Additional Enhancements Could Improve Tax Compliance of Employees Who Receive Tips

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 15, 2006

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Additional Enhancements Could Improve Tax Compliance of Employees Who Receive Tips (Audit # 200530029)

This report presents the results of our review of the Internal Revenue Service's (IRS) Tip Rate Determination and Education Program (the Tip Program). The overall objective of this review was to determine the progress the IRS has made in improving the Tip Program and expanding it to other industries where tipping is customary. Specifically, we reviewed the actions taken by the IRS based on the recommendations from a previous Treasury Inspector General for Tax Administration report.[1]

Impact on the Taxpayer

Although the IRS has made some enhancements to the Tip Program since our prior review, additional improvements could help achieve a higher level of tip income reporting compliance. We estimate the IRS could achieve $342 million in additional tax assessments over 5 years if it resumes soliciting new tip agreements with the Cosmetology industry and expands the agreements to the Taxi/Limo industry.

Synopsis

The reported amount of tip income increased from $8.52 billion for Tax Year (TY) 1994 to over $19 billion for TY 2004. However, the IRS has not consistently monitored the establishments in

[1] *Opportunities Exist to Improve the Tip Rate Education and Determination Program* (Reference Number 2001-30-076, dated May 2001).

the Food and Beverage and Cosmetology industries that had entered into tip agreements since Fiscal Year (FY) 2000 to determine if tip agreements secured actually increased tip income for these establishments.

Due to the voluntary nature of participation and limited staffing resources, disparity over the number of tip agreements secured in various locations across the country has continued to be an issue since our prior report. The IRS does not plan to actively solicit any new tip agreements beyond the Gaming industry in FY 2006. The majority of FY 2006 Tip Program staffing will be expended on soliciting and monitoring tip agreements with the Gaming industry and on audits of casino employees. Additionally, multiple realignments affected the transition of the outreach portion of the Tip Program from the Compliance function to the Taxpayer Education and Communication function. The Tip Program has not expanded to the Taxi/Limo industry.

The IRS has not yet established an automated system to identify business entities required to file an Employer's Annual Information Return of Tip Income and Allocated Tips (Form 8027).[2] The IRS recently manually matched the Employer's Quarterly Federal Tax Return (Form 941) data to the database of TY 2004 Forms 8027, identifying 33,685 employers as potential Form 8027 non-filers. However, the Form 8027 database data fields are not always accurate, and only the first quarter of TY 2004 Forms 941 have been matched to this database. Identification of Form 941 non-filing was not prioritized.

The IRS has automated the tracking of tip agreements for the Food and Beverage and Cosmetology industries. This automated database is part of a system that is not fully operational but is now funded with a tentative date of FY 2008 for full implementation. However, the Gaming industry tip agreements are maintained in a separate database that does not accommodate all necessary information, preventing consistent use of the information.

The Tip Program does not reach some small businesses in the Food and Beverage industry. To address this, the IRS developed the Attributed Tip Income Program Revenue Procedure, which the Department of the Treasury approved on July 11, 2006. The IRS plans to test it for 3 years. A similar Revenue Procedure is needed for small businesses in other industries.

Recommendations

We recommended the Director, Specialty Programs, ensure adequate staffing remains available for monitoring tip agreements for all industries and use the results of monitoring to measure compliance; prepare a workforce plan to determine the necessary staffing levels needed to

[2] Form 8027 is an information return filed by large food and beverage establishments when the employer is required to make annual reports to the IRS on receipts from food or beverage operations and tips reported by employees. Generally, a large employer is one who employs more than 10 employees on a typical business day.

accomplish Tip Program goals; ensure the automated tracking system remains funded and, once fully operational, includes the Gaming industry tip agreements; implement data verification procedures for Form 8027 data and prioritize identifying Form 941 non-filers; once the Attributed Tip Income Program Revenue Procedure is tested with the Food and Beverage industry for 1 year, consider developing a similar Revenue Procedure for small businesses in other industries; and establish an action plan to outline and monitor all planned actions, potential results, responsible individuals, staff to be allocated, and planned completion dates.

Response

IRS management agreed with all of our recommendations. The Director, Specialty Programs, will ensure consistent review and monitoring of existing and future voluntary agreements is done for all industries. The data from monitoring will be used to measure compliance. A Tip Program strategy will be developed to ensure the Program has sufficient staffing and resources to further tip compliance. Procedures will be developed to enhance current data verification procedures regarding Forms 8027. Potential Form 941 non-filers will be identified along with potential Form 8027 non-filers. IRS management will ensure development of the automated tracking system meets its estimated completion date of October 2008. The system will include the Gaming industry tip agreements. The Attributed Tip Income Program Revenue Procedure was issued on July 28, 2006, for small food and beverage establishments. When sufficient data have been captured after a 3-year pilot, they will be analyzed to determine if a similar Revenue Procedure for other industries would be beneficial. An action plan to monitor progress will be developed and will be consistent with information included in the Tip Program strategy.

IRS management did not agree with our estimate of additional tax assessments because they were unable to validate our estimate and the assumption that each taxpayer contact will result in full compliance. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment

We believe our estimate of potential additional tax assessments is valid. Our calculation was based on the FY 2005 methodology the IRS uses for selecting Cosmetology industry businesses for tip agreement leads and the actual results for tip examinations.

In addition, although the IRS' suggested evaluation period for the Attributed Tip Income Program Revenue Procedure is longer than we envisioned in our recommendation, we agree it is not unreasonable to expect such data capture and analysis to take up to 3 years.

Copies of this report are also being sent to IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-8500.

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Abbreviations

ATIP	Attributed Tip Income Program
EmTRAC	Employer-designed Tip Reporting Alternative Commitment
FY	Fiscal Year
GITCA	Gaming Industry Tip Compliance Agreement
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
SWETRS	Service Wide Employment Tax Research System
TEC	Taxpayer Education and Communication
TIGTA	Treasury Inspector General for Tax Administration
TRAC	Tip Reporting Alternative Commitment
TRDA	Tip Rate Determination Agreement
TY	Tax Year
U.S.	United States

Background

Historically, the Internal Revenue Service (IRS) has been concerned with employees not reporting tips earned in industries in which tipping is customary. An IRS study showed that the amount of tip income reported in Calendar Year 1993 was less than one-half of the tip income amount, leaving over $9 billion of unreported income.

As a result, the IRS developed the Tip Rate Determination and Education Program (the Tip Program), which is a voluntary compliance program originally developed in 1993 for the Food and Beverage industry. It was modeled after the tip compliance agreement used by casinos in the former IRS Nevada District. The Tip Program was extended to the Cosmetology industry in 1997 and the Barber industry in 2000. Since the Tip Program was introduced, voluntary compliance has increased significantly. In Tax Year (TY) 1994, tip wages reported were $8.52 billion. For TY 2004, the amount exceeded $19 billion. To date, over 16,000 employers, representing over 47,000 individual establishments, have entered into tip agreements.

