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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OCT 26 1994

MEMORANDUM FOR GENE SPERLING
DEPUTY ASSISTANT TO THE PRESIDENT
FOR ECONOMIC POLICY

BILL GALSTON
DEPUTY ASSISTANT TO THE PRESIDENT
FOR DOMESTIC POLICY

FROM: W. Scott Gould WSG
Deputy Assistant Secretary
(Departmental Finance and Management)

SUBJECT: Student Loan Wage Withholding

The attached draft materials have been prepared for our scheduled meeting on Thursday, October 27th at 12:00 noon, Executive Office Building, Room 230.

The information is designed to highlight the fundamental components of the student loan wage withholding concept and provide a summary of key wage withholding options. The materials have been prepared by staff from the Departments of the Treasury, the Department of Education and the Office of Management and Budget.

Attachment

AGENDA

TAB 1

OVERVIEW OF WITHHOLDING OPTIONS

Student Loan Repayment and Wage Withholding Employer Reporting Burden

Internal Revenue Service		Department of Education
Separate from the Tax System	**Using the Current Tax System**	
Employers withhold loan payments directly from wages upon borrower request;	Employees process employee withholding requests to increase withholding;	Employers withhold loan payments directly from wages upon borrower request;
New stringent and frequent (monthly) reporting requirements to IRS by employers --significant additional burden;	Integrated into the tax system reporting requirements -- no additional burden, and	Employer submits invoice with name, social security number, and withholding amount with each monthly transfer to service minimal burden;
Mandatory participation by certain employers, and	No new requirements same as tax reporting.	Mandatory participation by certain employers, and
Nonparticipating employers must certify monthly their relief from compliance.	No new requirements same as tax reporting.	No certification requirement.

TAB 2

ASSUMPTIONS RELATING TO EMPLOYER COSTS

Comments on Assumptions Relating to Employer Costs

Reporting Requirements

- Previous IRS estimates based the cost to employers if IRS were to develop a special withholding system, on the notion that only employers who employ student loan borrowers would be required to report the withholding amounts on a standardized reporting form, similar to the current Form 941 used to compute tax withholding;

- Recent estimates assume that employers not withholding student loan repayments will only be required to submit a simple certification form;

- IRS estimates the employer will complete a document similar to Form 941 in an average of 4.4 hours, while the completion time of the certification form is estimated at 0.04 hours for the employer;

Cost Reductions

- Most of the reduction burden estimates are based on the assumption that only 1.2 million, not 6 million employees would be included (firms under 10 would be excluded);

- Earlier estimates assumed that 6 million employees would be included under both a mandatory and voluntary system, while recent estimates assume only 4.5 million employees would participate under a voluntary system;

TAB 3

QUESTION 1:

Explain current methodology and provide alternatives within the established framework.

QUESTION 2:

Provide alternatives by stepping outside of established parameters.

Standard Cost Methodology

Chart 1:	Description of Cost Components
Chart 2:	Method One - IRS Standard Cost Model
Chart 3:	Method Two - Professional Association Standard Cost Model

Alternative Cost Methodology: ADP Marginal Cost Analysis

Chart 1:	Description of Cost Components
Chart 2:	Employers With Less Than 10 Employees Excluded

DESCRIPTION OF COST COMPONENTS

	Internal Revenue Service		Department of Education
	Separate from the Tax System	*Using the Current Tax System*	
Mandatory Employer Withholding	Total Burden = Fixed Costs + Variable Costs Fixed Costs = recordkeeping costs (accounting systems modifications and maintenance, data storage, etc) + the cost of generating summary withholding data (i.e., employer identifier, pay period covered, $ remitted) + the cost of firms certifying that they were not required to participate Variable Costs = The cost to employer of reporting withholdings for each student loan borrower	Not Applicable In this system, employers would not know that they were withholding for student loans. Therefore, employers do not experience additional burden.	Total Burden = Fixed Costs + Variable Costs Fixed Costs = the cost of having the necessary infrastructure to withhold student loans from an employee's paychecks and remit the amounts to Education. This cost consists of the system maintenance costs (record updates and other systems changes) and the cost of recordkeeping. Variable Costs = represents the transactions costs to the employer of actually withholding, reporting, and remitting payments to the Department of Education
Voluntary Employer Withholding	Total Burden = Fixed Costs + Variable Costs Fixed Costs = recordkeeping costs (accounting systems modifications and maintenance, data storage, etc) + the cost of generating summary withholding data (i.e., employer identifier, pay period covered, $ remitted) Variable Costs = The cost to employer of reporting withholdings for each student loan borrower	Not Applicable In this system, employers would not know that they were withholding for student loans. Therefore, employers do not experience additional burden.	Total Burden = Fixed Costs + Variable Costs Same as Column 1

Note: Employers with fewer than 10 employees are exempted from mandatory withholding--Employers with 50 or more employees elect to participate under the voluntary program.

METHOD ONE:
IRS STANDARD COST MODEL

This chart calculates employer costs based on IRS tax burden methodologies.

Assumptions: Employers with fewer than 10 employees are exempted from mandatory withholding.
Employers with 50 or more employees elect to participate under the voluntary program.

