



SOCIAL SECURITY

MEMORANDUM

Date: August 7, 2007

Refer To:

To: The Commissioner

From: Inspector General

Subject: Overstated Earnings and the Effect on Social Security Administration Programs
(A-03-05-25018)

The attached final report presents the results of our audit. Our objectives were to determine whether Title II beneficiaries were overstating self-employment income on their Federal income tax returns, and, if so, the effect on Social Security Administration programs.

Please provide within 60 days a corrective action plan that addresses each recommendation. If you wish to discuss the final report, please call me or have your staff contact Steven L. Schaeffer, Assistant Inspector General for Audit, at (410) 965-9700.

A handwritten signature in black ink, appearing to read "Patrick P. O'Carroll, Jr." with a stylized flourish at the end.

Patrick P. O'Carroll, Jr.

Attachment

**OFFICE OF
THE INSPECTOR GENERAL**

SOCIAL SECURITY ADMINISTRATION

**OVERSTATED EARNINGS AND THE
EFFECT ON SOCIAL SECURITY
ADMINISTRATION PROGRAMS**

August 2007

A-03-05-25018

AUDIT REPORT



Mission

By conducting independent and objective audits, evaluations and investigations, we inspire public confidence in the integrity and security of SSA's programs and operations and protect them against fraud, waste and abuse. We provide timely, useful and reliable information and advice to Administration officials, Congress and the public.

Authority

The Inspector General Act created independent audit and investigative units, called the Office of Inspector General (OIG). The mission of the OIG, as spelled out in the Act, is to:

- Conduct and supervise independent and objective audits and investigations relating to agency programs and operations.**
- Promote economy, effectiveness, and efficiency within the agency.**
- Prevent and detect fraud, waste, and abuse in agency programs and operations.**
- Review and make recommendations regarding existing and proposed legislation and regulations relating to agency programs and operations.**
- Keep the agency head and the Congress fully and currently informed of problems in agency programs and operations.**

To ensure objectivity, the IG Act empowers the IG with:

- Independence to determine what reviews to perform.**
- Access to all information necessary for the reviews.**
- Authority to publish findings and recommendations based on the reviews.**

Vision

We strive for continual improvement in SSA's programs, operations and management by proactively seeking new ways to prevent and deter fraud, waste and abuse. We commit to integrity and excellence by supporting an environment that provides a valuable public service while encouraging employee development and retention and fostering diversity and innovation.

Executive Summary

OBJECTIVE

Our objectives were to determine whether Title II beneficiaries were overstating self-employment income (SEI) on their Federal income tax returns, and, if so, the effect on Social Security Administration (SSA) programs.

BACKGROUND

SSA field offices (FO) have reported that Title II beneficiaries have been overstating SEI on their Federal income tax returns to become eligible for the Internal Revenue Service's (IRS) Earned Income Tax Credit (EITC). This credit can be claimed by lower-income earners. In addition to allowing EITC eligibility, the overstated SEI could allow the individuals to acquire Social Security credits for future Title II and Medicare benefits, which could increase their monthly Title II benefits. SSA will remove the SEI from an individual's earnings record if the individual disclaims the earnings (e.g. states that the earnings do not represent legitimate earnings activity).

RESULTS OF REVIEW

We found 2,348 SEI earnings items related to 1,355 individuals with Title II records who reported SEI in Tax Years (TY) 2000 to 2003 that were later removed from each earnings record at the individual's request. Based on information in SSA's records, we determined the following:

Reason for Overstated Self-Employment Income (SEI)	Number of Removed Earnings Items	Percent of Total Removed Earnings
Individual stated SEI was reported to obtain the EITC	166	7
Reported SEI related to potential tax fraud ¹	101	4
Individual stated SEI was reported to obtain the Social Security credits to qualify for benefits or increase benefits	15	1
Reason unknown: SSA's systems did not contain sufficient information	2,066	88
Total	2,348	100%

Note 1: While some form of potential tax fraud was mentioned by the individuals disclaiming the earnings, they did not specifically name the EITC as the primary factor.

We also found a number of issues related to SSA's processing of disclaimed earnings. For instance, we found that some of the removed earnings were erroneously placed in SSA's Earnings Suspense File rather than deleted from SSA's systems. As a result, at a later time some of these earnings were manually placed back on individuals' earnings

records in error by other field offices. We also found instances where SSA removed disclaimed earnings from earnings records but took no actions for similar questionable earnings on the same record. These incomplete actions can potentially lead to the overpayment of benefits.

In addition, we determined that FOs were not always reporting the disclaimed earnings to the IRS nor collecting the required information on the *Statement of Claimant or Other Person* (SSA-795) needed by the IRS to investigate these instances of potential tax fraud. We also found that the earnings item correction data shared with the IRS regarding disclaimed earnings was provided in a paper form rather than electronically, which may not be the most efficient method for sharing such data.

CONCLUSION AND RECOMMENDATIONS

To ensure consistent procedures for removing disclaimed earnings as well as the sharing of this information with the IRS, we recommend that SSA:

- Review the questionable earnings items identified in this audit where earnings may need to be removed from individuals' earnings records to prevent improper future SSA payments.
- After incorporating information included in this report, as appropriate, issue national instructions to FOs for processing SEI cases where income has been overstated, including information on when to delete such earnings, how to document such cases in SSA's electronic records, when to notify the IRS, and how to complete and forward Form SSA-795.
- Upon issuance of national instructions to FOs for processing SEI cases where income has been overstated, provide appropriate training to FO staff to ensure consistent implementation.
- Discuss data-sharing options with the IRS to determine if an electronic version of item correction transactions would be more useful.

AGENCY COMMENTS

SSA agreed with all our recommendations. The Agency's comments are included in Appendix F.

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OBJECTIVE

Our objectives were to determine whether Title II beneficiaries were overstating self-employment income (SEI) on their Federal income tax returns, and, if so, the effect on Social Security Administration (SSA) programs.

BACKGROUND

SSA is responsible for maintaining accurate individual earnings records, including wages and SEI. Wages and SEI are posted to SSA's Master Earnings File (MEF) and are used to determine eligibility for retirement, survivors, disability, and health insurance benefits as well as to calculate benefit amounts. Self-employed individuals report SEI to the Internal Revenue Service (IRS) on a *Profit or Loss from Business* (Schedule C) and *Self Employment Tax* (Schedule SE) attached to a Federal income tax Form 1040.¹ The IRS sends this SEI information to SSA where it is recorded on an individual's earning record.²

Reporting earnings activity to the IRS, even if that activity never occurred, could make an individual eligible for the Earned Income Tax Credit (EITC), which is a refundable Federal income tax credit created in 1975 for working individuals. To claim the EITC, individuals must meet eligibility requirements, including earned income for the tax year (TY) and a valid Social Security number (SSN) for all individuals on the tax forms.³ Earned income includes wages and SEI and must be below a specific amount (\$34,692 in TY 2003) to qualify the individual for the EITC. Earned income between \$10,500 and \$14,750 qualified an individual for the maximum EITC in TY 2003 (see Appendix B).