The Tip Program offers employers multiple voluntary agreement options designed to provide nonburdensome methods for employers and employees to comply with tip reporting laws. Options include:

- A Tip Rate Determination Agreement (TRDA) – Under a TRDA, the IRS will work with the employer to arrive at a tip rate for the various occupations in the industries in which tipping is customary. At least 75 percent of tipped employees must sign a participation agreement consenting to participate. Participating employees report tips at or above the rate determined in the agreement.

- A Tip Reporting Alternative Commitment (TRAC) – Under a TRAC, the employer agrees to institute and maintain a quarterly educational training program that trains newly hired employees and periodically updates existing employees as to their reporting obligations with respect to tips.

- An Employer-designed Tip Reporting Alternative Commitment (EmTRAC) – This program was initiated in December 2000 and allows any food or beverage establishment the opportunity to develop its own tip compliance program. An EmTRAC maintains the same filing, reporting, and educational requirements as an IRS-administered TRAC. Employers must apply in writing to obtain IRS approval of their programs and receive the same benefits and protections afforded under a TRAC. Very few EmTRACs have been submitted and approved.

- A Gaming Industry Tip Compliance Agreement (GITCA) – A GITCA is specifically designed for employers in the Gaming industry to determine tip rates for various occupations in the establishment by using historical tip data. These rates are subject to review and validation by the IRS. At least 50 percent of the tipped employees in the establishment must participate by signing a Model Gaming Employee Tip Reporting Agreement.

Participation in a tip agreement provides benefits for both employees and employers. Assuming that the employer recognizes higher income, employees would be eligible for greater Social Security income and increased unemployment benefits and worker's compensation. The increased income would also improve opportunities for approval when employees apply for loans. If the employer has a retirement contribution plan, there may be additional funding for employees. Once an employee signs a TRDA participation agreement, the employee will not be audited on future tips above the agreed tip rate during the agreement period. If an employee does not sign a participation agreement with an employer that has a TRDA, the employee will be subject to a possible audit. Under a TRAC agreement, tip examinations may occur for only those employees who underreport their tip income.

An employer that signs a TRDA or TRAC agreement will be deemed to be in compliance, meaning the IRS will not audit the employer's payroll tax returns for periods prior to the agreement or for those years covered by the agreement, as long as the employer remains in compliance with the agreement. Both programs prohibit "employer-only assessments" (assessments without auditing the employee(s)) during the period the agreement is in effect. Thus, participating in these agreements reduces uncertainty for employers.

In May 2001, we issued a report on the Tip Program.[1] Results showed that, while the amount of tip income reported to the IRS had consistently increased, additional enhancements could be made to increase compliance. We recommended the IRS reemphasize the Tip Program's importance, provide adequate oversight, ensure proper transfer of the Tip Program from the Employment Tax Compliance function to the new Taxpayer Education and Communication (TEC) function, and expand the Tip Program to other industries in which tipping is customary.

This review was performed at the Small Business/Self-Employed (SB/SE) Division Stakeholder Liaison Headquarters office and Specialty Programs office in New Carrollton, Maryland, during the period October 2005 through May 2006. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[1] *Opportunities Exist to Improve the Tip Rate Education and Determination Program* (Reference Number 2001-30-076, dated May 2001).

Results of Review

Some Progress Has Been Made to Enhance the Tip Program

The IRS has enhanced the Tip Program since our prior review. As of March 2006, the IRS had successfully secured 14,657 tip agreements for 41,606 establishments in the Food and Beverage industry and 1,686 tip agreements for 6,206 establishments in the Cosmetology industry. The IRS has also been successful in negotiating and securing tip agreements from 213 casinos in 17 States coast to coast. As of December 2005, 90 Gaming industry tip agreements had been secured, and an additional 63 agreements were in the process of being secured.

The IRS automated the tracking of tip agreements for the Food and Beverage and Cosmetology industries by creating the TRAC/TRDA Inventory Delivery System database, which is part of a larger program entitled the Service Wide Employment Tax Research System (SWETRS). The SWETRS is a web-based system that, when fully operational, will allow cross-matching of internal IRS program databases, identifying noncompliant employment taxpayers for potential audits. It is currently funded for completion in Fiscal Year (FY) 2008. Gaming industry tip agreements are maintained in a separate database that is also being upgraded.

In January 2006, the IRS established a Centralized Data Unit with three management and program assistants responsible for monitoring the tip agreements. Effective October 1, 2006, the SB/SE Division Employment Tax function is establishing an Employment Tax Monitoring and Support Unit at the Cincinnati Campus.[2] The three Centralized Data Unit employees will transition to this new Unit, along with two additional employees. Their responsibilities will include all monitoring duties related to Employment Tax Programs and will not be exclusive to monitoring tip agreements. New training material is being developed. Both Program placement and standardized training material will enhance consistency in monitoring practices.

Beginning in FY 2006, the IRS created a direct line-reporting authority from the Headquarters Employment Tax Division over the Tip Program's operations and policy, which management believes has created a greater consistency in the application of the Tip Program's expectations and guidelines. During FYs 2004 and 2005, the IRS trained over 200 managers, tax compliance officers, tax examiners, revenue agents, and employment tax specialists from the Employment Tax Program on the *Audit Technique Guide* for tip rate determinations. Over 100 Stakeholder Liaison Headquarters office tip tax specialists and managers received training on conducting Tip

[2] Campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

Program outreach and education and securing TRAC agreements. Compliance personnel are responsible for the enforcement aspects of the Tip Program and for conducting examinations of employer and employee tax returns to ensure tip reporting requirements are met.

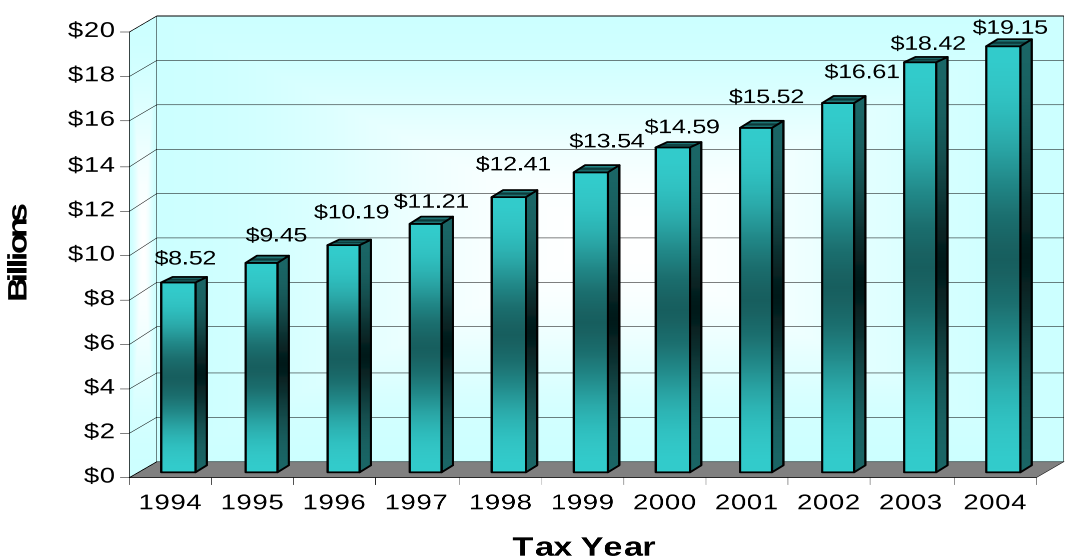
The IRS has made information regarding the Gaming, Cosmetology, and Food and Beverage industries available for the general public through its web site (IRS.gov). The web site includes information on the various types of tip agreements and publications on reporting and tracking tip income for both the employer and employee.