	Internal Revenue Service		Department of Education
	Separate from the Tax System	*Using the Current Tax System*	
Mandatory Employer Withholding	Total Burden = Fixed Costs + Variable Costs Fixed Costs = (1.2 million employers x 4.4 hours x \$10 per hour x 12 months) + (1.2 million employers x .04 hours x \$10 x 33 pay periods) + (4.8 million employers x .04 x \$10 x 12 months) = \$672 million Variable Costs = 6 million employees x .53 hours x \$10 per hours x 33 pay periods = \$1,050 million **Total Burden = \$672 + \$1,050 = \$1.7 billion**	Not Applicable	Total Burden = Fixed Costs + Variable Costs Fixed Costs = 1.2 million employers x \$42 per month x 12 months = \$605 million Variable Costs = 196 million transactions x \$2.5 per transaction = \$490 million **Total Burden = \$605 + \$490 = \$1.1 billion**
Voluntary Employer Withholding	Total Burden = Fixed Costs + Variable Costs Fixed Costs = (.174 million employers x 4.4 hours x \$10 per hour x 12 months) + (.174 million employers x .04 hours x \$10 x 33) = \$94 million Variable Costs = 4.5 million employees x .53 hours x \$10 per hours x 33 pay periods = \$787 million **Total Burden = \$94 + \$787 = \$0.9 billion**	Not Applicable	Total Burden = Fixed Costs + Variable Costs Fixed Costs = 174 thousand employers x \$42 per month x 12 months = \$88 million Variable Costs = 147 million transactions x \$2.5 per transaction = \$368 million **Total Burden = \$88 + \$368 = \$0.5 billion**

METHOD TWO:
PROFESSIONAL ASSOCIATION COST MODEL

This chart shows cost based on American Society of Payroll Management cost estimates.

Assumptions: Employers with fewer than 10 employees are exempted from mandatory withholding.
Employers with 50 or more employees elect to participate under the voluntary program.

	Internal Revenue Service		**Department of Education**
	Separate from the Tax System	*Using the Current Tax System*	
Mandatory Employer Withholding	Total Burden = Number of Transactions x $10 per transaction Number of Transactions = 196 million Based on 6 million borrowers repaying through wage withholding **Total Burden = $2.0 billion per year**	Not Applicable	Total Burden = Number of Transactions x $10 per transaction Number of Transactions = 196 million Based on 6 million borrowers repaying through wage withholding **Total Burden = $2.0 billion per year**
Voluntary Employer Withholding	Total Burden = Number of Transactions x $10 per transaction Number of Transactions = 147 million per year Based on 4.5 million borrowers repaying through wage withholding **Total Burden = $1.5 billion per year**	Not Applicable	Total Burden = Number of Transactions x $10 per transaction Number of Transactions = 147 million per year Based on 4.5 million borrowers repaying through wage withholding **Total Burden = $1.5 billion per year**

ALTERNATIVE COST METHODOLOGY
AUTOMATED DATA PROCESSING MARGINAL COST ANALYSIS

DESCRIPTION OF COST COMPONENTS

	Internal Revenue Service		Department of Education
	Separate from the Tax System	*Using the Current Tax System*	
Mandatory Employer Withholding	Total Burden = Total Marginal Cost = (cost of installation of payroll accounting systems for employers with10 to 49 employees) + (additional transaction costs for employers with 50 or more employees) Cost of Installation of Payroll Accounting Systems = set up fee + monthly servicing fee per employee Transaction Cost = cost of withholding a new payroll deduction per employee in a fully functioning automated payroll system	Not Applicable	Same as Column 1
Voluntary Employer Withholding	Same as Above	Not Applicable	Same as Column 1

ALTERNATIVE COST METHODOLOGY
AUTOMATED DATA PROCESSING MARGINAL COST ANALYSIS

EMPLOYERS WITH LESS THAN 10 EMPLOYEES ARE EXCLUDED

	Internal Revenue Service		Department of Education
	Separate from the Tax System	*Using the Current Tax System*	
Mandatory Employer Withholding	**Employers with under 10 employees are excluded from mandatory withholding, and 4.3 million borrowers choose to repay through wage withholding** Total Burden = Marginal Costs = (Payroll Accounting System Costs + (Marginal Transaction Costs) Payroll Accounting System Costs = (1.2 million borrowers employed by by employers with 10 to 49 employees) x ($1,780 payroll accounting systems costs per employee) = $2,211 million Marginal Transaction Costs = (3.9 million borrowers employeed by employers with 50 or more employees) x (annual transaction cost per borrower of $104) = $411 million **Total Burden = $2,211 million + $411 million = = $2.6 billion**	Not Applicable	Same as for IRS, Separate from the Tax System
Voluntary Employer Withholding	**Employers with under 10 employees are excluded from mandatory withholding, and 4.5 million borrowers choose to repay through wage withholding** Total Burden = Marginal Costs = (Payroll Accounting System Costs + (Marginal Transaction Costs) Payroll Accounting System Costs = (0.9 million borrowers employed by by employers with 10 to 49 employees) x ($1,780 payroll accounting systems costs per employee) = $1,658 million Marginal Transaction Costs = (3.0 million borrowers employeed by employers with 50 or more employees) x (annual transaction cost per borrower of $104) = $308 million **Total Burden = $1,658 million + $308 million = $2.0 billion**	Not Applicable	Same as for IRS, Separate from the Tax System

Student Loan Repayment and Wage Withholding
Employer Reporting Burden

Overview

This section describes the current methodology (Methodology #1) for estimating employer reporting burden. This section provides a step-by-step explanation of the methodology used by the Departments of Treasury and Education to estimate the cost to employers of withholding student loan payments from employee' wages in addition to the reporting and remitting of those payments to the student loan servicer.

Employer reporting burden represents the time (expressed in terms of money) and expenses incurred by employers for withholding, remitting, and reporting student loan payments to the Federal government. The burden experienced by employers will depend on the characteristics of the program, as set up by the government, the number of borrowers who choose to repay their loans through wage withholding, and the number of firms that are affected. Because the IRS and the Department of Education have proposed similar withholding systems, from the borrower's perspective, it is essential that the characteristics of each system and that the burden estimation methodology be thoroughly understood.