¹ *Tax Guide for Small Business (For individuals who use Schedule C or C- EZ)*, IRS Publication 334, 2006.

² SSA Program Operations Manual System (POMS), RS 01801.011.A – *Processing of SEI Tax Returns and Crediting Self-Employment Income*.

³ *Earned Income Credit (EIC)*, IRS Publication 596, 2006. Other eligibility requirements include (1) filing status restrictions, (2) citizenship or resident alien requirements, and (3) income restrictions.

SSA field offices (FO) have reported that Title II⁴ beneficiaries have been overstating SEI on their Federal income tax returns to become eligible for the EITC.⁵ In addition to allowing EITC eligibility, the overstated SEI could allow the individuals to acquire Social Security credits for future Title II and Medicare benefits, which could increase their monthly Title II benefits.

SSA FO staff reported that much of the erroneous SEI they encountered was reported for such work as cutting hair, yard work, and babysitting. The FOs also reported that the individuals overstating their income may have been encouraged by unscrupulous tax preparers who benefited from filing suspicious Federal tax returns with the IRS.

SSA removes the SEI from an individual's earnings record when it believes the SEI does not represent legitimate earnings. If the earnings could belong to someone else, SSA places the earnings in the Earnings Suspense File (ESF).⁶ When SEI is removed, the IRS has requested that SSA obtain a *Statement of Claimant or Other Person* (SSA-795) from individuals suspected of overstating SEI. The form is used to record a statement, and the individual attests the information is true.⁷ The form requests specific information to assist the IRS, including a statement that (1) the SEI did not belong to the individual, (2) the individual never earned the SEI and used the SEI to qualify for the EITC, and (3) the person knew it was wrong to overstate the SEI.

SCOPE AND METHODOLOGY

We reviewed cases where SSA had removed SEI originally posted for TYs 2000 to 2003 and met specific criterion, such as dollar amounts. We used data from this earlier time period since it allowed sufficient time for the SEI to be posted and then disclaimed by the earner. We believe the problem of individuals claiming overstated SEI is more

⁴ A Title II record is a Master Beneficiary Record that contains data for currently entitled beneficiaries, denied/disallowed beneficiaries, previously entitled beneficiaries, and uninsured Medicare enrollees.

⁵ FOs investigate earnings reported under the SSNs of individuals receiving Title II benefits if the earnings are above specific amounts. Earnings reported for disabled beneficiaries are reviewed as part of SSA's Continuing Disability Review Enforcement Operation (SSA POMS, DI 40510.030 – *Continuing Disability Review Enforcement Operation*), and earnings for retired persons are reviewed under the Annual Earnings Test (SSA POMS, RS 02501.021 – *The Annual Earnings Test*).

⁶ The ESF is a repository for reported earnings items with names/SSNs that do not match SSA's records or have other questionable characteristics, such as disclaimed earnings. SSA maintains two ESFs: one for wage items reported on a Form W-2 that cannot be matched to SSA's name and SSN records and another for SEI that does not match SSA's records. As of October 2006, there were 264 million wage items representing \$586 billion in wages and 2.4 million SEI items pertaining to \$12.7 billion in earnings.

⁷ The penalty clause on the SSA-795 states, "I declare under penalty of perjury that I have examined all the information on this form, and on any accompanying statements or forms, and it is true and correct to the best of my knowledge. I understand that anyone who knowingly gives a false or misleading statement about a material fact in this information, or causes someone else to do so, commits a crime and may be sent to prison, or may face other penalties, or both."

widespread than we are reporting. We only reviewed SEI earnings items removed by SSA,⁸ subject to EITC income limits, and reported under the SSNs of individuals with a Title II record.

Using information within SSA's records, we focused on those cases where (1) the reason cited for the overstated SEI was potential tax fraud and/or SSA benefits or (2) the SEI was removed and there was insufficient information to determine why the SEI was originally reported. See Appendix C for our full scope and methodology.

⁸ We did not review SEI removed by the IRS and later reported to SSA since the IRS would already be aware of these adjustments.

Results of Review

We found 2,348 earnings items related to 1,355 individuals with Title II records who reported SEI in TYs 2000 to 2003 that were later removed from each earnings record at the individual's request. These 2,348 earnings items totaled about \$21 million in overstated SEI, all of which SSA initially removed from the earners' records. Table 1 below provides information on why the disclaimed earnings were reported to SSA, as indicated in the Agency's records.

Table 1: Reasons for Disclaimed Earnings

Reason for Overstated Self-Employment Income (SEI)	Number of Removed Earnings Items	Percent of Total Removed Earnings
Individual stated SEI was reported to obtain the EITC	166	7
Reported SEI related to potential tax fraud ¹	101	4
Individual stated SEI was reported to obtain the Social Security credits to qualify for benefits or increase benefits	15	1
Reason unknown: SSA's systems did not contain sufficient information	2,066	88
Total	2,348	100%

Note 1: While some form of potential tax fraud was mentioned by the individuals disclaiming the earnings, they did not specifically name the EITC as the primary factor.

We also found a number of issues related to SSA's processing of disclaimed earnings. For instance, we found that some of the removed earnings were erroneously placed in SSA's ESF rather than deleted from SSA's systems. As a result, some of these earnings were erroneously placed back on individuals' earnings records. We also found instances where SSA removed disclaimed earnings from earnings records but took no actions for similar questionable earnings on the same record. In addition, we determined that FOs were not always reporting the disclaimed earnings to the IRS nor collecting the required information needed by the IRS to investigate these instances of potential tax fraud. We also found that the earnings item correction data shared with the IRS regarding disclaimed earnings was provided in a paper form rather than electronically, which may not be the most efficient method for sharing such data.

REMOVED SELF-EMPLOYMENT INCOME

We found 2,348 earnings items related to 1,355 individuals with a Title II record who reported SEI in TYs 2000 to 2003 that was later removed from the individuals' earnings record at their request. SSA removed about \$21 million in overstated SEI reported over this 4-year period related to these 2,348 earnings items. Table 2 provides details on the number of years during our review period that individuals reported overstated SEI that SSA later removed. We found that approximately 19 percent of the individuals overstated income for 3 or more years.

**Table 2: Distribution of Removed Earnings Items by Individual Earner
(TYs 2000 – 2003)**

Number of Tax Years with Removed Earnings	Number of Removed Earnings Items	Number of Individuals	Percent of Individuals
4	224	56	4.1
3	620	203	15.0
2	803	397	29.3
1	701	699	51.6
Total	2,348	1,355	100%

Note: SSA removed multiple earnings items for the same years for some individuals in our 4-year review period.

