TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

The IRS Continues to Reduce Backlog Inventories in the Tax Processing Centers

March 18, 2024

Report Number: 2024-406-020

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HIGHLIGHTS: The IRS Continues to Reduce Backlog Inventories in the Tax Processing Centers

Final Audit Report issued on March 18, 2024 **Report Number 2024-406-020**

Why TIGTA Did This Audit

Backlogs of tax returns and other types of tax account work resulting from the Coronavirus Disease 2019 Pandemic (Pandemic) have had a significant impact on the IRS and taxpayers. The backlogs continued into Calendar Year (CY) 2023 with approximately 4.5 million returns awaiting processing or other resolution as of the week ending December 23, 2022.

The IRS significantly reduced the inventories of tax returns and other types of tax account work during CY 2023, and many functions in the Tax Processing Centers have returned to pre-Pandemic levels. However, areas of concern remain.

This audit is part of a series of reviews to evaluate the IRS's efforts to reduce the significant backlogs at its Tax Processing Centers.

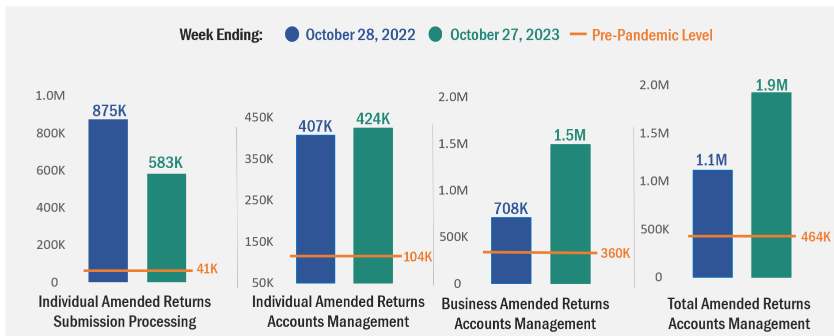
Impact on Tax Administration

Delays in processing backlogged tax returns and other types of tax account work burden taxpayers, including delays in receiving their refunds. Further, significant inventories of tax account work continue to delay the resolution of taxpayer account issues including the review of amended tax returns and other Accounts Management work.

What TIGTA Found

As TIGTA previously reported, the IRS implemented a *Get Healthy Plan* in CY 2022 intended to return the IRS to pre-Pandemic, *i.e.*, CY 2019, inventory levels by the end of CY 2022. Although the implementation of these initiatives resulted in a significant reduction of the backlogged inventories in the Tax Processing Centers, concerns remain with the inventories of suspended returns, *i.e.*, tax returns in the Rejects, Unpostables, and Files functions.

In addition, concerns remain with the inventories of amended tax returns remaining to be worked, which are significantly above the pre-Pandemic levels.



Accounts Management function inventories also remain above pre-Pandemic levels. As of October 28, 2023, there were 4.3 million Accounts Management cases, excluding amended returns, awaiting processing compared to 4.4 million as of October 29, 2022. Of these 4.3 million Accounts Management cases, 2.8 million were aged cases. This work has various criteria for its aged work, ranging from four to 180 days in inventory.

Finally, TIGTA's review of taxpayer concerns regarding delays in receiving refunds identified 121,449 Tax Year 2020 tax accounts with overpayments totaling $783.3 million that were delayed or erroneously held from issuance. This occurred because of errors in programming changes made by the IRS.

What TIGTA Recommended

TIGTA made two recommendations to the IRS including to identify a process to review and release the overpayments that are being erroneously held, and to perform an analysis of Tax Year 2019 tax accounts with abated Failure to File penalties to identify additional tax accounts where overpayments are being held.

The IRS agreed with both recommendations.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

March 18, 2024

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

FROM: Matthew A. Weir
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The IRS Continues to Reduce Backlog Inventories in the Tax Processing Centers (Audit No.: 202340610)

This report represents the results of our review to assess the Internal Revenue Service's efforts to address backlogs of unworked inventories at its Tax Processing Centers during the 2023 Filing Season and the effect on taxpayers. This review is part of our Fiscal Year 2024 Annual Audit Plan and addresses the major management and performance challenge of *Taxpayer Service*.