All of these enhancements have improved the Tip Program. However, additional improvements could help the IRS reach a higher level of tip income reporting compliance.

Additional Methods Could Be Used to Measure the Effectiveness of the Tip Program

The SB/SE Division continues to gauge the success of the Tip Program using the total Social Security Tip Wages reported on the Employer's Quarterly Federal Tax Returns (Form 941) for all industries. As shown in Figure 1, the reported amount of tip income increased from $8.52 billion for TY 1994 to $19.15 billion for TY 2004.

Figure 1: Total Tip Income Reported on Forms 941 – All Industries

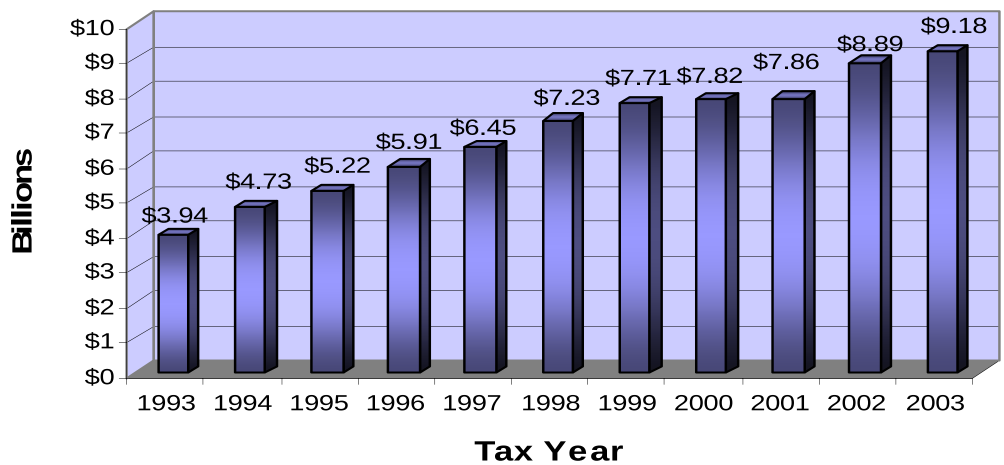


Source: SB/SE Division Specialty Programs function.[3]

[3] We did not verify or validate the IRS data.

The IRS has acknowledged that there are limitations to measuring tip income reported by industry because many tax returns have incorrect or missing industry codes. It specifically tracks tip income from large food and beverage establishments using information from the Employer's Annual Information Return of Tip Income and Allocated Tips (Form 8027).[4] As shown in Figure 2, the total amount reported on Forms 8027 increased from $3.94 billion for TY 1993 to $9.18 billion for TY 2003, the latest year for which data were available.

Figure 2: Total Tip Income Reported on Forms 8027



Source: SB/SE Division Specialty Programs.[5]

These increases seem to indicate the Tip Program is effective but cannot alone be considered adequate for measuring the Program's success. A contributing factor could be that restaurant-industry employment has increased from 10 million in 1996 to 12.5 million in 2006. Also, tip income for the Food and Beverage industry may be increasing because more two-income households with families are opting for the convenience of dining out. In addition, the professional beauty services market in the United States (U.S.) is a $62-billion industry that is continually growing and could also contribute to the gradual increase in tip income reported.

Due to lack of staff availability, the IRS has not consistently monitored those establishments in the Food and Beverage and Cosmetology industries that have entered into tip agreements since FY 2000 to determine if tip agreements secured actually increased tip income for these establishments. Although the IRS will have five employees available to conduct monitoring of

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[4] Form 8027 is an information return filed by large food and beverage establishments when the employer is required to make annual reports to the IRS on receipts from food or beverage operations and tips reported by employees. Generally, a large employer is one who employs more than 10 employees on a typical business day.

[5] We did not verify or validate the IRS data.

these tip agreements, their responsibilities are not exclusive to Tip Program monitoring. Such monitoring of the agreements would provide additional assurance that IRS efforts are resulting in increased compliance levels.

Recommendation

Recommendation 1: To measure the success of the Tip Program in improving tip income reporting compliance, the Director, Specialty Programs, should ensure adequate staffing remains available to monitor the tip agreements for all industries and use the results of monitoring to measure compliance.

> ***Management's Response:*** IRS management agreed with this recommendation. The Director, Specialty Programs, will ensure consistent review and monitoring of existing and future voluntary agreements is done for all industries, as a component of the overall Tip Program strategy. The goal is to have a dedicated staff of five employees assigned to monitor compliance with the various tip agreements. The data yielded from monitoring will be used to measure compliance.

A Workforce Plan Is Needed to Ensure Staffing Levels Are Adequate to Achieve Tip Program Goals

Due to the voluntary nature of participation and limited staffing resources, disparity over the number of tip agreements secured in various locations across the country has continued to be an issue since issuance of our prior report in May 2001. As of March 2006, the TRAC/TRDA database showed the number of tip agreements per State ranged from 0 to over 1,400 for the Food and Beverage industry. In FY 2006, the IRS does not plan to actively solicit any new tip agreements except in the Gaming industry. Outreach has been limited to conducting broad-based efforts, including speeches and seminars, and workshops. However, if contacted by a business, the IRS will work with the taxpayer to secure an agreement.

Tipping noncompliance in the Cosmetology and Taxi/Limo industries is not being addressed

Based on a November 2004 research project, which recommended the IRS not spend a disproportionate amount of resources on the Cosmetology industry, the IRS discontinued soliciting and working leads for that industry. The IRS research concluded Cosmetology industry filers make up a very small portion of the total business filers (0.6 percent) and primarily have low-dollar gross receipts. Also, the IRS never expanded the Tip Program to the Taxi/Limo industry.

According to the U.S. Bureau of Labor Statistics, overall employment of barbers, cosmetologists, and other personal appearance workers is projected to grow about as fast as the average for all occupations through 2012. In addition, Figure 3 indicates a survey conducted by the U.S.

Bureau of Labor Statistics in May 2004 showed careers in this field are paid higher annual salaries than those in the Food and Beverage and Gaming industries.

Figure 3: Occupational Employment Statistics Survey – May 2004

Occupations in Which Tipping Is Customary	Total Estimated Employment	Mean Hourly Wage	Mean Annual Wage	Total Estimated Annual Income for Estimated Total Employment
Barbers	15,830	$12.04	$25,040	$396,383,200
Hairdressers, Hairstylists, and Cosmetologists	331,260	$10.95	$22,770	$7,542,790,200
Manicurists and Pedicurists	38,030	$9.65	$20,080	$763,642,400
Concierges	17,310	$11.93	$24,820	$429,634,200
Baggage Porters and Bellhops	55,910	$10.46	$21,760	$1,216,601,600
Taxi Drivers and Chauffeurs	132,650	$10.34	$21,510	$2,853,301,500
Bartenders	463,000	$8.29	$17,240	$7,982,120,000
Waiters and Waitresses	2,219,850	$7.66	$15,930	$35,362,210,500
Gaming Dealers	82,560	$7.89	$16,420	$1,355,635,200

Source: U.S. Bureau of Labor Statistics web site – May 2004.