REASONS FOR REMOVED EARNINGS

Using information from SSA's Item Correction (ICOR) system,⁹ we found that individuals overstated SEI for a variety of reasons (see Figure 1), including:

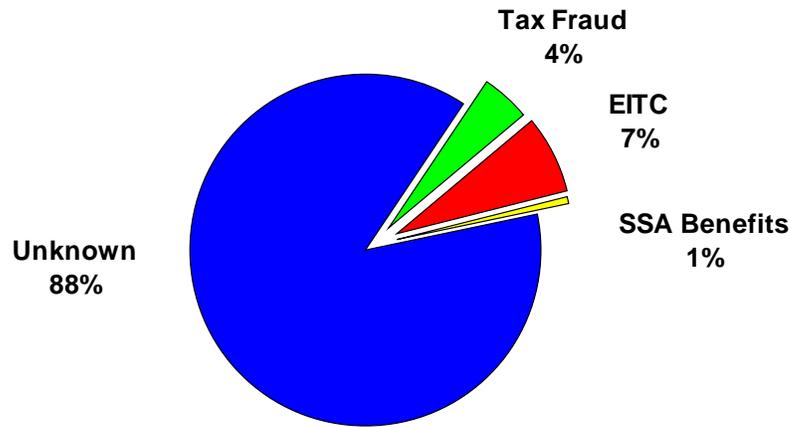
- 166 earnings items were reported to obtain the EITC (7 percent);
- 101 earnings items potentially related to income tax fraud (4 percent);¹⁰
- 15 earnings items were reported to obtain Social Security coverage (1 percent); and
- 2,066 earnings items reported for other undeclared/unrecorded reasons (88 percent).

We found that 142 (50 percent) of the 282 earnings items where we could determine why the SEI was originally reported involved tax preparers completing the Federal income tax returns. Based on SSA's records, we determined that paid preparers assisted with 137 of the cases, and family members (sister, daughter, and brother-in-law) were named as preparers in the remaining five cases.

⁹ ICOR was formerly called Earnings Modernization 2.8 (EM 2.8) and is used by SSA personnel to add, remove, and adjust earnings.

¹⁰ While some form of potential tax fraud was mentioned by the individuals disclaiming the earnings, they did not specifically name the EITC as the primary factor.

Figure 1: Reason for Reporting Overstated Self-Employment Income



Earned Income Tax Credit

SSA's records indicated that 166 (7 percent) of the 2,348 earnings items were removed after the individuals stated they reported this income to obtain the EITC. These 166 earnings items related to 91 individuals and approximately \$1.3 million in earnings. In one example, SSA staff removed approximately \$37,000 in SEI over a 5-year period from the earnings record of a Texas resident. Field office staff noted in the ICOR system that the individual's tax preparer reported self employment earnings for years 1999 through 2003 to claim the EITC, and the individual "stated he had never owned or operated a business during the years in question."¹¹

Apparent Income Tax Fraud

Another 101 earning items (4 percent) were removed after individuals stated they were attempting some form of Federal income tax fraud. These 101 earnings items, totaling over \$832,000, were originally reported by 59 individuals. Although we are not aware of any formal charges of fraud against these individuals, they admitted misrepresenting their financial circumstances on Federal income tax forms. SSA's records indicated the individuals did not work, but reported SEI on their Federal tax forms. However, specific reasons for reporting the earnings, such as the EITC or Social Security benefits, were not mentioned.

In one case, SSA removed SEI of close to \$29,000 recorded for a 4-year period. The individual stated to SSA that, based on the advice of her accountant, she ran a "child care business." In fact, she was caring for her 11 year-old granddaughter.¹²

¹¹ Approximately \$7,300 of this amount related to TY 1999, which is outside of our review period. This 35-year-old individual (in 2003) became entitled to Title II disability benefits in January 1998.

¹² Almost \$4,000 of the reported SEI was for TY 1999, which is outside of our review period. This individual has been receiving Title II disability benefits since October 1999.

Social Security Administration Coverage and Benefits

Information in SSA's records also indicated an additional 15 overstated earnings items (or 1 percent of the overall earnings items) were reported to obtain Social Security credits¹³ to qualify for benefits or increase existing benefit amounts. These 15 earnings items were reported by 7 individuals and totaled approximately \$128,500 in earnings.

In one example, SSA removed 2 years of overstated SEI totaling almost \$25,000 from the earnings record of a California resident. SSA staff noted in the ICOR system that the individual stated, "his brother-in-law did SE returns for him for 2001 and 2002 even though he did not work so that he could receive SSA credits."¹⁴

Unknown Reasons

For the remaining 2,066 earnings items (88 percent), we were unable to determine why the income was originally reported since SSA's records did not provide sufficient information pertaining to the transactions. These 2,066 earnings items were reported by 1,198 individuals and totaled approximately \$18.7 million in earnings. There are several possible explanations for SSA removing these earnings, including reporting errors,¹⁵ identity theft,¹⁶ scrambled earnings,¹⁷ and SSN misuse.¹⁸ SSA's records did not provide sufficient information as to why the SEI was originally reported, even when multiple years of SEI was removed from an individual's earnings record.

As an example of these types of cases, FO staff in California removed almost \$29,000 in SEI for 2000 through 2003 and noted in the ICOR system that the individual stated "I have never claim (sic) self employment."¹⁹

¹³ Individuals earn Social Security credits, previously called Quarters of Coverage, by working and paying taxes. In 2003, one credit was earned for each \$890 earned, up to a maximum of \$3,560 annually. These credits count toward eligibility for future Social Security benefits (SSA POMS, RS 00301.250 – *Increment Amounts*).

¹⁴ This individual became entitled to Social Security retirement benefits and Supplemental Security Income payments in September 2003.

¹⁵ Reporting or clerical errors are made in recording information.

¹⁶ Identify theft occurs when someone uses the personal identifying information of another person, such as name, SSN, driver's license number or mother's maiden name, without authorization and for an unlawful purpose (SSA POMS, RM 00205.051.B – *Identify Theft and SSA Fraud*).

¹⁷ Scrambled earnings are wages or SEI belonging to one individual that are posted to another individual's earnings record (SSA POMS, RM 03870.045.A – *Scrambled Earnings – General*).