Management's complete response to the draft report is included as Appendix IV. If you have any questions, please contact me or Diana M. Tengesdal, Assistant Inspector General for Audit (Returns Processing and Account Services).

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Background

This audit is part of a series of reviews to evaluate the Internal Revenue Service's (IRS) efforts to reduce the significant backlogs at its Tax Processing Centers.[1] As previously reported, the IRS took unprecedented and drastic actions during Calendar Year (CY) 2020 in response to the Coronavirus Disease 2019 Pandemic (Pandemic) to protect the health and safety of its employees and the taxpaying public.[2] This included closing its Tax Processing Centers, Taxpayer Assistance Centers, and other offices nationwide, creating a backlog of tax returns awaiting processing. The IRS had additional challenges during CY 2021 that further contributed to the backlog. These challenges included:

- An inability to hire sufficient staff needed to work through the backlog inventories.
- Closing of the Fresno, California, Tax Processing Center, which further increased backlogs when work was transferred to the Austin, Texas, Kansas City, Missouri, and Ogden, Utah, Tax Processing Centers.
- Limitations to operate at full capacity due to social distancing requirements.

The backlog of returns, correspondence, and other types of work resulting from the Pandemic had a significant impact on the IRS and taxpayers. Figure 1 provides a comparison of individual and business tax return inventory levels at various stages of processing for CYs 2019 through 2022.

Figure 1: Comparison of Submission Processing Function Individual and Business Inventories at the End of CYs 2019 Through 2022[3]

Function	12/28/2019	12/25/2020	12/31/2021	12/23/2022
Paper Returns Waiting to Be Processed	421,285	12,469,182	8,259,918	1,442,678
Error Resolution	31,488	196,453	131,933	233,539
Processing Rejects	152,449	1,799,479	622,559	823,462
Unpostable Cases	504,093	2,104,335	1,805,740	1,965,001
Totals	1,109,315	16,569,449	10,820,150	4,464,680

Source: IRS Filing Season Statistics for the week ending December 28, 2019, and IRS inventory numbers for the weeks ending December 25, 2020, December 31, 2021, and December 23, 2022.

The IRS took various actions to address tax return inventories. For example, in CY 2020, the IRS increased employee telework capability, provided incentive pay for employees to return to the office, and offered overtime. The IRS also transshipped unopened mail from the Kansas City and

[1] See Appendix III for a list of prior audit coverage.

[2] TIGTA, Report No. 2021-46-023, *Results of the 2020 Filing Season and Effects of COVID-19 on Tax Processing Operations* (Mar. 2021).

[3] See Appendix V for a glossary of terms.

Ogden Tax Processing Centers to the Austin Tax Processing Center, and to the lockbox sites in Louisville, Kentucky, or Cincinnati, Ohio.[4]

Post tax return processing

The Accounts Management function is responsible for assisting individual and business taxpayers with tax law and tax account inquiries, including adjusting taxpayer accounts when necessary. The Accounts Management function has 10 sites nationwide that work paper inventory; seven sites are supported by an Accounts Management Campus Support Site, and three sites are supported by the Submission Processing function.

Most of the Accounts Management function's inventory is received from taxpayers via the mail. The time it takes for the Accounts Management function to receive and work its taxpayer-initiated inventory affects how timely taxpayers receive a response from the IRS and have their case resolved.

Amended tax returns

Form 1040-X, *Amended U.S. Individual Income Tax Return*, *i.e.*, amended individual tax return, is worked by both the Submission Processing and Accounts Management functions. In August 2020, the IRS began accepting electronically filed Forms 1040-X, no longer requiring IRS staff to open these Forms 1040-X. However, the IRS continues to receive paper-filed Forms 1040-X.

Beginning in November 2020, the IRS began scanning all paper-filed Forms 1040-X received at IRS Tax Processing Centers.[5] Previously only those that were routed to the Accounts Management function were scanned. For CY 2023, the IRS reported that it had scanned 1.9 million amended returns, as of October 28, 2023.

All amended individual tax returns are screened either by the Submission Processing function or systemically for electronically filed forms, and those that meet certain criteria are routed to the Accounts Management function. Amended business returns are filed on paper or electronically but are only worked by the Accounts Management function. While amended returns are received electronically, or are scanned into IRS systems, the forms are still processed manually.