A review of IRS records for TY 2004 business tax returns[6] showed $13.6 billion and $4 billion in gross receipts were reported for the Cosmetology and Taxi/Limo industries, respectively (see Figure 4). Using the SB/SE Division's FY 2005 criteria for selecting Cosmetology industry leads, we estimate both industries are potentially underreporting millions of dollars in tip income for their employees.

[6] Business returns included only TY 2004 U.S. Corporation Income Tax Return (Form 1120), U.S. Corporation Income Tax Return for an S Corporation (Form 1120S), and U.S. Return of Partnership Income (Form 1065). We did not include data from U.S. Individual Income Tax Returns (Form 1040) with a Profit or Loss From Business (Schedule C).

Figure 4: TY 2004 Business Returns Reporting Wage and Tip Income, by Industry

Industry	Total Business Returns (TY 2004)	Total Gross Receipts	Returns Meeting the SB/SE Division's FY 2005 Selection Criteria	Returns Meeting Part of the SB/SE Division Criteria		Returns Claiming No Tip Income		Total Returns Claiming No Tip Income or Meeting Part of the SB/SE Division Criteria	
Cosmetology	51,288	$13,626,177,115	4,335	1,822	42.03%	2,059	47.5%	3,881	89.5%
Taxi/Limo	16,477	$ 4,284,779,430	1,103	52	4.71%	881	80%	933	84.6%
Totals	67,765	$17,910,956,545	5,438	1,874	34.5%	2,940	54.1%	4,814	88.5%

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the IRS Business Return Transaction File[7] for TY 2004.

Based on these results, we determined in Figure 5 the differences in the amount of potential tip income that should have been reported versus the amount actually reported by the employers for these industries.

Figure 5: TY 2004 Actual and Potential Tip Income

Industry	Total Returns Claiming No Tip Income or Meeting Part of the SB/SE Division's FY 2005 Selection Criteria	Actual Tip Income Reported	Potential Tip Income (SB/SE Division Criteria)	Difference in Potential Versus Actual Tip Income Reported
Cosmetology	3,881	$99,537,485	$309,201,683	$209,664,199
Taxi/Limo	933	$1,003,127	$44,980,363	$43,977,236
Totals	4,814	$100,540,612	$354,182,046	$253,641,435

Source: TIGTA analysis of the IRS Business Return Transaction File for TY 2004.

As shown in Figure 5, the potential exists to increase reported tip income for these industries by approximately $254 million if taxpayers who reported no tip income or underreported their tip income were in compliance with an amount equal to the SB/SE Division selection criteria. As shown in Figure 6, results of employee tip income audits for FY 2005 for the Cosmetology industry showed 11 percent resulted in no change to the original tax assessment. Therefore, we reduced our estimate of $254 million by 11 percent,[8] which resulted in potential additional reported tip income of approximately $226 million for both industries.

[7] The Business Return Transaction File contains the line items transcribed from all business tax returns and their accompanying schedules or forms as the returns are processed.
[8] We also applied this percentage to the Taxi/Limo industry figures because the IRS did not have any tip income audit results available for this industry.

We estimated the income tax due[9] on $226 million would be $33.9 million per year. Additionally, Social Security and Medicare taxes[10] would be $34.5 million per year, for a total of $68.4 million per year. Over a 5-year period, the IRS could assess additional taxes of approximately $342 million. Appendix IV contains additional information.

Although the IRS' November 2004 research concluded the data do not support an increase in the expenditure of compliance resources for examinations in the Cosmetology industry, audit information provided by the IRS for FY 2005 (see Figure 6) showed similar dollars per return for the Cosmetology, Food and Beverage, and Gaming industries.

Figure 6: FY 2005 Results of Employee Tip Income Audits, by Industry

Industry	Closures	No Change	Dollars Assessed	Average Dollars Per Return
Gaming	2025	22%	$4,135,070	$2,042
Food and Beverage	436	4%	$1,173,071	$2,691
Cosmetology	37	11%	$83,884	$2,267

Source: SB/SE Division Specialty Programs function.

The IRS needs to resume soliciting tip agreements for the Cosmetology industry, begin soliciting tip agreements for the Taxi/Limo industry, and provide for better balanced examination coverage, which is one of its goals in FY 2006. However, the IRS is expending the majority of FY 2006 Tip Program staffing on soliciting and monitoring tip agreements with the Gaming industry and on audits of casino employees. Figure 6 shows there were over 54 times more audits of Gaming industry employees than of Cosmetology industry employees and over 4 times more audits than those of Food and Beverage industry employees.

The IRS selects casino employees' tax returns for examination based on information provided by their employers annually as part of the Gaming Industry Tip Agreement. A casino employee's tip income for the year is reported based on the last position held for the tax year. However, this could inflate the amount of tip income reported because the employee may have held different positions during the year, resulting in less tip income.

Employers in the Food and Beverage and Cosmetology industries who participate in a TRDA are not required to submit an annual report for any employees who reported tips at a rate equal to or greater than the rates established in the TRDA. They are required to submit an annual report for all nonparticipating employees. Employers who participate in a TRAC agreement do not have a requirement to file an annual report of tip income claimed by their employees. However, due to

[9] Taxes were based on the mean annual wage amounts for employees in the Cosmetology and Taxi/Limo industries (see Figure 3) and calculated using the TY 2004 individual income tax rate of 15 percent.
[10] The TY 2004 Social Security and Medicare tax rate is 15.30 percent, which includes both the employee and employer shares.

lack of staff availability, the IRS has not consistently monitored those establishments in the Food and Beverage and Cosmetology industries that have entered into these tip agreements since FY 2000.

Limited staffing reduces Tip Program outreach activities

Multiple IRS realignments have affected transition of the Tip Program from the Compliance function to the TEC function since 2003. During FY 2003, the outreach portion of the Tip Program transitioned from the Compliance function to the TEC function, with the Compliance function retaining policy responsibility. Also, the TEC function was restructured, resulting in a 50 percent reduction in the number of tax specialists. In FY 2004, the TEC function continued to conduct education and outreach, securing TRAC agreements from selected restaurants and cosmetology establishments. However, during the filing season,[11] TEC function resources were redirected to assist with filing season support. In FY 2005, the TEC function evolved into the Stakeholder Liaison Headquarters office, in the Communications, Liaison, and Disclosure function. At that time, a decision was made to no longer solicit tip agreements from the Cosmetology industry and to have Stakeholder Liaison Headquarters office tax specialists secure tip agreements exclusively from Food and Beverage industry establishments.

