough issue of immigration, and we realize that tax administration may be a small factor in those policy considerations.

As the agency responsible for collecting and administering the more than \$2 trillion that we use to fund the government, we will play whatever role Congress deems appropriate.

We urge, however, that any change in the current tax system encourage the type of behavior that we desire from both employees and employers. We are collecting some taxes in these areas and with comprehensive reform we hope we can collect even more.

Similarly, imposing requirements that the IRS verify the accuracy of tax payments by aliens would challenge our ability to maintain our current level of service and enforcement.

Thank you for inviting me to testify this morning. I will be happy to take any questions you may have.