Results of Review

The Inventories of Unprocessed Returns Have Been Significantly Reduced, but Concerns Remain in Inventories of Suspended Returns

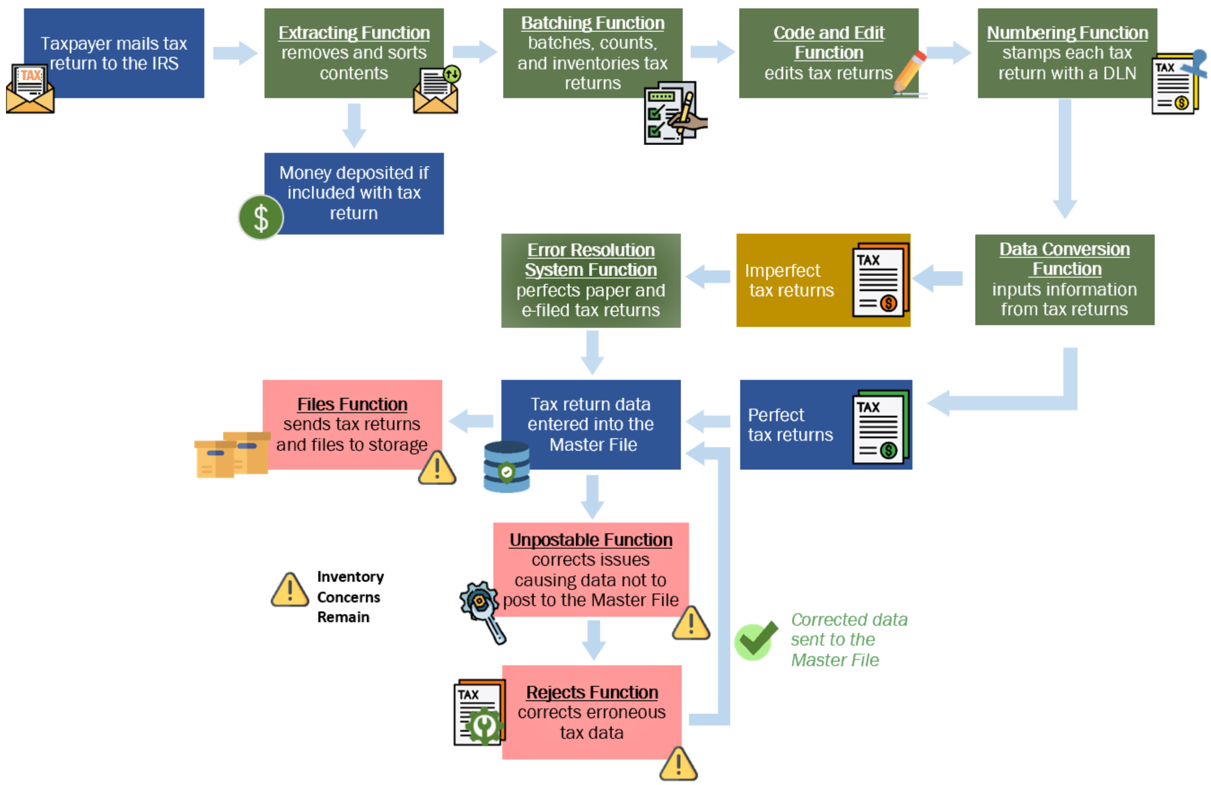
On March 10, 2022, the IRS announced several initiatives it planned to undertake as part of addressing the continuing backlog of tax returns and other tax account work. These initiatives, referred to as the *Get Healthy Plan*, were intended to return the IRS to pre-Pandemic inventory

[4] An IRS lockbox is a facility operated by a Federally insured bank that the IRS has contracted for the purpose of, among other things, processing Federal tax remittances.