In FY 2006, due to limited staffing and the IRS' created direct line-reporting authority from the Headquarters Employment Tax Division over the Tip Program's operations and policy, the Tip Program was refocused. The Stakeholder Liaison Headquarters office is no longer required to actively pursue TRAC agreements but is responsible for working or handling externally generated (unsolicited) taxpayer requests for general tip information and TRAC and EmTRAC agreements. This limitation could reduce the effect of the Tip Program on increasing reporting compliance.

In all Federal Government agencies, employees are the most important asset in accomplishing missions and achieving goals. The Government Performance and Results Act of 1993[12] calls for agencies and their operating divisions to address human capital in the context of performance management and requires annual performance plans to describe how agencies will use resources to accomplish their strategic direction and program goals. As part of human capital management, strategic workforce planning helps ensure organizations have the right number of staff with the right skills and competencies in the right locations to fulfill their goals both now and in the future, given the strategies they have adopted to carry out their missions.

[11] The filing season is the period from January through mid-April when most individual income tax returns are filed.
[12] Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

Recommendation

Recommendation 2: To ensure the Tip Program provides better balanced coverage of noncompliance, the Director, Specialty Programs, and the Director, Communications, Liaison and Disclosure, should prepare a workforce plan to determine the necessary staffing levels needed to maximize the Tip Program to accomplish its goals. Without a plan, the Specialty Programs function cannot ensure it has the necessary workforce to meet its current program goals and to manage changes in its programs and goals. Adequate staffing would provide a better balance of examination coverage and allow the IRS to resume the solicitation of tip agreements with the Food and Beverage and Cosmetology industries and to expand to other industries such as the Taxi/Limo industry.

> ***Management's Response:*** IRS management agreed with this recommendation. The Director, Specialty Programs, will collaborate with the Director, Communications, Liaison, and Disclosure, to develop a Tip Program strategy that will ensure the program has sufficient staffing and resources to further tip compliance. The strategy will include targeted education and outreach, communication efforts, taxpayer correspondence, examination coverage, and monitoring of existing agreements. The strategy will also include both short- and long-term planning and consideration of expansion to other industries, as warranted. In conjunction with these efforts, a work plan will be developed to set realistic program goals, identify barriers, project resource needs, and develop implementation strategies.
>
> IRS management did not agree with our estimate of additional tax assessments because they were unable to validate our estimate and the assumption that each taxpayer contact will result in full compliance.
>
> ***Office of Audit Comment:*** We believe our estimate of potential additional tax assessments is valid. Our calculation was based on the FY 2005 methodology the IRS uses for selecting Cosmetology industry businesses for tip agreement leads and the actual results for tip examinations.

The Processing of Tip Program Data Needs Additional Improvement

Identification of potential Form 8027 non-filers

The IRS has not yet established an automated system to identify business entities required to file a Form 8027. For TY 2004, employers filed 54,183 Forms 8027 for large food and beverage establishments. The IRS recently analyzed TY 2004 records by manually matching Forms 941 showing reported tip income and employment taxes for establishments that would meet the requirement of filing a Form 8027 to a database of TY 2004 Forms 8027. This match identified 33,685 employers as potential Form 8027 non-filers. These non-filers were also matched against the TRAC/TRDA database to ensure none of these taxpayers had an existing tip agreement. The number of non-filers has increased from previous research conducted for TY 2001 by the SB/SE Division Research function, which identified 27,040 potential non-filers. The IRS believes the increase could be attributed to a high rate of restaurants going out of business after their first year of operation.

A problem also exists with the accuracy of the data fields for the TY 2004 Form 8027 database. Some of the files were transcribed using dollars and cents instead of only whole dollar amounts. As many as 1,000 records were incorrectly transcribed. In March, 2006, an alert was issued providing instructions to employees to enter all money amounts as dollars only. A data verification procedure should be implemented to ensure employees are following these procedures.

Identification of potential Form 941 non-filers

The IRS is also using the Form 8027 database to manually identify employers that may not have filed their quarterly Forms 941 to report tip income and employment taxes due that they are claiming on their annual Forms 8027. To date, the IRS has matched information for only the first quarter of TY 2004 but has already identified 3,228 potential Form 941 non-filers. It is important to reach these non-filers as early as possible to increase the chance of collecting the employment taxes due. The IRS' compliance objectives include collecting the proper amount of tax at the least cost. Taxpayers expect the IRS to promote voluntary compliance by ensuring all taxpayers promptly pay their fair share. Employers that do not pay their fair share of trust fund taxes[13] can have a significant impact on several Federal Government programs.

Upgrades for Tip Program databases

The TRAC/TRDA Inventory Delivery System database is included in the SWETRS program, which is not yet fully operational. Once it is fully developed, the SWETRS should optimize the examination case selection process for employment tax returns, increase workload efficiency, and implement a standardized method of case selection for prefiling activities (outreach). This automated System was recommended during our prior review. A lack of funding has prevented the IRS from fully developing the System. The program is now funded, and a tentative date of FY 2008 has been established for full implementation of this System.

Only the Food and Beverage and Cosmetology industry tip agreements are maintained on the TRAC/TRDA database. The Gaming industry tip agreements are maintained in a separate database. However, this database does not accommodate information such as the type of agreement (for example, GITCA or TRDA). Also, it does not contain a field for an agreement termination date or current status of a business. The IRS could not determine which tip

[13] A trust fund tax is money withheld from an employee's wages (income, Social Security, and Medicare taxes) by an employer and held in trust until paid to the Department of the Treasury.

agreements were active because there could be several tip agreements for the same casino stored in the database. The IRS analyst responsible for monitoring the Gaming industry must rely on information maintained in local IRS offices to obtain employee tip income information annually from those casinos known to be currently in business.

To obtain an overall assessment of the progress of the Tip Program and to provide consistency, the IRS should track all tip agreements in the SWETRS once it is fully operational. This System will contain 15 to 20 databases that can be cross-matched electronically and used to monitor, compare, and evaluate compliance issues related to the same taxpayer. If the IRS discontinues funding the SWETRS program, it could miss an opportunity to ensure all available efforts are made to focus on this significant noncompliance issue.

Recommendations

Recommendation 3: To ensure data are accurately transcribed and analysis of Forms 941 and 8027 data is prioritized to expedite the collection of employment taxes, the Director, Specialty Programs, should (1) implement data verification procedures for the transcription of Forms 8027 and (2) give priority to the identification of potential Form 941 non-filers over the identification of Form 8027 non-filers.

> ***Management's Response:*** IRS management agreed with this recommendation. The Director, Specialty Programs, will develop procedures that enhance current data verification procedures regarding the transcription of Forms 8027. Potential Form 941 non-filers will be identified along with potential Form 8027 non-filers. The SB/SE Division currently has ongoing examination programs that identify Form 941 non-filers. While this will continue, it also recognizes that identification of Form 8027 non-filers will give rise to identification of additional Form 941 non-filers. The Division's goal is to affect the tax gap by identifying the most egregious noncompliance.

Recommendation 4: To ensure all tip agreement information from every industry receives the benefit of the SWETRS matching program, the Director, Specialty Programs, should (1) ensure the SWETRS program remains funded through completion and, (2) once the SWETRS program is fully operational, include the Gaming industry tip agreements in the TRAC/TRDA database.