The estimates of employer burden have been developed within the expected steady-state for the Direct Loan Program. While the estimates are based on the steady-state basis, the actual costs are based in terms of 1994 dollars. Under steady-state conditions, it is assumed that there will be 20 million borrowers repaying their Direct Loans. Not only will borrowers be able to choose repayment plans (standard, extended, graduated, and income-contingent), but borrowers will also be able to repay their loans through a wide assortment of methods. Besides the typical monthly check, borrowers will be able to repay through alternative repayment vehicles such as automated bank debits or wage withholding.

Internal Revenue Service

The Internal Revenue Service envisioned several ways of implementing a student loan repayment system using wage withholding. The first method involves using the current tax withholding system to collect student loan payments. The second method involves setting up a special operation within the IRS, yet separate from the tax system, for the collection and servicing of Direct Loans. Each method has it own distinct characteristics and implications for employer reporting burden.

Characteristics of the Proposed IRS Administered Programs

<u>Using the Current Tax System</u>

The following points highlight using the current tax withholding system to collect student loan payments by the Internal Revenue Service as:

- Employees increase the amount withheld by employers to cover both student loans and income tax liabilities
- Employers would not know that employees would be repaying Direct Student Loans through wage withholding
- Reconciliation between student loan and income tax payments would be done on a new schedule attached to Form 1040

Because employers would not be required to differentiate between income tax withholdings and student loan withholdings, this program would impose no additional burden on employers.

Separate from the Tax System

The following points highlight a student loan withholding system administered by the Internal Revenue Service separate from the normal tax collection system:

- Employers withhold, remit and report student loan payments separate from income and employment taxes
- Employers report individual employee's student loan payments made via wage withholding more frequently to the IRS than what is required for tax withholding (The Department of Education administered program has a similar requirement)
- IRS compliance action centers on employers rather than the borrower
  - Initial contact would be with employer if IRS detects either a nonpayment or underpayment of student loans
  - Employers would be required to keep and submit detailed records with each transaction
  - Borrower would be contacted after the employer demonstrated that the short fall was due to the borrower

Burden Estimation Methodology

Under the existing tax system, the IRS designed a program that would not require employers to differentiate student loan withholdings from income tax withholdings. Therefore, the following burden analyses applies only to IRS operating a special operation separate from the current tax system.

The estimate of employer reporting burden for a withholding system separate from the tax system is based on the following equation:

(4) $$\textbf{Total Burden} = \textbf{Employer Burden}_A + \textbf{Employer Burden}_U$$

where

Employer Burden$_A$ (*the burden of Affected employers*) represents the costs incurred by employers affected in reporting student loan repayments to the Internal Revenue Service.

Employer Burden$_U$ (*the burden of Unaffected employers*) represents the burden experience by employers who do not have employees who repay student loans through wage withholding, yet have to certify to the IRS that withholding was not required. This burden would not be applicable to firms under a voluntary program.

The burden imposed on unaffected employers is similar to the burden imposed on employers who reports to the IRS that they have employees. Under the tax system, once an employer reports that they have employees, the IRS requires a quarterly statement regarding employee withholdings. The IRS envisions a similar requirement for the student loan system. However, student loan servicing is distinctly different from the tax system. Therefore, the IRS would want monthly certification. If an exempt employer grows and losses its exempt status, less frequent certification would result in limiting the availability of repayment through withholding. Furthermore, from a compliance perspective, more frequent reporting results in improved compliance and a higher probability of detecting noncompliance. It should be noted that the Department of Education intends to implement its withholding program without require certification, thus the two systems have different operational philosophies.

Like the program administered by the Department of Education, burden under the IRS special operation can be expressed in terms of fixed and variable costs. Manipulating (4) into fixed and variable costs allows the burden under an IRS special operation to be presented in a format similar to the burden under an Education withholding program. Rewriting (4), burden is defined as:

(4)' Total Burden = Fixed Costs + Variable Costs

where

Fixed Costs = the cost of having the necessary infrastructure to withhold student loans from an employee's paycheck and remit the amount to Education. Employer fixed costs also consist of the cost of generating summary withholding data (employer identifier, pay period covered, amount remitted) so that the IRS can reconcile the payment amount with the employer prior to applying the payments to individual borrower's accounts. Also included in the Fixed costs are the certification costs (under the mandatory program) for employers who do not have to withhold student loan payments.

Variable Costs = The cost to employers for reporting withholdings for each student loan borrower (i.e., the cost of getting the data to the IRS)

Estimate of Fixed Costs under an IRS Administered Withholding Program Separate from the Tax System

From the basic definition of Total Burden, the first major component of Fixed Costs is the recordkeeping costs. Firms affected by the withholding requirement would be required to set up and maintain a withholding system, as was the case in the Education administered system. To comply with the Paperwork Reduction Act, the Service developed models to estimate the time necessary to comply with Federal tax reporting requirements. The IRS estimates the average time for each IRS form. Not only does the IRS estimate the average time per form, but it also estimates the average time to perform subtasks. For example, the IRS estimates both the recordkeeping and reporting burden for all business tax forms. Extrapolating from known tax forms to what student loan requirements would necessitate permits the estimation of employer burden. For example, the type of recordkeeping necessary to withhold, remit and report student loan withholdings would be similar to the recordkeeping necessary to complete Form 941 (Employer's Quarterly Withholding). The burden associated with remitting and reporting the information to the IRS would be similar to the burden of completing Form W-2 (or any other information return) and Form W-3, the document that summarizes employee withholdings.

Fixed Costs for student loans are the sum of the recordkeeping costs, the summary reporting costs, and the cost of employers not affected by the withholding requirement to certify that they did not have to withhold.