[5] The Austin Tax Processing Center began scanning all paper-filed Forms 1040-X in November 2020, the Ogden Tax Processing Center began in January 2022, and the Kansas City Tax Processing Center began in May 2022.

levels, *i.e.*, CY 2019, by the end of CY 2022. While the backlog of tax returns continued into Processing Year (PY) 2023, the IRS significantly reduced the inventories of tax returns and other types of tax account work during CY 2023 and many functions in the Tax Processing Centers have returned to pre-Pandemic levels. Figure 2 provides a summary of the flow of work for tax return processing at the Tax Processing Centers. As of October 2023, the "pipeline" inventory concerns remain at the end of the processing pipeline in the Rejects, Unpostables, and Files functions.

Figure 2: Tax Return Processing "Pipeline" at the Tax Processing Centers



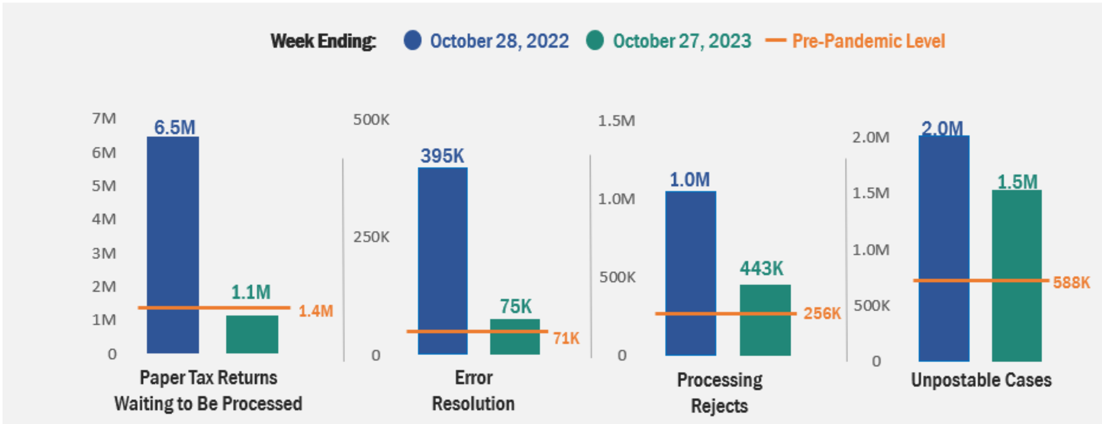
Source: Treasury Inspector General for Tax Administration (TIGTA) observations of Tax Processing Centers. DLN = Document Locator Number.

During PY 2023, the IRS:

- Cleared the backlog of unprocessed individual tax returns received during CY 2022 as of February 3, 2023, and business tax returns as of March 17, 2023.
- Processed over 26 million paper-filed information returns as of December 1, 2023.
- Reduced Error Resolution cases to near pre-Pandemic levels as of August 25, 2023.

Figure 3 provides a comparison of individual and business tax return inventory levels in various stages of processing as of the end of October 2022 and October 2023.

Figure 3: Comparison of Submission Processing Individual and Business Tax Returns Inventory as of October 2022 to October 2023



Source: IRS Filing Season Statistics Report for the week ending October 26, 2019, and IRS inventory numbers for the weeks ending October 28, 2022, and October 27, 2023.

Rejects and unpostable inventories remain above pre-Pandemic levels

The IRS leveraged its employees by cross-training and assigning more employees to work the rejects and unpostable inventories during CY 2023. The IRS also conducted a Lean Six Sigma assessment to identify opportunities to increase production efficiencies for unpostable cases.[6] The IRS identified some areas for potential improvement, but changes have not been implemented. For example, the assessment identified six unpostable conditions that are being assessed to determine if any programming changes can be made to reduce and eliminate volumes of the condition. The IRS continues to assess whether additional programming can be updated or modified to reduce or eliminate other unpostable conditions and/or whether a process can be developed to automatically close unpostable conditions.

Despite the IRS's efforts, its inventories of rejected returns and unpostable cases remain above pre-Pandemic levels.[7] Although IRS management estimates that the rejected return inventories will be at pre-Pandemic levels by the beginning of CY 2024, they anticipate that the unpostable inventories will remain high throughout CY 2024. Figure 4 summarizes the IRS's revised estimates for reaching pre-Pandemic inventory levels for rejected returns and unpostable cases.