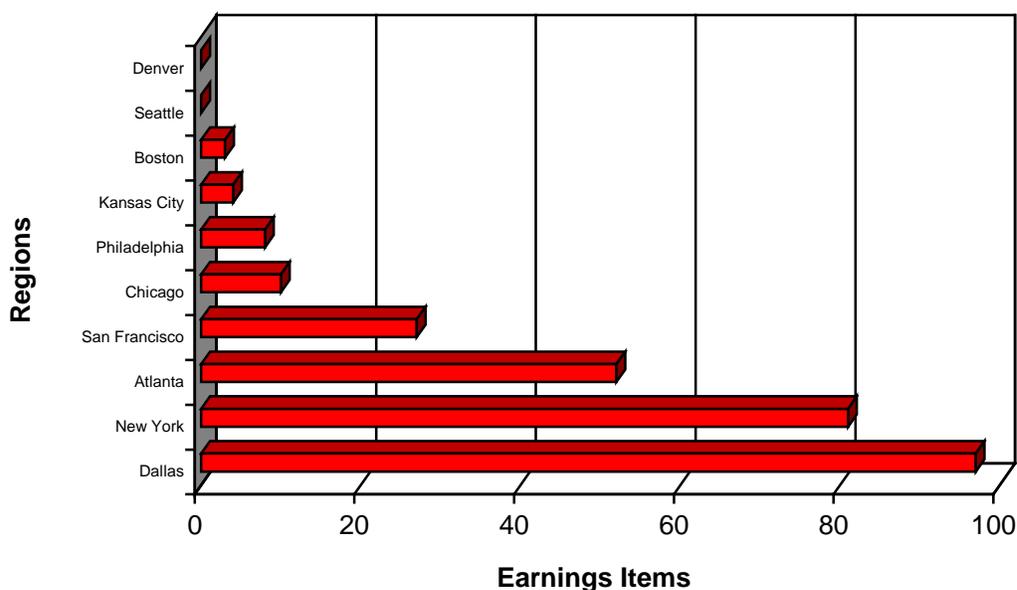
¹⁸ SSN misuse occurs when the SSN is used with criminal or harmful intent (SSA POMS, RM 00205.054 – *New SSN Requests Where SSN Misuse and Disadvantage is Alleged*).

¹⁹ This individual, born in 1960, became entitled to disability benefits under both Social Security (in June 1996) and Supplemental Security Income (in August 1996).

REGIONAL DISTRIBUTION OF OVERSTATED EARNINGS

We found disclaimed SEI items related to potential tax fraud and/or attempts to acquire SSA benefits in 8 of SSA's 10 regions (see Figure 2). The largest numbers of instances were in the Dallas, New York, and Atlanta Regions. The Denver and Seattle Regions did not have any disclaimed earnings items in this category. The absence of disclaimed SEI related to claims for the EITC and/or Social Security benefits does not mean such problems did not occur in these regions. Some regions may be better at detecting overstated earnings and recording why the earnings were originally reported. Our review was limited to problems detected by FOs and not all potential problems in SSA's records. Additional undetected cases of individuals reporting overstated earnings may exist that have not come to our or SSA's attention. All 10 regions also removed earnings items where we could not determine why the earnings were originally reported (we discuss this later in our report).

Figure 2: Regional Distribution of Overstated Earnings Related to IRS/SSA Benefits (TYs 2000 - 2003)



RESOLUTION OF DISCLAIMED EARNINGS

Among the 282 disclaimed earnings items related to potential tax fraud and/or attempts to acquire SSA benefits, we found that 11 percent were placed in the ESF rather than deleted from SSA's earnings records. SSA staff are expected to delete earnings that do not represent legitimate work activity rather than place them into the ESF. We also found that the removal process often missed other questionable earnings. In addition, we found SSA deleted approximately one-third of the 2,066 earnings items that were disclaimed for unknown reasons, indicating these items may have represented tax fraud and/or an attempt to obtain SSA benefits. Finally, we found cases where removed earnings were later placed back on individuals' records in error.

EARNED INCOME TAX CREDIT AND SSA PAYMENTS

While SSA properly deleted most of the 282 earnings items associated with potential tax fraud and/or attempts to acquire SSA benefits, we found that 30 items (11 percent) were moved to the ESF. These 30 earnings items totaled over \$286,000 in overstated SEI, an average of \$9,557 per item for our review period. Placing earnings items in the ESF is appropriate when the identity of the person who earned the money is unknown.²⁰ However, when the individual disclaims the earnings and states they overstated the SEI, the earnings should be deleted since they do not represent a real work activity. Deletion permanently removes the earnings from the earnings system so they cannot be posted to another record, whereas moving earnings items to the ESF allows for the possibility that someone may later receive credit for earnings that should never have been reported.²¹ The 30 earnings items moved to the ESF were in the SSA regions shown in Table 3.

Table 3: Earnings Items Erroneously Moved to the ESF (TYs 2000 – 2003)

SSA Region	Total Earnings Items Disclaimed (EITC/SSA)	Earning Items Erroneously Posted to the ESF	Percent of Earnings Items Posted to the ESF
Chicago	10	3	30
San Francisco	27	7	26
New York	81	10	12
Atlanta	52	4	8
Dallas	97	6	6
Philadelphia	8	0	0
Boston	3	0	0
Kansas City	4	0	0
Total	282	30	11% (avg.)

Note: The Denver and Seattle Regions did not have disclaimed earnings that were originally reported to obtain IRS and/or SSA benefits. The Philadelphia, Boston, and Kansas City Regions had these types of earnings items but did not move them to the ESF.

We also found that SSA appropriately deleted 243 (86 percent) of the 282 disclaimed earnings items. SSA took other actions for the remaining 9 disclaimed earnings items (3 percent).²²

²⁰ SSA POMS, RM 03816.016 - *General Information on the Transfer of Earnings*. This section states earnings should be transferred to the correct earnings record when possible. When the correct record may not be ascertained, earnings may be transferred to the ESF.

²¹ All the earnings items moved from an individual earnings record to the ESF had a special indicator, *Self-Employment Earnings Discrepancy*, which prevented the item from being placed back on the original earnings record using one of SSA's automated processes. However, it is possible the items could be manually reinstated or moved to another earnings record.

²² These nine disclaimed earnings items were either transferred to another account or otherwise adjusted. For instance, seven of these earnings items were moved from one earnings record to another.

QUESTIONABLE EARNINGS NOT ADDRESSED

We found that while SSA employees removed earnings after the 157 individuals associated with the 282 earnings items admitted the earnings were not legitimate, no actions were taken on other questionable earnings reported by the individuals. During our review period (TYs 2000 to 2003), 25 of the 157 individuals who admitted they did not earn any form of SEI had reported additional SEI of over \$354,000 that SSA did not appear to question. While SSA staff removed earnings for some years from these 25 individuals' earnings records, the staff did not remove 35 similar earnings items for other years.