The recordkeeping required for students loans would approximate what would be required by firms in filing the Form 941, Employers Quarterly Withholding. Therefore, recordkeeping for firms affected by the withholding requirement can be estimated by the following equation:

(5) Recordkeeping Costs = Time x Freq x Monetary Value x number of employers affected

where

Time = 4.4 hours per month[1]
Freq = 12 months per year

---

1 While the use of an estimate of a quarterly form may cause some concern, the IRS burden models developed by Arthur D. Little estimate burden based on the characteristics of the form and the information needed to complete the form. The frequency of reporting is not a factor. The recordkeeping burden associated with Form 941 would be the same regardless of whether the form was filed monthly or quarterly.

Monetary Value = $10 per hour

or

Recordkeeping Costs = 4.4 hours x 12 months x $10 per hour x number of employers
= $528 x number of employers affected

Based on the analyses performed in estimating the Department of Education burden, the number of employers participating in a mandatory program is 1.2 million while the number of employers participating in a voluntary program is 174 thousand (See Page 10).

The Summary Reporting costs represent the cost of employers to summarize the withholdings each pay period. It was estimated that there would be 196 million transactions per year (See Page 11) under a mandatory program administered by the Department of Education. Given 6 million employees, each employee is paid, on average, 33 time per year. The summary reporting costs can be estimated by the following equation:

(6) Summary Reporting Costs = number of employers affected x time x $ value x frequency

where

time = .04 hours (the estimated time to complete a Federal Tax Deposits)
$ value = $10 per hour (assumed hourly dollar value for wages)
frequency = 33 times per year (See Page 9)
number of employers = 1.2 million, if mandatory (.174 million, if voluntary)

or

Summary Reporting Costs = number of employers affected x .04 x $10 x 33
= number of employers affected x $13.20

While not all firms would necessarily be affected, the Service would still require that firms certify that they were not required to withhold for student loans (only under the mandatory program). Because employers would be the conduit for wage withholding, the IRS would begin investigating underpayments or nonpayments through employers. The certification cost is estimated by:

(7) Certification Costs = number of employers not affected x time x $ value x frequency

where

time = .04 hours (based on Federal Tax Deposits, represents a simple check sheet with basic employer information)
$value = $10 per hour
frequency = 12 times per year
number of employers not affected = 4.8 million

or

Certification Costs = number of employers not affected x time x $value x frequency
= number of employers not affected x $4.8
= $23 million (Mandatory program only)

The estimate of Fixed Costs is based on the following equation:

Fixed Costs = Recordkeeping Costs + Summary Reporting Costs + Certification Costs

= $528 x number of employers affected + number of employers affected x $13.20 + number of employers not affected x $4.8 per employer not affected

Therefore, it is estimated that the Fixed Costs are:

- Mandatory Withholding: $672 million
- Voluntary Withholding: $ 94 million

Estimate of the Variable Costs

The variable costs are dependent upon the number of employers for whom employers are required to withhold for the repayment of student loans. Under the IRS administered program, it is envisioned that employers would be required to submit W-2 type information every pay period. Therefore, variable costs can be estimated by the following equation:

(8) Variable Costs = number of employees x estimated time x number of pay periods x $10 per hour
where

estimated time = .53 hours (based on Form W-2)
average number of pay periods per year = 33 (See Page 9)
number of employees = 6 million, if mandatory (4.5 million, if voluntary)

The estimated Variable Costs are:

- Mandatory Withholding: $1,050 million
- Voluntary Withholding: $ 787 million

Estimate of Employer Burden under the IRS Administered Program (Separate from the Tax System)

The preceding sections developed all of the necessary assumptions and inputs for estimating the total employer reporting burden for an IRS administered student loan collection and servicing system separate from the tax system. Recall that employer reporting burden can be defined by:

(4)' Total Burden = Fixed Costs + Variable Costs

Based on this analysis, the estimates for employer reporting burden as administered by the Internal Revenue Service are:

- Mandatory Withholding:
  - Fixed Costs: $ 670 million
  - Variable Costs: $1,050 million
  - Total Burden: $1,720 million

- Voluntary Withholding:
  - Fixed Costs: $ 90 million
  - Variable Costs: $790 million
  - Total Burden: $880 million

Department of Education

Characteristics of the Education Administered Program

The following points highlight the student loan withholding system envisioned by the Department of Education:

- A program similar to a savings bond campaign or employer charitable contribution program
- A compliance/enforcement strategy centered on the borrower
  - Borrowers would be contacted initially if either a nonpayment or underpayment is detected
  - Borrower attempts to resolve issues with employers before Education interaction with the employer
- A program goal to minimize employer reporting
- A program that gives borrowers the maximum flexibility to match the combination of repayment plans and methods to their individual situations

Burden Estimation Methodology

The estimate of employer burden is based on the following equation:

(1) **Total Burden = Total Fixed Costs + Total Variable Costs**

where

Total Fixed Costs are the costs incurred by employers for having the necessary infrastructure to withhold student loan payments frcm employees' paychecks and remit the amounts to Education. This cost primarily consists of the system maintenance costs (updating of records and other changes to the system) and the cost of recordkeeping. Total Fixed Costs for student loans is the cost over and above what the employer expends to comply with Federal tax requirements or other withholding programs. *Note: Start-up costs are not included*

Total Variable Costs represent the transaction costs to the employer of actually withholding, reporting, and remitting payments to the Department of Education. These costs are in addition to the burden experience by employers in complying with Federal tax requirements and other withholding programs.

The estimate of Total Fixed Costs is based on the following equation:

(2) Total Fixed Costs = number of employers x Average Monthly Fixed Costs x 12 months

where

Average Monthly Fixed Costs = $42.00[2]

The estimate of Total Variable Costs is based on the following equation:

(3) Total Variable Costs = number of transactions per year x average cost per transaction

where

Average cost per transaction = $2.50[3]
Number of transactions = f(number of employees participating, payroll frequency distribution)
Payroll frequency distribution:[4]

Weekly:	31.5%
Biweekly:	36.3%
Monthly:	7.0%
Bimonthly:	25.2%

Based on the payroll frequency distribution, the weighted average for the number of payrolls per year is 33.