[6] The Lean Six Sigma methodology focuses on eliminating waste and non-value-added activities, which improves process effectiveness and efficiency.

[7] IRS tax return inventories fluctuate during the processing year because of the due dates of the returns. For example, individual tax return inventories increase in April and October corresponding with the due date and extension due date of the Form 1040, *U.S. Individual Income Tax Return*.

Figure 4: Estimates to Reach Pre-Pandemic Inventory Levels

	GOAL	REMAINING INVENTORY	WEEKLY PROCESSING RATE	ESTIMATED DATE FOR GOAL	ON TARGET TO MEET GOAL
INDIVIDUAL AND BUSINESS REJECTED RETURNS	214,000	443,000	86,000	JANUARY 2024	✓
UNPOSTABLE CASES	640,000	1.5 M	900,000	DECEMBER 2024*	⊗

*Source: IRS inventory numbers for the week ending October 27, 2023. * Adjusted to include further inventory considerations discussed with the IRS on September 14, 2023, and October 30, 2023.*

Our review showed that closures during CY 2023 are consistent with new unpostable case receipts. Our discussions with IRS management indicated that the inventories of unpostable cases remained high because incoming unpostable cases are higher than the IRS anticipated. The IRS indicated that total receipts for CY 2023 through September 2023 were 7 million more than received through September 2022, *i.e.*, over 33.5 million compared to 26.5 million. Further, management indicated that anytime the number of transactions being input increases, there is a chance that the number of unpostables will also increase.

Status of actions taken to address previously reported concerns and recommendations

Staffing needs at the Tax Processing Centers

We previously reported that ongoing substantial hiring shortfalls of employees needed to fill mission-critical Tax Processing Center positions continued to hamper the IRS's efforts to address these backlog inventories.[8] During the 2022 Filing Season, the IRS took several steps to address staffing needs at its Tax Processing Centers. These steps included the use of Surge Teams, *i.e.*, employees from other IRS functions, Direct Hire authority, and the use of contract employees.

During PY 2023, the IRS continued to take steps initiated during CY 2022 to address the staffing needs at the Tax Processing Centers. These actions included:

- **Surge Teams:** The IRS used Small Business/Self-Employed Division and Accounts Management function Surge Teams to assist with working the backlog of tax return inventories. For example, these employees prepared tax returns for data input and scanning, resolved tax returns with unpostable conditions, *etc*. The majority of the Surge Team employees returned to their original functions by April 2023.
- **Direct Hire Authority:** The IRS continued to use direct hiring authority to assist with meeting hiring goals. As of July 18, 2023, the IRS hired 3,570 (65 percent) of the 5,473 goal for Fiscal Year (FY) 2023.[9]
- **Contract Employees:** The IRS hired contract employees to perform clerical duties related to the processing of tax returns including receiving, sorting, numbering, scanning, manually inputting information from the tax return into IRS systems, filing, *etc*.

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[8] TIGTA, Report No. 2022-46-057, *Delays in Management Actions Contribute to the Continued Tax Processing Center Backlogs* (Sept. 2022).

[9] While the IRS continues to hire, the new employees hired after July are counted toward the IRS's FY 2024 hiring goals so that they are fully trained by January 1, 2024, to support the 2024 Filing Season.

The IRS indicated that there were 716 contract employees through September 23, 2023, when the contract was terminated. IRS management indicated that they plan to continue to use contract employees at the Kansas City Tax Processing Center through March 2024.

In addition to these hiring initiatives, the IRS added 306 employees in Memphis, Tennessee, an Accounts Management Campus Support Site to assist with working amended individual tax returns. These employees completed training by May 2023. The IRS expects that these employees will also assist with other Tax Processing Center work as needed. This may include data verification work for the Service Center Recognition/Image Processing System for the processing of Form 941, *Employer's QUARTERLY Federal Tax Return*, Form 940, *Employer's Annual Federal Unemployment Tax Return*, Schedule K-1, and information returns.

Expanding the automated Error Resolution correction tool

In response to recommendations in our prior reports, the IRS implemented an automated Error Resolution correction tool, referred to as the FixERS tool.[10] The tool systemically replaces the steps an IRS Error Resolution employee would take to resolve errors, shortens the time needed to resolve taxpayer errors that could delay refunds, and reduces the risk of IRS employee error.