For example, an Arkansas FO removed almost \$20,000 from an individual's earnings record for TYs 2003 and 2004 after the individual admitted the SEI was not earned and was used to qualify for the EITC. However, this individual had over \$28,000 of SEI recorded for TYs 2000, 2001, and 2002 that was not removed and apparently not questioned. These earnings, if not legitimate, could lead to improper benefit payments.

When we expanded our analysis to an 11-year period (TYs 1995 to 2005), we determined that 51 of the 157 individuals who admitted they did not earn SEI had additional SEI of over \$968,000 that SSA did not question. These 51 individuals had reported an additional 130 similar earnings items for this period that SSA did not review.

As an example, SSA removed about \$14,000 in SEI that was recorded on an individual's earnings record for TYs 2000 and 2001 after the individual admitted she did not earn the money and filed tax returns for a "tax write-off." This individual had similar amounts of SEI recorded for TYs 1995 to 1999 that SSA did not remove or address, and became eligible for Social Security disability benefits in September 2002. If the 1995 to 1999 SEI had not been used in her benefit computations, she would have received about \$16,000 less in benefits from her date of entitlement through December 2006.

UNKNOWN REASONS

FO staff deleted 637 (31 percent) of the 2,066 SEI items for which SSA's records did not contain sufficient information to determine why they were originally reported and later disclaimed. These earnings items totaled over \$5.4 million in alleged SEI. Deleting the earnings rather than moving them to the ESF indicates the FOs determined the earnings did not represent a real event. However, the FOs did not record sufficient information in the ICOR system for others to reach the same conclusion. These 637 earnings items that were deleted occurred in all 10 SSA regions, as shown in Table 4.

Table 4: Deleted Earnings Items with Insufficient Information (TYs 2000 – 2003)

SSA Region	Total Earnings Items Disclaimed (Unknown)	Earning Items Deleted	Percent of Earnings Items Deleted
<i>Denver</i>	8	5	63
<i>Kansas City</i>	93	42	45
<i>San Francisco</i>	323	127	39
<i>Chicago</i>	84	32	38
<i>Philadelphia</i>	154	57	37
<i>Dallas</i>	172	56	33
<i>Atlanta</i>	237	75	32
<i>New York</i>	953	238	25
<i>Boston</i>	26	4	15
<i>Seattle</i>	16	1	6
Total	2,066	637	31% (Avg.)

We determined 1,363 (66 percent) of the 2,066 disclaimed earnings items with insufficient ICOR information were transferred to the ESF. These earnings items totaled almost \$12.7 million in SEI. SSA took other actions for the remaining 66 (3 percent) earnings items, representing about \$587,000 in SEI.²³

REINSTATEMENTS FROM THE ESF TO EARNINGS RECORDS

Among the 2,348 removed earnings items, we determined that 109 earnings items were later moved back (reinstated) to the individual's earnings records from the ESF. These earnings items totaled over \$1 million in disclaimed SEI reported by 59 individuals. We could not find any evidence that the SSA offices contacted the individuals regarding these reinstatements, nor did SSA staff provide an explanation as to why it was done. As a result, these disclaimed earnings could be used to generate improper benefit payments.

In one case, a FO removed over \$62,000 of SEI for TYs 1997 through 2003 from an individual's earnings record after the individual stated she was never self-employed and a tax preparer prepared her return to get a refund. About 2 years later, another FO reinstated almost \$34,000 of the SEI for TYs 1998 through 2001 with no explanation.

Offices in one SSA region processed 81 (74 percent) of these potentially erroneous transactions totaling about \$740,000 that were originally reported by 43 individuals. We discussed these cases with the appropriate regional employees and referred the cases to them for action. After their review, regional staff agreed that the majority of the earnings should not have been reinstated, noting that regional staff were given refresher training to prevent future occurrences.

²³ These 66 disclaimed earnings items were either transferred to another account or otherwise adjusted.

COORDINATION WITH THE INTERNAL REVENUE SERVICE

We found that FOs did not always notify the IRS of disclaimed earnings that potentially involved fraud. In addition, FOs did not always capture sufficient information from individuals to assist the IRS with potential investigations.

NOTIFYING THE IRS OF EARNINGS INVOLVING FRAUD

Among the 282 disclaimed earnings items associated with potential tax fraud and/or attempts to acquire SSA benefits, we determined the IRS was not notified about 35 (12 percent) of the removed earnings items. These 35 earnings items represented almost \$336,000 of nonexistent SEI. The IRS was notified of the SEI adjustments for 247 of the 282 earnings items.

SSA's ICOR system is used to notify the IRS about an SEI adjustment. SEI adjustment data are to be sent to the IRS if earnings are deleted, added, or changed²⁴ within SSA's statute of limitations.²⁵ After the time limit expires, an individual's earnings record may be changed if there is an exception to the time limit. The ICOR system can be overridden and the IRS notified after this time limit for certain exceptions, one of which is fraud.²⁶

Moreover, since we found that SSA processed 32 of the 35 earnings items adjustments within the statute of limitations, it is not clear why FOs did not notify the IRS of the adjustments processed within the time limit.

Unknown Reasons

We also reviewed the 2,066 disclaimed earnings items with insufficient ICOR information to determine if they were reported to the IRS. We found that:

- 1,373 (66 percent) earnings adjustments were not reported to the IRS,
- 688 (33 percent) earnings adjustments were reported to the IRS, and
- we could not determine whether the IRS was notified of the remaining 5 (1 percent) adjustments.

²⁴ SSA POMS, RM 01103.003 – *SSA's Role in Support of Tax Laws*. This POMS states SSA should inform the IRS of changes in employment or self-employment tax liability based on SSA determinations.

²⁵ SSA POMS, RS 02201.001.B.2.a. – *Establishing and Maintaining Earnings Records*. This POMS defines the time limitation for revising an earnings record for cases after July 31, 1956 as "...3 years, 3 months, 15 days after the "year" in which wages were paid or SEI derived."

²⁶ SSA POMS, RS 02201.008 – *Exceptions to the Statute of Limitations* lists other applicable exceptions, including (1) application for benefits, (2) written request for revision, (3) apparent error, (4) conforming to tax return, (5) errors in allocation, (6) SEI included in place of wrongly reported wages, and (7) SE returns were filed but there is no SEI on the earnings record.

Of the 1,373 earnings adjustments not reported to the IRS, 1,284 were processed by SSA within the time limit for notifying the IRS. We could not determine what should have been reported to the IRS in these instances because SSA's records lacked sufficient detail to make such a determination, although the ICOR system should have defaulted to notify the IRS for adjustments processed within the statute of limitations.