Because Total Fixed Costs depends on the number of employers affected by student loan withholding and Total Variable Costs depends upon both the number of transactions per year <u>and</u> the number of borrowers repaying through wage withholding, it is necessary to determine:

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[2] Per conversations with Automated Data Processing, Inc. (ADP), the American Payroll Association, and the American Society of Payroll Management, it was determined that the model for child support administrative wage garnishment was the closest model to the proposed Education student loan withholding system. The Average Monthly Fixed Cost was provided by ADP.

[3] Source: ADP, The transaction cost per employee for administrative wage garnishment.

[4] Source: ADP's distribution of client pay cycles. Discussions with the American Payroll Association indicated that ADP's clients were representative of the employer population.

- the number of employers affected
- the number of borrowers repaying through wage withholding
- the number of transactions per year

Estimated Number of Employers Affected by Student Loan Withholding

To estimate the Total Fixed Costs, it is necessary to first estimate the number of employers who withhold for student loans. Based on the IRS's employment tax reporting, approximately 6 million employers could be affected by a student loan wage withholding program. However, it was assumed that employers with fewer than 10 employees would be exempted from the mandatory reporting requirement. Based on an analysis of IRS, Census, and Department of Education data, it is expected that the maximum of 1.2 million employers would be affected under a mandatory withholding program. However, exempting these employers does not mean that they would be prevented from offering wage withholding as a means to repay student loans as an employee benefit. All firms can participate--but firms with 10 or more employees must participate.

With respect to the voluntary withholding program, one would expect that larger employers would be more willing to offer repayment of student loans through wage withholding as an employee benefit. While the average monthly fixed cost per employer and the average cost per transaction are identical under both the mandatory and voluntary programs, the perception changes. The mandatory withholding program would be viewed as another government mandate while the voluntary program permits businesses to decide whether to offer loan repayment via wage withholding to their employees. In other words, the business community could view mandatory employer withholding as a cost while the voluntary program could be viewed as an employee benefit.

Based on conversations with United Way concerning employer participation in charitable withholding programs, and on Treasury statistics for the government savings bond program, our best assumption concerning the number of employers offering wage withholding on a voluntary basis is 174,000. This assumes that employers with fewer than 50 employees will elect not to participate.

To summarize, the projected number of employers participating in a wage withholding program for the repayment of Federal student loans are:

- Mandatory Withholding Program: 1.2 million employers
- Voluntary Withholding Program: 174 thousand employers

Estimated Number of Borrowers Participating in a Wage Withholding Program

Under the mandatory withholding program, it was estimated that 1.2 million employers would be affected by the requirement. Approximately 84% of all employees are employed under this employer subpopulation. Based on all available information, IRS, Treasury, and Education assume that approximately 6 million borrowers would elect to repay their loans through wage withholding (including income contingent and all other repayment plans). This 6 million borrowers represents 30% of the entire steady-state direct loan repayment population.

Because the number of firms electing to participate in a voluntary withholding program is considerably less, fewer borrowers will be able to repay student loans through wage withholding. Census employment statistics indicate that the majority of employees work for larger firms. While over a million firms that would have been affected under a mandatory program would elect not to participate under a voluntary program, only a small proportion of the employment population would be affected. Even with the substantial drop in the number of employers participating in a voluntary program. it is assumed that approximately 4.5 million employees would be able to participate under the voluntary withholding program.

To summarize, the best estimates for the number of borrowers electing to repay student loans through wage withholding are:

- Mandatory Withholding Program: 6.0 million borrowers
- Voluntary Withholding Program: 4.5 million borrowers

Estimated Number of Transactions Per Year

As stated in the methodology, the number of transactions is dependent upon the payroll frequency distribution and the number of employees participating. It is reasonable to assume that the payroll frequency distribution can be used to extrapolate how frequently employees are paid. Therefore the number of transactions per year can be estimated through the following equation:

(4) Number of Transactions (#/yr) = number of borrowers x Σ(payroll frequency distribution x number of pay cycles per year (cycles/yr))

Using the estimate of 6 million borrowers under the mandatory withholding system the number of transactions per year would be:

- 6 million x (.315 x 52 + .363 x 26 + .07 x 12 + .252 x 24)
  or
  196 million transactions under a mandatory program

Using the same approach for the voluntary withholding program, 4.5 million employees participating generates 147 million transactions.

Estimate of Employer Reporting Burden under an Education Administered Program

Recall that the employer reporting burden is represented by the following equation:

(1) **Total Burden = Total Fixed Costs + Total Variable Costs**

Both Total Fixed Costs and Total Variable Costs were also determined based on the analyses presented above.

(2) Total Fixed Costs = number of employers x Average Monthly Fixed Costs (per employer) x 12 months

= number of employers x $42 per employer/month x 12 months
= number of employers x $504

(3) Total Variable Costs = number of transactions per year x average cost per transaction

= number of transactions per year x $2.50 per transactions

The preceding sections developed the inputs necessary to estimate employer burden under both a mandatory and voluntary program. Based on the assumptions and the analytical approach detailed above, the estimates for employer burden are:

- Mandatory Withholding:
  - Total Fixed Costs: $ 610 million
  - Total Variable Costs: $ 490 million
  - Total Burden: $1,100 million

- Voluntary Withholding:
  - Total Fixed Costs: $ 90 million
  - Total Variable Costs: $ 370 million
  - Total Burden: $ 460 million

An Alternative Methodology

This methodology is based on the concept that the additional costs incurred by employers to effect wage withholding for student loan borrowers can be treated as marginal costs. The employer burden, therefore, is:

- **Total Burden = Marginal Costs = (Payroll Accounting System Costs) + Marginal Transactions Costs)**

Under this construct, costs are neutral vis-a-vis the collector, i.e., the IRS or the Department of Education. The basic assumptions are:

- small employers, i.e., those with less than 50 employees, would incur a marginal cost equal to the cost per employee of establishing and servicing a payroll accounting system; and,

- large employers, i.e., those with 50 or more employees, would incur a marginal cost equal to the cost per employee of withholding the payment from the salary of a borrower and remitting it to the collector. Large companies already have payroll accounting systems.