The IRS used the tool to address five common taxpayer errors when claiming the Earned Income Credit, Child Tax Credit, Recovery Rebate Credit, and Child and Dependent Care Credit during PY 2022. The IRS reported that through January 5, 2023, nearly 13.5 million tax returns were corrected using the FixERS tool.

The IRS expanded the FixERS tool to include 16 additional error codes for a total of 21 error codes for PY 2023. As of October 31, 2023, the IRS reported that 2.4 million tax return errors were identified and corrected using the tool. IRS management noted that the number of returns addressed by the tool declined from PY 2022 due to the expiration of tax provisions of the American Rescue Plan Act legislation.[11] According to the IRS, it costs $1.01 to work an individual tax return in the Error Resolution program. Using the IRS's estimated cost of $1.01 per return, we estimate that the use of the FixERS tool resulted in a cost savings of $13.6 million for PY 2022 and $2.4 million for PY 2023.

Replacing decades-old mail sorting machines

We previously reported that the IRS's mail sorting equipment (referred to as Service Center Automated Mail Processing Systems) in place at the Tax Processing Centers was at least 20 years old and has not had any significant technical upgrades in more than 15 years. Moreover, the IRS had not taken any significant actions to review and assess needed equipment upgrades, replacement options, *etc.*, until we raised the numerous concerns brought to our attention by employees responsible for using this system to process incoming mail.[12]

In August 2023, IRS management stated that they are in the process of replacing the mail sorting machines. The IRS expects that these new machines will allow them to quickly open and

[10] TIGTA, Report No. 2022-46-032, *Processing of Recovery Rebate Credit Claims During the 2021 Filing Season* (May 2022) and TIGTA, Report No. 2022-40-024, *Results of the 2021 Filing Season* (Mar. 2022).

[11] Pub. L. No. 117-2, 135 Stat. 4 (codified in scattered sections of 7, 12, 15, 19, 20, 26, 29, 42 and 45 U.S.C.).

[12] TIGTA, Report No. 2022-40-015, *Plans to Close the Austin Tax Processing Center Should Be Halted Until Hiring Challenges and Substantial Backlogs at Remaining Centers Are Addressed* (Feb. 2022).

prepare mail for processing, which will result in the IRS processing paper returns and delivering refunds more quickly.

The IRS plans to replace six mail sorting machines in the Austin, Kansas City, and Ogden Tax Processing Centers and three mail sorting machines in Cincinnati, Ohio; Fresno, California; and Philadelphia, Pennsylvania, Accounts Management sites. The delivery and installation of these machines is in process as of December 12, 2023. When we discussed the replacement process, the IRS indicated that it is planning to incrementally replace these machines to ensure that the Tax Processing Centers can continue opening mail if an issue arises with the installation of the new machines. We plan to follow up on the installation process during our 2024 Filing Season review.[13]

Addressing the backlog of transcript requests

The Return and Income Verification Services has a variety of responsibilities related to processing transcript requests. This includes processing requests for tax transcripts related to disaster relief, *e.g.*, the Small Business Administration Economic Injury Disaster Loans, and processing taxpayer requests for photocopies of taxpayers' tax returns and/or copies of their tax transcript.

In a prior audit, we reported that as of December 10, 2021, the Kansas City Tax Processing Center had over 751,000 unprocessed transcript requests compared to a little more than 145,000 unprocessed transcript requests at the Ogden Tax Processing Center.[14] However, the IRS had an imbalance between available staff (183 employees in Ogden versus 70 employees in Kansas City) and the assigned inventory of unprocessed transcript requests.

To address the imbalance of inventory and staffing, the IRS transshipped Kansas City Return and Income Verification Services inventory to the Austin and Ogden Tax Processing Centers. Additionally, the IRS created a global inventory system, which allows the IRS to estimate staffing needed to work inventory and the ability to shift staff between programs/inventories. For example, the Ogden and Austin Tax Processing Centers focused on completed Income Verification Express Service Program work while the Kansas City Tax Processing Center could focus on reducing its Return and Income Verification Services inventory. The IRS has consistently decreased the combined Return and Income Verification Services inventory from 929,847 requests as of October 28, 2022, to 38,593 as of October 27, 2023. This includes 98 percent of the inventory being within the 10-day processing goal.[15]

Amended Tax Return Inventories Remain Above Pre-Pandemic Levels

Significant inventories remain to be worked in both the Submission Processing and Accounts Management functions. Figure 5 summarizes and compares inventory levels pre-Pandemic as of the end of October 2019 with those as of the end of October 2022 and October 2023.

