The National Association of Professional Employer Organizations (NAPEO)
Statement for the Record

U.S. House of Representatives
Committee on Ways and Means
Subcommittee on Oversight

Hearing on IRS Return on Investment and the Need for Modernization

February 11, 2025

The National Association of Professional Employer Organizations (NAPEO) would like to thank Chairman Schweikert, Ranking Member Sewell and the members of the Oversight Subcommittee for holding this important hearing to shine a spotlight on the need to modernize the antiquated systems and procedures at the IRS that bog down American small businesses.

NAPEO represents the professional employer organization (PEO) industry, which plays a vital role in supporting the backbone of the American economy – small businesses. Today, the more than 500 PEOs in the U.S. enhance employment benefits for more than 4.5 million Americans whose employers rely on PEOs for payroll, benefits, HR, tax administration and regulatory compliance. Importantly, we ensure that payroll taxes are collected and remitted accurately and quickly to both the federal and state governments. Because PEOs take over the back-office tasks that consume time, energy and resources, it's no surprise that small businesses working with a PEO grow two times faster, have employee turnover that is 10 to 14 percent lower, and are 50 percent less likely to go out of business.

NAPEO is submitting this statement to call attention to the harm being done to small businesses as a direct result of the antiquated technologies and inefficient processes used by the IRS to process payroll tax credits that PEOs manage on behalf of their small business clients. Paper tax documents, fax machines and optical scanners that cannot transcribe tax returns into their proper format are just a few examples of inefficient technology used by the IRS. The use of these outdated technologies in 2025 is inexcusable. For small businesses that use a PEO, the only way they can claim payroll tax credits is on the PEO's aggregate tax return. Congress should require the IRS to make changes so that small business eligibility for payroll tax credits is determined quickly, payment is made in a timely manner and visibility into the process is significantly enhanced.

<u>The Efficiencies PEOs Provide to Payment of Payroll Taxes</u>

PEOs collect and remit billions of dollars of payroll taxes annually to the IRS with respect to their small business clients in a timely and efficient manner. The efficiencies PEOs bring to the tax collection system benefit the federal government, taxpayers and small businesses. In addition, PEOs take responsibility for the payment of employment taxes with respect to the remuneration they pay to the workers performing services for a client employer. PEOs have knowingly accepted that responsibility because they can determine with a high degree of certainty the amount of employment tax liability that is generated by those payments of remuneration.

Significant Problems with IRS Processing of Payroll Tax Credits
The efficiency and speed of payroll tax remittances made by PEOs to the IRS are in sharp contrast to the process a PEO must use to obtain payroll tax credits for their small business clients.

The only way an eligible PEO small business client can take advantage of an available payroll tax credit is by filing an original or amended employment tax return through their PEO. Amended returns filed before this year could not be filed electronically and were required to be filed on paper tax forms and faxed to the IRS. For larger PEOs, these amended paper returns can amount to hundreds of pages. Once faxed to the IRS, the Service uses an optical reader to scan the return into their system. However, their scanners cannot transcribe the return into the IRS form – which means an IRS employee must transcribe the return into the electronic form. After the information is transcribed, there is no efficient way for the PEO or the client to receive an update from the IRS on the status of the return.

As a result, the IRS is unable to quickly process payroll tax credits claimed on paper-filed amended aggregate tax returns, and in most instances, is unable to communicate to taxpayers the status of these claims. The frustrations, delays and problems associated with the IRS's processing of these credits harms small businesses and defeats the purpose of legislation designed to provide expedited assistance to these entities.

Once the IRS begins to process a PEO's return, it can further be delayed by the IRS reviewing some of the credits claimed on the PEO's aggregate filing. A PEO may submit dozens of payroll tax credit claims by their clients on a single return. If the IRS reviews any one of those amended claims, the other claims made on behalf of other unrelated small businesses must wait for the IRS to finish the review before they can receive the credit. As a result, hundreds of legitimate small business payroll tax claims can be held up *for years* due to an audit of a few claims on a single return.

When payroll tax credit claims result in a refund and those amounts are finally returned to a PEO for distribution to the PEO's clients, many times the amount of money sent by the IRS does not match the amount of tax credits claimed by the PEO on behalf of their small business clients. The IRS often does not send sufficient supporting information to enable the PEO to match the tax credit amount with the client.

IRS's Indefensible Position on Liability of Third-Party Payers Regarding Payroll Tax Credits
Further complicating the process is the fact that the IRS has taken the position that third-party payers, such as PEOs, are liable for improperly claimed payroll tax credits. This position is inconsistent with the statute and congressional intent in creating such tax credits. In addition, PEOs do not have access to all the information needed to verify the eligibility of their clients for payroll tax credits. Congress' increased reliance in recent years on employment tax credits to deliver tax relief to employers - including those that use a PEO - necessitates a modified scope of a third-party payers' responsibility when the third-party payer lacks control and/or full knowledge over its clients' claims for payroll tax credits. In these situations, the only outcome that makes sense from a fairness and tax administration standpoint is that the liability for such claims belongs

to the entity that initiates and benefits from the claim and is only expanded to an aggregate filer in cases of fraud or knowledge of an improper payroll tax credit claim.

<u>Conclusion</u>

For the benefit of small businesses, we ask the subcommittee to require that the IRS update its old and outdated technologies, streamline its processes for reviewing payroll tax credits, and increase transparency in the process so that a taxpayer, including a PEO, can check the status of their employment tax returns and any payroll tax credits claimed on those returns. These changes need to be made so that eligibility for payroll tax credits is determined quickly, payment is made in a timely manner and visibility into the process is significantly enhanced.