> ***Management's Response:*** IRS management agreed with this recommendation. The SWETRS will, among other things, match numerous employment tax data sources and determine areas of greatest compliance risk. The Director, Specialty Programs, is committed to its full development and will continue to work with software developers and other stakeholders to ensure the SWETRS meets its goals, with an estimated completion date of October 2008. To augment the Tip Program, the SWETRS will include the Gaming industry tip agreements in the TRAC/TRDA database so they can be included in the automated matching process.

A Method to Increase Tip Reporting for All Small Businesses Is Needed

The IRS has been unable to adequately expand the Tip Program to successfully reach some small businesses in the Food and Beverage industry. Several factors such as limited staffing and multiple realignments have contributed to this situation. As previously stated, millions of additional dollars in potential tip income could be reported if the IRS provided more outreach to such businesses in the Cosmetology and Taxi/Limo industries. The IRS is working on a resolution to expand the Tip Program by creating a new Revenue Procedure entitled the Attributed Tip Income Program (ATIP). The ATIP Revenue Procedure aims at increasing tip reporting for small businesses that report at least 20 percent of their tip income as charged tips. It will provide benefits similar to those of previous tip reporting agreements for employers and employees who report tips at or above a minimum level of gross receipts. One-on-one meetings with the IRS are not required to determine tip rates or eligibility. The ATIP Revenue Procedure will also focus on all non-filers, including employers that do not file a Form 8027 and employees that either fail to report or underreport any of their charged tips and/or cash tips.

The ATIP Revenue Procedure was approved by the Department of the Treasury on July 11, 2006. The IRS plans to test it with the Food and Beverage industry for 3 years. For small businesses in other industries such as the Cosmetology or Taxi/Limo industries to benefit from this program, the IRS would need to develop similar procedures that would be specific for each industry. If consideration is not given to developing these Revenue Procedures, the IRS could lose the opportunity to increase the amount of tip income reported.

The IRS' compliance objectives include collecting the proper amount of tax at the least cost. Taxpayers expect the IRS to promote voluntary compliance by ensuring all taxpayers promptly pay their fair share.

Recommendation

Recommendation 5: Once the ATIP Revenue Procedure is issued and has been tested with the Food and Beverage industry for 1 year, the Director, Specialty Programs, should ensure results of initial testing are analyzed and consider developing similar Revenue Procedures for small businesses in other industries, such as the Cosmetology and Taxi/Limo industries, to increase the chances of improving tip income reporting compliance.

> ***Management's Response:*** IRS management agreed with this recommendation. The Director, Specialty Programs, working with the IRS Division Counsel/Associate Chief Counsel (Small Business/Self-Employed), the IRS Office of Chief Counsel, and internal and external stakeholders, ensured the ATIP Revenue Procedure was issued on July 28, 2006. This expansion of the Tip Program allows small food and beverage establishments to also benefit from tip compliance agreements. When sufficient data have been captured to provide meaningful results, they will be analyzed to determine if a similar Revenue

Procedure would be beneficial. This Revenue Procedure would apply to small businesses in other industries where tipping is customary, with the ultimate goal of improving tip income reporting compliance. The ATIP Revenue Procedure was designed as a 3-year pilot to provide time to assess its impact on tip reporting compliance. It will take up to this length of time to assess whether the ATIP Revenue Procedure has achieved its goal and to consider whether it is appropriate to expand and modify to other industries.

Office of Audit Comment: Although the IRS' suggested evaluation period is longer than we envisioned in our recommendation, we agree it is not unreasonable to expect such data capture and analysis to take up to 3 years.

An Action Plan Is Needed to Ensure Adequate Monitoring of Future Progress

Currently, the IRS does not have an action plan to track and monitor all progress achieved for the Tip Program. An action plan would assist the IRS in assuring that all actions planned for the continued success of the Tip Program are taken. For example, several actions are planned and should be monitored to ensure completion:

- Completion of the SWETRS program is tentatively planned for FY 2008, providing the program continues to be funded. This automated System was recommended in our prior report and has not yet been implemented due to a lack of funding.
- Automated matching of Form 8027 data to Form 941 data was also a recommendation but continues to be a manual process.
- Implementation of a data verification procedure is needed to ensure the accuracy of manual data transcription for Forms 8027.

Office of Management and Budget Circular A-123[14] requires management to develop and maintain effective internal control. Programs must operate and resources must be used consistent with agency missions, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement.

Without an action plan to monitor the progress of all steps planned or in process, the IRS may miss an opportunity to achieve its goal for the success of the Tip Program.

[14] Circular A-123, *Management's Responsibility for Internal Control* (revised December 2004).

Recommendation

Recommendation 6: To ensure plans to achieve success for the Tip Program continue to progress, the Director, Specialty Programs should establish an action plan to monitor progress. It should be an outline of all planned actions, potential results, responsible individuals, staff to be allocated, and planned completion dates.

> ***Management's Response:*** IRS management agreed with this recommendation. The Director, Specialty Programs, will develop an action plan to monitor progress. It will include an outline of all planned actions, potential results, responsible individuals, staff allocations, and planned completion dates consistent with the Tip Program strategy.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine the progress the IRS has made in improving the Tip Rate Determination and Education Program (the Tip Program) and expanding it to other industries in which tipping is customary. Specifically, we reviewed the actions taken by the IRS based on the recommendations from a previous TIGTA report.[1] To accomplish the objective, we:

I. Determined how the IRS monitors the Tip Program nationwide.

   A. Reviewed the Program objectives and respective policy guidance issued as a result of the prior TIGTA report and obtained statistics currently used for measuring the success of the Tip Program.

   B. Obtained and analyzed a March 2006 list by State of 14,657 tip agreements for the Food and Beverage industry and 1,684 for the Cosmetology industry, to determine if there are any inconsistencies in the number of agreements obtained by the various offices nationwide.

II. Determined the methodology used for reconciling the Employer's Quarterly Federal Tax Return (Form 941) data to the Employer's Annual Information Return of Tip Income and Allocated Tips (Form 8027)[2] data.

   A. Obtained the results of the manual matching of Form 8027 data and Form 941 data and determined the status of the automated reconciliation of Forms 941 and 8027.

III. Reviewed the IRS' multiuser software application contained in the SWETRS[3] used by Tip Program personnel to add and append records, edit fields, generate reports, and perform comparative analyses of agreements and establishments.

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[1] *Opportunities Exist to Improve the Tip Rate Education and Determination Program* (Reference Number 2001-30-076, dated May 2001).

[2] Form 8027 is an information return filed by large food and beverage establishments when the employer is required to make annual reports to the IRS on receipts from food or beverage operations and tips reported by employees. Generally, a large employer is one who employs more than 10 employees on a typical business day.

[3] The SWETRS is a web-based system that, when fully operational, will allow cross-matching of internal IRS program databases, identifying noncompliant employment taxpayers for potential audits. It is currently funded for completion in FY 2008.

IV. Obtained FY 2006 guidance for obtaining new tip agreements with industries such as Food and Beverage, Cosmetology, and Gaming and expanding the Tip Program to other industries such as Taxi/Limo.