Payroll Accounting System Costs are the costs incurred by employers to establish and service a payroll accounting system. Based on the models of wage withholding for savings bonds and for charitable contributions, these costs are estimated to average $1,780 per borrower.

Marginal Transactions Costs are those costs incurred to withhold the borrower's loan payment and submit it to the collector. Based on anecdotal information, these cost are nearly zero in automated systems, and it is assumed that these annual costs amount to $104 per borrower.

Under a mandatory wage withholding system, there will be an average of 6 million borrowers in repayment status. Under a voluntary system, only 4.5 million borrowers would elect wage withholding. It is also assumed that these 6 million borrowers are distributed among employers in the same proportion as the existing distribution of employees.

Based upon the assumptions and data included in the burden calculation tables, the estimates for employer burden are:

- Mandatory Wage Withholding: $2.6 billion

- Voluntary Wage Withholding: $2.0 billion.

Selected Statistics, By Size of company,
By Number of Employees: 1987

Employment Size Class:	Companies	Owned Establishments	Employees	Annual Payroll	Sales and Receipts
	(000)	(000)	(000)	($ billions)	($ billions)
0 to 4	2,231.0	2,239.4	4,121.2	$50.6	$384.6
5 to 9	783.8	804.9	5,135.0	56.2	357.9
10 to 49	722.3	841.7	14,092.7	161.6	1,008.3
50 to 99	81.9	146.3	5,583.2	63.5	386.4
100 to 499	51.1	200.2	9,699.2	110.6	669.5
500 to 999	4.6	61.4	3,141.1	35.5	217.2
1,000 and over	4.2	454.2	26,368.2	435.9	2,338.1
TOTALS	3,878.8	4,748.1	68,140.5	$913.9	$5,362.0
DISTRIBUTION					
0 to 4	57.5%	47.2%	6.0%	5.5%	7.2%
5 to 9	20.2%	17.0%	7.5%	6.1%	6.7%
10 to 49	18.6%	17.7%	20.7%	17.7%	18.8%
50 to 99	2.1%	3.1%	8.2%	7.0%	7.2%
100 to 499	1.3%	4.2%	14.2%	12.1%	12.5%
500 to 999	0.1%	1.3%	4.6%	3.9%	4.0%
1,000 and over	0.1%	9.6%	38.7%	47.7%	43.6%
TOTALS	100.0%	100.0%	100.0%	100.0%	100.0%

TAB 4

QUESTION 3:

Analyze and explain DoE option.

Analyze and explain the ED mandatory wage withholding option

- **ED mandatory wage withholding means:**

  - Employee/borrowers would direct their employer to withhold a specified amount from their salary check and to forward the withheld amounts monthly to ED's loan servicer. The employer would withhold the amount and forward it as instructed. Employer reporting would be limited to keeping ordinary business accounting records, including appropriate entries on the employee's pay stub, and specifying the employee's name, SSN, and amount when forwarding the monthly payments.

  - Builds on the system that ED has already established for collecting student loans through wage withholding: ED's system makes use of the widespread existing practice of the employer effecting deductions from wages as a service to employees, such as deductions for charitable contributions, for 401(k)-type retirement programs, or for savings and savings bond programs.[5]

  - Employers with 10 or more employees would be legally required to participate.

- **How it works:**

  - Education would notify employers generally about the system and provide a description of the wage withholding program and all information necessary to make deductions and forward payments to a servicer. This would be done periodically to remind employers of their obligation. This would be a public information notice with minimal costs involved.

  - When a student loan borrower is ready to begin repaying the loan, the servicer would provide him or her information regarding loan repayment through wage withholding.

  - If the borrower chose wage withholding, the borrower would be given loan specific information about how much the employer must withhold on a monthly basis and to where the deduction must be sent. Thereupon the

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5 If administered by ED, a voluntary and mandatory system operates in the same way. Employer participation is optional in a voluntary system, while it is required for all but the smallest employers in a mandatory system. The costs to the participating employer and the benefits to the borrower are the same under the voluntary or mandatory system.

borrower would notify the employer who would begin salary deductions and forward payments monthly.

- The servicer would provide borrowers with periodic statements of the amounts received and the status of the account so the borrower could notify the employer and/or the servicer of any discrepancies.

- Education would set up appropriate internal controls to identify missing payments and ensure employer and borrower compliance.

- **Advantages**

  - Being based on a voluntary system with minimal record keeping demands, the system poses little burden on most employers.

  - The system is borrower focused, meaning that the amount withheld and reconciliation of amounts withheld are the responsibility of the borrower in communication with the Department of Education, similar to other borrower initiated wage deductions.

  - Being borrower focused, the system reduces employer burden, since ED would not require employer reports to demonstrate the status of revenue collections. Borrowers, notified of missing payments, would be an automatic compliance check.

  - The system is available to everyone who works for an employer with 10 or more employees.[6]

- **Disadvantages**

  - Employers, with under 50 employees, that do not currently offer wage withholding benefits would incur a significant start-up cost and additional administrative burden.