Electronic Data

Although the ICOR earnings information could be sent electronically to the IRS, a paper listing of these ICOR transactions was printed in SSA's Office of Central Operations and mailed to an IRS Post Office box in Pennsylvania. SSA and IRS staff told us that sharing the information electronically had been discussed, but the IRS had not specifically requested an electronic report. However, sharing information in this form requires manual processing which, in addition to being labor intensive, may introduce errors since manual input is generally less reliable than electronic transfer of data.

PROVIDING SUFFICIENT INFORMATION TO THE IRS

The IRS requested that SSA obtain a signed *Statement of Claimant or Other Person* (SSA-795) from individuals involved in cases where the individual reported SEI to claim the EITC.²⁷ The SSA-795 should state that the SEI was not earned by the individual and was used to obtain the EITC. Upon receipt of the signed statement, the IRS can take appropriate actions, including civil penalties and/or banning the individual from receiving the EITC.

We reviewed a sample of case folders related to individuals whom SSA determined had provided overstated earnings related to tax fraud and/or an attempt to acquire SSA benefits. We found the case folders did not contain required information for the IRS to pursue potential fraud in 20 of the 25 cases. In our review of the 25 sample folders, we determined whether a signed SSA-795 was prepared to document the reason for disclaimed earnings and was signed by the earner. We requested 25 folders and found:

- 5 folders had a signed SSA-795 with sufficient information for the IRS;
- 8 folders lacked a signed SSA-795 and the ICOR system made no reference to its existence;
- 5 folders lacked a signed SSA-795, though the ICOR system referred to the forms, indicating that the folders were incomplete;
- 5 folders had a signed SSA-795, but it did not have sufficient information for the IRS; and
- 2 folders were not received.

²⁷ SSA POMS, RS 01804.070 – *Bona Fide Reporting is in Doubt*. The SSA-795 is a written statement signed by the individual over a penalty clause, which states “I declare under penalty of perjury that I have examined all the information on this form, and on any accompanying statements or forms, and it is true and correct to the best of my knowledge. I understand that anyone who knowingly gives a false or misleading statement about a material fact in this information, or causes someone else to do so, commits a crime and may be sent to prison, or may face other penalties, or both.”

We were unable to determine whether any of the signed statements were sent to the IRS. When we asked SSA staff in four regions what happened to these forms, we learned the policy differs by region. Some regions maintain the Form in their FOs, while others are not collecting the Forms. In none of the cases were we told that the Form had been shared with the IRS.

SOCIAL SECURITY ADMINISTRATION ACTIONS

Agency management was aware individuals were reporting overstated SEI to become eligible for the EITC and/or Social Security benefits and had taken steps to address the problem. For example, SSA met with the IRS and discussed methods of inter-agency data sharing. In addition, the Agency was preparing new guidance informing FOs and other components about the scheme and providing specific instructions to employees when processing these cases. These proposed instructions included the following:

- an explanation in the ICOR system to alert both SSA and IRS employees of the situation;
- instructions on when to delete the overstated earnings from the individual's earnings record;
- instructions on how to notify the IRS of actions taken by SSA; and
- instructions on how to obtain a signed SSA-795 with sufficient information for the IRS and how to send the Form to a central SSA location.

In addition to Agency Headquarters actions, we determined that the Atlanta, Dallas, New York, and Philadelphia Regions have issued instructions for processing these types of cases. While these instructions vary, they alerted FOs to some of the problems identified in this report. See Appendix E for more information.

Conclusions and Recommendations

Our review indicated that SSA has encountered instances where individuals knowingly overstated SEI, but the Agency's procedures for resolving these matters were not consistently applied, and the IRS was not always receiving the information it needed to properly review these matters. For example, we found that some of the disclaimed earnings were erroneously placed in SSA's ESF, and FOs were not always collecting the data the IRS would need to investigate these instances of potential tax fraud.

To ensure consistent procedures for removing disclaimed SEI as well as the sharing of this information with the IRS, we recommend SSA:

1. Review the questionable earnings items identified in this audit where earnings may need to be removed from individuals' earnings records to prevent improper future SSA payments.
2. After incorporating information included in this report, as appropriate, issue national instructions to FOs for processing SEI cases where income has been overstated, including information on when to delete such earnings, how to document such cases in SSA's electronic records, when to notify the IRS, and how to complete and forward Form SSA-795.
3. Upon issuance of national instructions to FOs for processing SEI cases where income has been overstated, provide appropriate training to FO staff to ensure consistent implementation.
4. Discuss data-sharing options with the IRS to determine if an electronic version of ICOR transactions would be more useful.

AGENCY COMMENTS

SSA agreed with all our recommendations. The Agency's comments are included in Appendix F.

Appendices

Acronyms

EITC	Earned Income Tax Credit
ESF	Earnings Suspense File
FO	Field Office
ICOR	Item Correction System
IRS	Internal Revenue Service
MEF	Master Earnings File
POMS	Program Operations Manual System
SECA	Self-Employment Contribution Act
SEI	Self-Employment Income
SSA	Social Security Administration
SSN	Social Security Number
TY	Tax Year

Forms

SSA-795	<i>Statement of Claimant or Other Person</i>
W-2	<i>Wage and Tax Statement</i>

The Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a refundable tax credit for people with earned income under \$34,692 (in Tax Year 2003) who meet other eligibility requirements.¹ The EITC was implemented in 1975 to help offset payroll taxes, including Social Security and Medicare taxes, incurred by low-income working parents and to encourage parents to work.² While primarily for parents, there is a small tax credit for low-income workers who do not have a qualifying child.

The credit amount rises with earnings, levels out, and then diminishes with additional earned income. In Table B-1 we provide Tax Year 2003 dollar amounts for the EITC.

Table B-1: Earned Income Tax Credit Amounts (Tax Year 2003)

Number of Qualifying Children	Maximum Credit	Earned Income Range to Obtain Maximum Credit	Upper Income Limit for Credit
2	\$4,204	\$10,500 to \$14,750	\$34,692
1	\$2,547	\$7,450 to \$14,750	\$30,666
0	\$382	\$4,950 to \$7,250	\$12,230

Note: Amounts relate to some filing as “married filing jointly.”

In addition to the above income limits, individuals must meet all eligibility requirements to claim the EITC, including:

- possessing a valid Social Security number;
- residency and filing status requirements;
- qualifying children must meet relationship, age and residency tests; and
- age and other eligibility factors without a qualifying child.

¹ *Earned Income Credit (EIC)*, IRS Publication 596, 2003.

² *The Earned Income Tax Credit*, Welfare Information Network, April 2000.