A. Reviewed the plans for issuance of the new ATIP Revenue Procedure to help address the limitation of expanding to small businesses.

B. Obtained and analyzed TY 2004 business returns[4] from the IRS Business Return Transaction File[5] using Principle Business Activity Codes[6] for the Cosmetology and Taxi/Limo industries to determine the amount of potential taxes assessable if additional outreach is conducted for these industries. There were 51,288 business tax returns for the Cosmetology industry and 16,477 for the Taxi/Limo industry. Data verification procedures were used to eliminate duplicate information obtained for this test. Data were verified using the IRS Integrated Data Retrieval System[7] to eliminate amended tax return information and validate the remaining data. The data were determined to be sufficiently reliable.

1. A total of 5,438 business tax returns for both industries met the criteria.
2. Determined 4,814 of 5,438 TY 2004 business tax returns claimed tip income at an amount less than that meeting the SB/SE Division's FY 2005 criteria or claimed no tip income.
3. Compared the amount of actual tip income reported versus the potential tip income reportable.
4. Obtained the results of FY 2005 employee tip income audits for the Cosmetology, Food and Beverage, and Gaming industries. We reduced the potential tip income reportable by 11 percent, which was the percentage of Cosmetology industry tip income audits[8] resulting in no change to the original tax assessments.

[4] Business returns included U.S. Corporation Income Tax Return (Form 1120), U.S. Income Tax Return for an S Corporation (Form 1120S), and U.S. Return of Partnership Income (Form 1065) matched against the Employer's Quarterly Federal Tax Return (Form 941) for the same tax year.
[5] The Business Return Transaction File contains the line items transcribed from all business tax returns and their accompanying schedules or forms as the returns are processed.
[6] Principal Business Activity Codes are used to classify businesses and sole proprietorships by type of activity.
[7] This is the IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.
[8] We applied this percentage to the Taxi/Limo industry figures because the IRS did not have any tip income audit results available for this industry.

5. Determined the estimated amount of income tax due by multiplying the reduced potential tip income amount by the individual income tax rate of 15 percent.[9]

6. Determined the estimated amount of both the employee and employer share of Social Security and Medicare taxes due by multiplying the reduced tip income amount by 15.30 percent.[10]

V. Obtained information on transition of the Tip Program from the SB/SE Division Compliance function to the TEC function.

A. Reviewed the procedures for the monitoring and soliciting of tip agreements for other IRS divisions, such as Large and Mid-Size Business Division.

[9] Taxes were based on the mean annual wage amounts for employees in the Cosmetology and Taxi/Limo industries (as of May 2004 per the U.S. Bureau of Labor Statistics) and calculated using the TY 2004 individual income tax rate of 15 percent.

[10] The TY 2004 Social Security and Medicare tax rate is 15.30 percent, which includes both the employee and employer shares.

Appendix II

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs)
Parker F. Pearson, Director
Richard T. Hayes, Audit Manager
Carole E. Connolly, Lead Auditor
Janis Zuika, Senior Auditor
Judith P. Harrald, Information Technology Specialist

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division SE:S:CLD
Director, Examination, Small Business/Self-Employed Division SE:S:E
Director, Specialty Programs, Small Business/Self-Employed Division SE:S:SP
Director, Policy and Strategic Planning, Small Business/Self-Employed Division SE:S:CLD:PSP
Director, Stakeholder Liaison Headquarters, Small Business/Self-Employed Division SE:S:CLD:SLHQ
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division SE:S:CLD

Appendix IV

Outcome Measure

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; approximately $342 million in additional tax assessments over 5 years (see page 6).

Methodology Used to Measure the Reported Benefit:

To determine the amount of potential tip income that could be reported if the IRS would resume soliciting new tip agreements from the Cosmetology industry and expand the Tip Program to the Taxi/Limo industry, we obtained TY 2004 business return data[1] from the IRS Business Return Transaction File.[2] Using the SB/SE Division's FY 2005 criteria for selecting Cosmetology industry leads, we estimated the differences in the amount of potential tip income that could have been reported versus the actual amount of Social Security Tip Wages reported by employers on the Employer's Quarterly Federal Tax Return (Form 941) for the Cosmetology and Taxi/Limo industries.

Actual Tip Income Reported:	$100,540,612
Potential Tip Income Reportable:	$354,182,046
Difference:	$253,641,435

We reduced this amount by 11 percent, which was the percentage of Cosmetology industry tip income audits[3] resulting in no change to the original tax assessments.

Potential Tip Income Reportable: $253,641,435 – 11 percent = $225,740,877

[1] Business tax returns included U.S. Corporation Income Tax Return (Form 1120), U.S. Income Tax Return for an S Corporation (Form 1120S), and U.S. Return of Partnership Income (Form 1065) matched against the Employer's Quarterly Federal Tax Return (Form 941) for the same tax year.
[2] The Business Return Transaction File contains the line items transcribed from all business tax returns and their accompanying schedules or forms as the returns are processed.
[3] We also applied this percentage to the Taxi/Limo industry figures because the IRS did not have any tip income audit results available for this industry.

We determined the amount of individual income tax using the 15 percent tax bracket[4] and both the employee and employer shares of Social Security and Medicare taxes of 15.30 percent.[5]

Potential Individual Income Taxes – 1 Year:	$33,861,132
Potential Social Security and Medicare Taxes – 1 Year:	$34,538,354
Combined Estimated Total Taxes – 1 Year:	$68,399,486
Total Estimated Taxes – 5 Years:	$341,997,430

[4] Taxes were based on the mean annual wage amounts for employees in the Cosmetology and Taxi/Limo industries (as of May 2004 per the U.S. Bureau of Labor Statistics) and calculated using the TY 2004 individual income tax rate of 15 percent.
[5] The TY 2004 Social Security and Medicare tax rate is 15.30 percent, which includes both the employee and employer shares.

Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

RECEIVED
AUG 31 2006

August 28, 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kevin M. Brown
Commissioner, Small Business/Self Employed Division

SUBJECT: Draft Audit Report – Additional Enhancements Could Improve Tax Compliance of Employees Who Receive Tips (Audit # 200530029)

We have reviewed your draft report on tip reporting compliance and agree with your audit recommendations. We appreciate your acknowledgement of the enhancements to tip reporting compliance resulting from the Small Business/Self-Employed (SB/SE) Tip Rate Determination and Education Program (Tip Program).

We agree with your recommendations and your assessment that additional enhancements are needed to improve tax compliance among the food and beverage and gaming industries. The Tip Program offers employers multiple voluntary agreement options and it is designed to enhance tax compliance among employers and employees in industries where tipping is customary. Expansion to other industries will be considered as we work towards improving voluntary compliance in tip income reporting.

We recently expanded the Tip Program to include small food and beverage establishments by offering them the Attributed Tip Income Program (ATIP). ATIP is a new voluntary tip reporting program that promotes tip income reporting and reduces industry record keeping burdens. It provides benefits to employers and employees in the food and beverage industry similar to those enjoyed under existing agreements. ATIP provides simple enrollment, eliminates one-on-one meetings with the IRS, and does not require a signed agreement.