  - Even though employer data processing costs are relatively minor on aggregate, employers may claim that the mandate poses other significant unfunded costs, involving: coordination between payroll and personnel management operations; keeping and maintaining records; setting up and revising accounting system changes; resolving reconciliation problems; and fees for legal and professional advice.

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6 Covers about 85% of employees.

- There would be significant perceptions of federal intrusion that accompany a federal mandate versus an invitation to voluntarily offer the same thing under the umbrella of an employee benefit. Payroll associations report widespread dissatisfaction with the increased number of government mandated wage withholdings and the complexity involved.

- There would be some degree of administrative burden affecting ED and employers associated with compliance activity.

TAB 5

QUESTION 4:

Describe split servicing.

Describe split servicing between IRS and ED

- **Split loan servicing means**

  - IRS would collect all loans that involve wage withholding, using the current tax collection system, with minimal changes to IRS processes and no changes to employer processes. ED would collect loans under all other conditions and, for all loans, ED would counsel borrowers, maintain loan data, respond to inquiries, process adjustments, etc. Using IRS, borrowers would:

    - Request employers to increase wage withholdings for taxes and forward the payments to IRS as required.

    - Claim their loan obligation as an item on their tax return and offset them with wage withholdings.

  - In order to avoid a duplication of effort, IRS would not service loans beyond collecting payments.

  - Loan balances would become taxes, which IRS would collect through the tax system.

- **How it works**

  - When a student loan borrower is ready to begin repaying the loan, the ED contracted loan servicer (servicer) would provide him or her information regarding loan repayment by all methods including wage withholding paid to IRS through the tax system.

  - If the borrower chose to repay through any means except wage withholding, the servicer would provide the borrower information and assistance for making the monthly payments to the servicer, would monitor the receipt of monthly payments and would send the borrower periodic quarterly reconciliations.

  - If the borrower chose wage withholding, the borrower would be given loan specific information about how much the employer must withhold monthly based on the repayment plan selected.[7] Then the borrower would notify the employer to appropriately increase tax withholdings.

- The borrower would be advised that the borrower must file a tax return to declare the loan liability and adjustments, even if a tax return were not otherwise required.

- Employers would withhold wages according to the employee's request according to normal tax withholding rules.

- ED would annotate its own records and would notify IRS during the tax year concerning which borrowers have elected to repay loans through wage withholding and how much was expected to be repaid.

- At year end, ED would notify IRS concerning any adjustments to the repayment obligation (forebearances, unemployment, deferments, changed payment plans)[8] and, by January 31 of the next year, ED would furnish the borrower a yearly statement of the loan obligation to file with the tax return.

- The borrower would file a tax return and declare the loan obligation on a tax schedule furnished by IRS, making the loan obligation a tax liability.

- IRS would collect any tax shortage or refund any tax overage.

- **Advantages:**

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7 Borrowers can repay their loans according to 5 repayment plans: standard repayment plan (fixed payments for 10 years); extended repayment plan (fixed payments for 12 to 30 years depending on amount borrowed); graduated repayment plan (increasing payment amounts for 12 to 30 years depending on the amount borrowed); income contingent (varying payments for up to 25 years depending on amount of income, with forgiveness of balance at 26th year); alternative plan (unspecified conditions to meet special circumstances).

8 Neither IRS nor ED would know how much a borrower had paid on the loan until the tax return was filed and the information was compiled by IRS. However, to accommodate certain change in borrowers' status, ED and IRS are considering a system that would prorate the loan repayment obligation. A borrower changing the wage withholding plan would incur a tax liability for the months when wage withholding applied. The new plan would assume the wages withheld covered the prorated loan repayment.

- The borrower has the benefits of automatic wage withholding and ease of loan payments with little or no inconvenience to the employer.

- This method builds on an existing framework that all employers and employees are required to use.

- The employer has no significant additional cost or administrative burden than already present in the tax withholding system.

- IRS could integrate loan collections as taxes into its current system and administer loan repayment through the tax system.

- **Disadvantages**

  - Borrowers would experience uncertainty in knowing the true extent of their indebtedness during the year, since the amount of the withholding that would apply to the loan liability would be dependent on the accuracy of estimated tax withholdings.

  - Results in critical disparities in treatment between borrowers who use wage withholding, other direct loan borrowers and guaranteed student loan borrowers that may be exploited by private lenders, guaranty agencies and secondary markets to discourage participation in the direct loan program or in the wage withholding method of repayment.

    - Borrowers wishing wage withholding could be made to feel uneasy with wage withholding and the linkage of loan collections with the IRS. Potentially, underestimated withholdings, which did not cover income taxes and loan liabilities, could subject the borrower to more extensive collection remedies for recovering tax debt (e.g. levies, seizures of assets, interest charges and penalties) than borrowers would encounter as a consequence of underpaying a loan.

    - Loans would be considered paid once a year after the end of the year, regardless of the actual pattern of payments throughout the year.

    - A borrower focus group and student associations have expressed clear opposition to IRS involvement in loan collections, in principle.

- From ED's perspective, it is essential to have current loan repayment information in order to effectively manage the loan program. Generally information transferred to ED by IRS would be 18 months old.[9]

- From IRS perspective receivables will increase from the transfer of ED's receivables to IRS as tax debt. This transfer would increase total government receivables, since IRS would likely not expend much resources on the collection of liabilities resulting from student loan debt. On an individual basis collection of such accounts would not be cost effective.

- From ED's perspective, the absence of current loan repayment data would not permit ED identify non-payers for denying them further loans.

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9 Critics and analysts have pointed out repeatedly that, to prevent fraud and abuse, Education needs access to real time data on loan repayments for efficiency in loan servicing, monitoring of school performance, budget forecasting, and financial management purposes.

TAB 6

QUESTION 5:

Compare advantages and disadvantages between IRS and DoE.