Scope and Methodology

To accomplish our objectives, we:

- Reviewed pertinent sections of the Social Security Administration’s (SSA) policies and procedures as well as other relevant Federal laws and regulations.
- Reviewed Internal Revenue Service (IRS) publications and instructions to gain an understanding of the Earned Income Tax Credit (EITC) process, including eligibility criteria.
- Reviewed any applicable Office of the Inspector General, Government Accountability Office, and Treasury Inspector General for Tax Administration reports and other relevant documents.
- Interviewed SSA staff to gain an understanding of the scope of overstated self-employment income (SEI) being reported and how SSA staff removes SEI from individual’s earnings records.
- Interviewed SSA and IRS staff to gain an understanding of SSA/IRS communication in this area.
- Reviewed cases where SSA had removed SEI using the Item Correction (ICOR) system. The SEI was originally posted for Tax Years 2000 to 2003 and met specific criterion, such as dollar amounts. The cases were reviewed using SSA’s records, including the Master Earnings File, SEI Earnings Suspense File (ESF), Numident, ICOR, and case folders. Using information from these records, we focused on those cases where (1) the reasons cited for the overstated SEI was potential tax fraud and/or acquiring SSA benefits or (2) the overstated SEI was removed and there was insufficient information to determine why the SEI was originally reported.
- For the SEI earnings items, we determined whether (1) SEI items were properly deleted and/or moved to the ESF and (2) the ICOR system indicated the IRS was properly notified. We also selected a sample of 25 cases to determine whether the *Statement of Claimant or Other Person* (SSA-795) was properly prepared and forwarded, when necessary. We highlighted these trends by SSA region.
- Shared our results with SSA staff and contacted each SSA region to determine what additional guidance may have been shared relating to these SEI problems.

Our audit did not include an evaluation of SSA’s internal controls over the SEI reporting or recording processes. The purpose of our audit was to determine whether Title II beneficiaries had overstated SEI on their Federal income tax returns for Tax Years 2000

to 2003, and, if so, the effect on SSA programs. We were limited to reviewing cases where SSA had removed SEI from an individual's earnings record using the ICOR system because only these cases contained information as to why the SEI was originally reported and later removed. The entities audited were SSA's Offices of the Regional Commissioner under the Office of the Deputy Commissioner for Operations, and the Office of Earnings, Enumeration and Administrative Systems under the Deputy Commissioner for Systems. We conducted our audit between April 2005 and December 2006 in Philadelphia, Pennsylvania. We conducted our audit in accordance with generally accepted government auditing standards.

Non-Legitimate Earned Income Tax Credit Process

Self-employed individuals report self-employment income (SEI) to the Internal Revenue Service (IRS) on a *Profit or Loss from Business* (Schedule C) and *Self Employment Tax* (Schedule SE) attached to a Federal income tax Form 1040.¹ The IRS then sends this SEI information to the Social Security Administration (SSA) where it is recorded within an individual's earnings record.

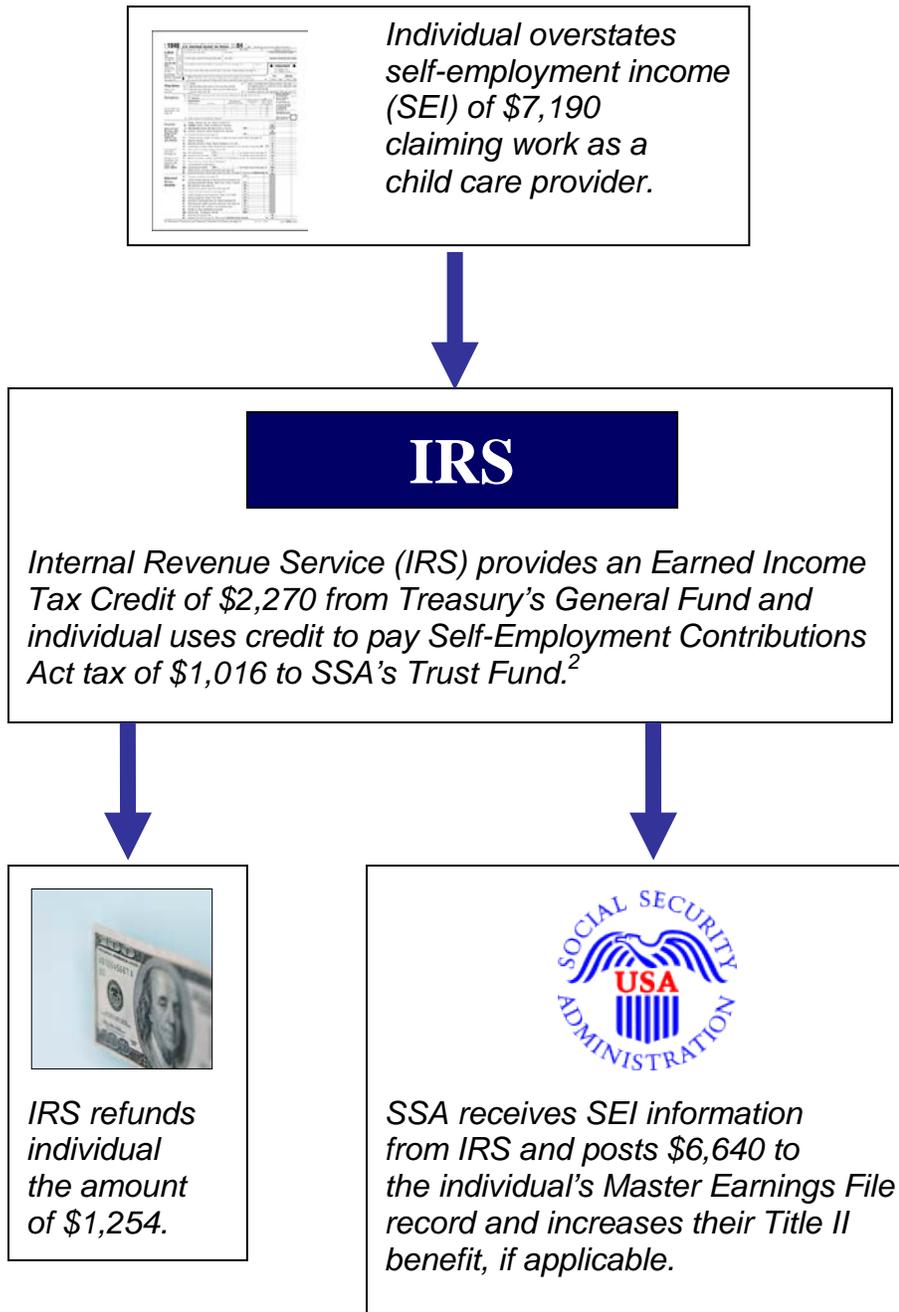
Individuals reporting SEI are liable for paying Self-Employment Contribution Act (SECA) tax on self-employment earnings.² If the SECA tax due is less than the refund, the SECA tax is deducted from the refund, netting the individual a refund without paying any taxes. The individual may also receive Social Security and Medicare coverage by having the SECA tax deducted from the refund.