The Tip Program strategy incorporates a number of initiatives and balances many compliance facets including filing, payment, and reporting compliance in the food and beverage and gaming industries. In addition, the securing of new voluntary compliance agreements, monitoring existing and future agreements and auditing of apparent noncompliant taxpayers remain primary areas of emphasis for our strategy.

With respect to your estimated measurable impact of the recommended actions, we are unable to validate your estimate, and the underlying assumption that each taxpayer contact will result in full compliance.

Our comments on your recommendations are attached. If you have questions or concerns, contact me at (202) 622-0600 or William Conlon, Director, Specialty Programs, at (202) 283-7660.

Attachment

Attachment

Recommendation 1

To measure the success of the Tip Program in improving tip income reporting compliance, the Director, Specialty Programs, should ensure adequate staffing remains available to monitor the tip agreements for all industries and use the results of monitoring to measure compliance.

Corrective Action

As a component of the overall Tip Program strategy, the Director, Specialty Programs, will ensure consistent review and monitoring of existing and future voluntary agreements for all industries. Our goal is to have a dedicated staff of five employees assigned to monitor compliance with the various tip agreements. The data yielded from monitoring will be used to measure compliance.

Implementation Date

June 30, 2007

Responsible Official

Director, Specialty Programs, Small Business/Self-Employed Division

Corrective Action Monitoring Plan

The Chief, Employment Tax Operations, will advise the Director, Specialty Programs, of any corrective action delays.

Recommendation 2

To ensure the Tip Program provides better balanced coverage of noncompliance, the Director, Specialty Programs, and the Director of Communication and Liaison, SB/SE Division, should prepare a workforce plan to determine the necessary staffing levels needed to maximize the Tip Program to accomplish its goals. Without a plan, the Specialty Programs function cannot ensure it has the necessary workforce to meet its current program goals and to manage changes in its programs and goals. Adequate staffing would provide a better balance of examination coverage and allow the IRS to resume the solicitation of tip agreements with the Food and Beverage and Cosmetology industries and to expand to other industries such as the Taxi/Limo industry.

Corrective Action

The Director, Specialty Programs, will collaborate with the Director, Communications, Liaison and Disclosure, to develop a Tip Program strategy that will ensure the program has sufficient staffing and resources to further tip compliance. The strategy will include targeted education and outreach, communication efforts, taxpayer correspondence (i.e. soft notice), examination coverage and monitoring of existing agreements. The strategy will also include both short and long term planning, and consideration of expansion to other industries, as warranted. In conjunction with these efforts, a work plan will be developed to set realistic program goals, identify barriers, project resource needs, and develop implementation strategies.

Implementation Date
June 30, 2007

Responsible Official
Director, Specialty Programs, Small Business/Self-Employed Division, and Director Communications, Liaison and Disclosure, Small Business/Self-Employed Division.

Corrective Action Monitoring Plan
The Chief, Employment Tax Operations, will advise the Director, Specialty Programs, of any corrective action delays.

Recommendation 3
To ensure data are accurately transcribed and analysis of Forms 941 and 8027 data is prioritized to expedite the collection of employment taxes, the Director, Specialty Programs, should (1) implement data verification procedures for the transcription of Forms 8027 and (2) give priority to the identification of potential Form 941 non-filers over the identification of Form 8027 non-filers.

Corrective Action
The Director, Specialty Programs, will develop procedures that enhance current data verification procedures regarding the transcription of Forms 8027. Potential Form 941 non-filers will be identified along with potential Form 8027 non-filers. We currently have ongoing examination programs that identify Form 941 non-filers. While this will continue, we also recognize that identification of Form 8027 non-filers will give rise to identification of additional Form 941 non-filers. Our goal is to impact the tax gap by identifying the most egregious noncompliance.

Implementation Date
June 30, 2007

Responsible Official
Director, Specialty Programs, Small Business/Self-Employed Division

Corrective Action Monitoring Plan
The Chief, Employment Tax Operations, will advise the Director, Specialty Programs, of any corrective action delays.

Recommendation 4
To ensure all tip agreement information from every industry receives the benefit of the SWETRS matching program, the Director, Specialty Programs, should (1) ensure the SWETRS program remains funded through completion and (2) once the SWETRS program is fully operational, include the Gaming tip agreements in the TRAC/TRDA database.

Corrective Action
SWETRS is an automated program that will, among other things, match numerous employment tax data sources and determine areas of greatest compliance risk. The Director, Specialty Programs, is committed to its full development and will continue to work with software developers and other stakeholders to ensure that SWETRS meets its goals with an estimated completion date of October 2008. To augment the Tip Program, SWETRS will include the gaming tip agreements in the TRAC/TRDA database so that they can be included in the automated matching process.

Implementation Date
January 31, 2009

Responsible Official
Director, Specialty Programs, Small Business/Self-Employed Division

Corrective Action Monitoring Plan
The Chief, Employment Tax Operations, will advise the Director, Specialty Programs, of any corrective action delays.

Recommendation 5
Once the Attributed Tip Income Program Revenue Procedure is issued and has been tested with the Food and Beverage industry for one year, the Director, Specialty Programs, should ensure results of initial testing are analyzed and consider developing similar Revenue Procedures for small businesses in other industries, such as the Cosmetology and Taxi/Limo industries, to increase the chance of improving tip income reporting compliance.

Corrective Action
The Director, Specialty Programs, working with the SB/SE Counsel, the Office of Chief Counsel and internal and external stakeholders, ensured the Attributed Tip Income Program (ATIP) Revenue Procedure was issued on July 28, 2006. This expansion of the Tip Program allows small food and beverage establishments to also benefit from tip compliance agreements. When sufficient data has been captured to provide meaningful results, it will be analyzed to determine if a similar revenue procedure would be beneficial. This revenue procedure would apply to small businesses in other industries where tipping is customary with the ultimate goal of improving tip income reporting compliance. ATIP was designed as a three year pilot to provide time to assess its impact on tip reporting compliance. It will take up to this length of time to assess whether ATIP has achieved its goal and to consider whether it is appropriate to expand and modify to other industries.

Implementation Date
January 31, 2009

Responsible Official
Director, Specialty Programs, Small Business/Self-Employed Division

Corrective Action Monitoring Plan
The Chief, Employment Tax Operations, will advise the Director, Specialty Programs, of any corrective action delays.

Recommendation 6
To ensure plans to achieve success for the Tip Program to continue to progress, the Director, Specialty Programs, and the Director of Communication and Liaison, SB/SE Division should establish an action plan to monitor progress. It should outline all planned actions, potential results, responsible individuals, staff to be allocated and planned completion dates.

Corrective Action
The Director, Communications, Liaison and Disclosure is no longer responsible for the Tip Program. The Director, Specialty Programs, will develop an action plan to monitor progress. It will include an outline of all planned actions, potential results, responsible individuals, staff allocations and planned completion dates consistent with Corrective Action 2.

Implementation Date
June 30, 2007

Responsible Official
Director, Specialty Programs, Small Business/Self-Employed Division

Corrective Action Monitoring Plan
The Chief, Employment Tax Operations, will advise the Director, Specialty Programs, of any corrective action delays.