Compare service delivery advantages and disadvantages between IRS and ED

- **IRS Advantages**
    - Assuming use of the tax system, use of IRS would pose little additional burden from the employer's perspective.
        - The tax withholding system already exists and both employers and employees are used to using it.
        - It would be available to all employees.
    - There is a perception among borrowers that IRS would take more effective enforcement action to collect unpaid debts than would ED, which perception may increase borrower compliance.
- **IRS Disadvantages**
    - Student loan borrowers are concerned about IRS involvement in loan collections and its ability to change missions from tax collector to loan collector.
    - Unless IRS set up a customer service operation, a borrower would have to deal with two federal agencies, IRS for collections and ED for advice and counsel on repayment alternatives.
    - Using the IRS tax system, borrowers could not monitor payments on an ongoing basis and evaluate the effects of payments on interest and principle.
    - Borrowers changing employers would have difficulty knowing payments were current and may underpay the loan obligation incurring an unexpected liability.
- **ED Advantages**
    - The borrower could use wage withholding to repay loans under the most advantageous loan repayment plan from the borrower's perspective and move between plans easily.
    - The borrower's payments would be made automatically, but the borrower would have the advantage of following his/her account balance, monitoring the effect of payments on principal and interest, and assuring him/herself that payments were posted and current.

- ED can provide one-stop shopping. By controlling all aspects of loan administration, ED would have the means to achieve accountability for providing a measurable degree of customer service in all aspects of student financial assistance administration.

- Because there are necessary linkages between aspects of program administration and subsequent loan service and collection, customer service would be strengthened if responsibilities for it are carried out by a single agency.

- With its close relationship to the schools and the continuous relationship it establishes with the students beginning in the earliest stages of the loan cycle, ED would be well placed to advise a student on loan repayment throughout the repayment process.

- In general, withholding the payments and forwarding them to ED would be no more difficult than the common practice of withholding contributions for charity, or for purchasing savings bonds, or for forwarding payments to a credit union or bank for savings.

- The Department of Education has developed and put in place the infrastructure necessary to administer a centralized loan program that includes wage withholding as an option.

- **ED Disadvantages**

  - In terms of service delivery, there are no disadvantages to using ED as the primary servicer.

TAB 7

QUESTION 6:

Develop carrot and stick options.

Develop a blend of carrot and stick options for ED mandatory and voluntary options

- **Mandatory option**

  - Excluding employers with fewer than 10 employees from the requirement would exempt over 75 percent of the employers but reach about 85 percent of the employees.

  - Reimburse employers for all or a portion of costs. Note: (Reimbursements would increase administrative burden considerably because of unavoidable government accountability standards. In addition to the budget impact, increasing direct loan program expenses has a high political cost).

  - Obtain legislation providing for civil penalties for non-compliance.

- **Voluntary option**

  - Employers could be offered cash incentives to cover expenses (Note: subject to the cautions cited under mandatory carrots.)

  - Using a wage withholding system based on the model of voluntary deductions from salary as an employee benefit.

  - Initiate public service advertising campaign, utilizing trade and payroll providers and associations, to promote wage withholding as a public service and employee benefit.[10]

  - Prepare instructional and software packages to assist employers in effecting the option.

  - Enlist payroll servicers, such as ADP, to assist ED in developing the operational aspects of the voluntary option as a simple and inexpensive service.

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10 About 80 percent of the employees in the U.S. are employed by businesses that participate in the voluntary savings bond program. In terms of number of employees, only the top 25 percent of the employers have to participate to afford wage withholding to 85 percent of the employees.

QUESTION 7:

Explain options from the borrower's perspective.

TAB 8

QUESTION 7:

Explain options from the borrower's perspective.

Explain how wage withholding looks to the borrower

- A number of borrowers would not wish to use the IRS tax system. They may fear the consequences of dealing with an agency geared to law enforcement.

- Borrowers using the IRS tax system, who encountered problems, would have to coordinate between IRS and ED, both of which may have trouble coordinating with the other because of the volume of filers at tax time, but especially because of a potential 18 month information lag.

- With current account information and only one point of contact, borrowers under an ED administered system would be able to easily change payment plans, yet continue to use wage withholding.

- Borrowers under an ED administered plan could easily stop wage withholding without over or underpaying.

- By authorizing the employer to pay salary through electronic funds transfer to the employee's bank account and authorizing the bank to transfer funds to an ED account, many borrowers could achieve the same benefit as wage withholding provides.[11]

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11 According to ADP, a large number of employers use electronic funds transfer to pay employee salaries.

HOW WAGE WITHHOLDING LOOKS TO THE BORROWER

You can choose from the following menu:	You can repay in the following ways:	If you choose wage withholding:
Standard Fixed 10 year **Extended** Fixed 12 - 30 years **Graduated** Increasing payment 12 - 30 years **Income Contingent** Varies with income up to 25 years **Alternative** Special arrangements	• Check or other negotiable instrument • Electronic funds transfer (EFT) from bank or any other source (trust account, investment fund, etc.) • Wage withholding for borrowers who are employees	• You must be employed • You must have your employer deduct $**** each month from your earnings • You must report immediately to ED if you stop working or change employers, or wish to stop wage withholding **ED System** • You must give to your employer certain info provided by ED (begin date, amount, mail or EFT address, info to send with payment - employee name/SSN/amount) • ED will send you a statement of your account each quarter • You should notify ED of any discrepancies or problems **IRS System** • You must notify your employer on form W-4 to increase your tax withholding by $**** per month • You will receive an annual loan liability form **** by January 31 each year • You must file a Federal income tax return with the IRS by April 15 each year attaching form **** • Your increased loan deduction will be treated as tax liability if withheld amounts do not cover tax and loan liabilities