Shown is an example where an individual falsely reported SEI in Tax Year 2001 of \$7,200 as a child care provider on her Federal tax return, making her eligible for the Earned Income Tax Credit (EITC). The EITC was paid from the Department of the Treasury's General Fund, and the SECA tax was paid from the General Fund to SSA's Old Age, Survivors, and Disability Insurance Trust Funds. The difference between the EITC and the SECA tax was refunded to the individual. SSA later removed the overstated 2001 SEI from the individual's earnings record and notified the Internal Revenue Service (IRS) that they had removed the earnings. We do not know whether the IRS ever recovered this EITC payment.

¹ *Tax Guide for Small Business (For Individuals who use Schedule C or C- EZ)*, IRS Publication 334, 2006.

² *Ibid.*

Figure D-1: Non-Legitimate Earned Income Tax Credit Process¹



Note 1: The amounts shown below are from an actual taxpayer's forms. They are shown as an example of a specific calculation. We did not include all amounts used to generate the numbers provided.

Note 2: The individual's income is not subject to income tax since the standard deduction and personal exemptions reduced their taxable income to zero.

Regional Instructions for Processing Overstated Self-Employment Income Cases

Four of the Social Security Administration’s (SSA) 10 regions have recently issued instructions for processing self-employment income (SEI) cases where individuals have reported overstated income to become eligible for the Earned Income Tax Credit (EITC) and/or Social Security benefits. These instructions vary by region, with the New York Region’s instructions being the most comprehensive. Table E-1 summarizes the contents of the regional instructions.

Table E-1: Regional Instructions for Processing Overstated SEI Cases¹

Region	Informs Field Offices (FO) of Problem	Requires Interview of Person	Requires Proof of Income	Requires Notification to Region	Instructs FOs to Remove SEI	Requires Completion of Form SSA-795 ²	Requires Notification to Internal Revenue Service	Requires Notification to Office of the Inspector General
<i>New York</i>	Y	Y	Y	Y	Y	Y	Y	Y
<i>Philadelphia</i>	Y	Y	Y	Y	-	-	-	-
<i>Atlanta</i>	Y	Y	Y	Y	-	-	-	-
<i>Dallas</i>	Y	Y	-	Y	-	-	-	-

Note 1: When we contacted all of the SSA regions, six stated they had not issued similar instructions – Boston, Chicago, Denver, Kansas City, San Francisco and Seattle.

Note 2: *Statement of Claimant or Other Person* (SSA-795) is a written statement signed by the individual over a penalty clause, which states “I declare under penalty of perjury that I have examined all the information on this form, and on any accompanying statements or forms, and it is true and correct to the best of my knowledge. I understand that anyone who knowingly gives a false or misleading statement about a material fact in this information, or causes someone else to do so, commits a crime and may be sent to prison, or may face other penalties, or both.”

Agency Comments



SOCIAL SECURITY

MEMORANDUM

Date: July 11, 2007 Refer To: S1J-3

To: Patrick P. O'Carroll, Jr.
Inspector General

From: Larry W. Dye /s/

Subject: Office of the Inspector General (OIG) Draft Report, "Overstated Earnings and Their Effect on Social Security Administration Programs" (A-03-05-25018)--
INFORMATION

We appreciate OIG's efforts in conducting this review. Our comments on the recommendations are attached.

Please let me know if we can be of further assistance. Staff inquiries may be directed to Ms. Candace Skurnik, Director, Audit Management and Liaison Staff, at extension 54636.

Attachment:
SSA Response

COMMENTS ON THE OFFICE OF THE INSPECTOR GENERAL (OIG) DRAFT REPORT, "OVERSTATED EARNINGS AND THEIR EFFECT ON SOCIAL SECURITY ADMINISTRATION (SSA) PROGRAMS" (A-03-05-25018)

Thank you for the opportunity to review and provide comments on this draft report. Our responses to the specific recommendations are provided below.

Recommendation 1

SSA should review the questionable earnings items identified in this audit where earnings may need to be removed from individuals' earnings records to prevent improper future SSA payments.

Comment

We agree. We will proceed with case reviews upon issuance of national instructions.

Recommendation 2

After incorporating information included in this report, as appropriate, issue national instructions to field offices (FO) for processing self employment income (SEI) cases where income has been overstated, including information on when to delete such earnings, how to document such cases in SSA's electronic records, when to notify the Internal Revenue Service (IRS), and how to complete and forward Form SSA-795.

Comment

We agree. We have drafted a Program Operations Manual System (POMS) instruction that incorporates all of the requirements of this recommendation. These instructions should be released to all SSA FOs by the end of July 2007.

Recommendation 3

Upon issuance of national instructions to FOs for processing SEI cases where income has been overstated, provide appropriate training to FO staff to ensure consistent implementation.

Comment

We agree. We will provide appropriate training once new POMS instructions are released.

Recommendation 4

SSA should discuss data-sharing options with the IRS to determine if an electronic version of item correction transactions would be more useful.

Comment

We agree. We recently met with IRS to discuss the data sharing of item correction transactions in an electronic format. IRS is currently working on a proposed system environment that would allow them to receive the item correction data electronically. IRS anticipates a timeframe of 1 to 2 years to be ready to accept data electronically. Therefore, until IRS has more precisely defined and developed the capability to accept the item correction data electronically, we cannot move forward with implementing a data sharing process.

OIG Contacts and Staff Acknowledgments

OIG Contacts

Walter Bayer, Director, Philadelphia Audit Division, (215) 597-4080

Cylinda McCloud-Keal, Audit Manager, (215) 597-0572

Acknowledgments

In addition to those named above:

Michael Thomson, Auditor-in-Charge

Richard Devers, Information Technology Specialist

For additional copies of this report, please visit our web site at www.socialsecurity.gov/oig or contact the Office of the Inspector General's Public Affairs Specialist at (410) 965-3218. Refer to Common Identification Number A-03-05-25018.

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OA conducts and/or supervises financial and performance audits of the Social Security Administration's (SSA) programs and operations and makes recommendations to ensure program objectives are achieved effectively and efficiently. Financial audits assess whether SSA's financial statements fairly present SSA's financial position, results of operations, and cash flow. Performance audits review the economy, efficiency, and effectiveness of SSA's programs and operations. OA also conducts short-term management and program evaluations and projects on issues of concern to SSA, Congress, and the general public.

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OCCIG provides independent legal advice and counsel to the IG on various matters, including statutes, regulations, legislation, and policy directives. OCCIG also advises the IG on investigative procedures and techniques, as well as on legal implications and conclusions to be drawn from audit and investigative material. Finally, OCCIG administers the Civil Monetary Penalty program.

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