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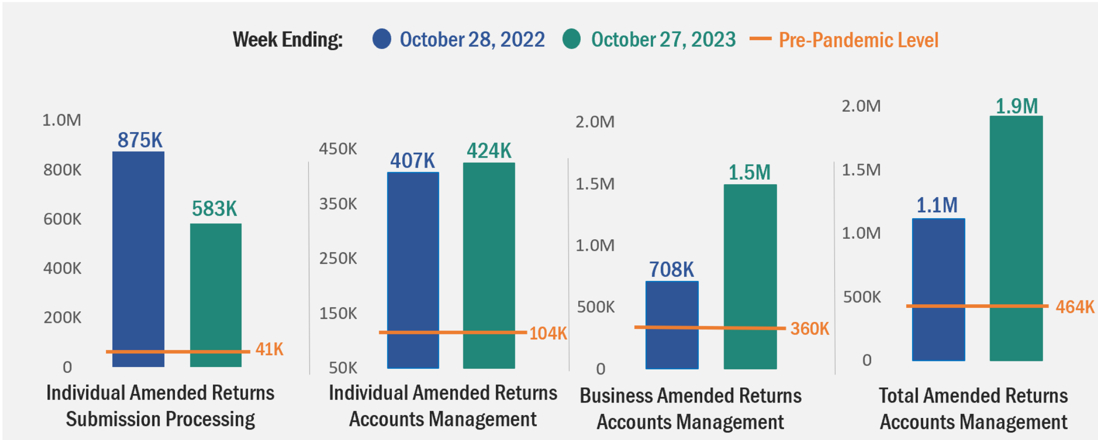
[13] TIGTA, Audit No. 2024408023, *2024 Filing Season (Interim)*.

[14] TIGTA, Report No. 2022-46-057, *Delay in Management Actions Contribute to the Continued Tax Processing Center Backlogs* (Sept. 2022).

[15] The 10-day processing goal is business/workdays or calendar days depending on the type of the inventory.

Figure 5: Comparison of Amended Tax Return Inventory as of October 2022 to October 2023



Source: Customer Account Services Form 1040X Consolidated Inventory Report as of October 26, 2019. IRS inventory numbers for the weeks ending October 28, 2022, and October 27, 2023. Accounts Management Inventory Report as of October 26, 2019, October 29, 2022, and October 28, 2023.

IRS actions to address amended return processing

The IRS has taken actions to address the processing of amended returns during PY 2023. These actions included:

- Hiring and training 306 employees in Memphis, Tennessee to specifically address the inventory of amended returns in the Submission Processing function.
- Reassigning 180 employees within the Accounts Management function focused on processing Forms 1040-X as of March 24, 2023.
- Implementing a centralized inventory for amended returns processed by the Submission Processing function on August 9, 2023. This allows the IRS to work Forms 1040-X based on IRS receipt date regardless of which Tax Processing Center received the amended tax return. The IRS began scanning paper-filed Forms 1040-X screened to be worked by the Submission Processing function in PY 2020 at the Austin Tax Processing Center followed by the Ogden and Kansas City Tax Processing Centers in PY 2022.

Even though the inventories of unprocessed amended returns are scanned, the IRS continues to manually process them. IRS management advised that in response to our prior recommendation, funding was approved in FY 2023 to automate processing of electronically filed Forms 1040-X.

As part of its efforts to incrementally build an automation process, the IRS identified programming requirements for certain simple returns and requested that the Information Technology organization determine if those returns can be processed exclusively by automation. For example, Forms 1040-X with changes to wages and withholding on Form W-2, *Wage and Tax Statement*; a requested change of filing status from head of household to single; removing claimed credits; or change(s) to Schedule A, *Itemized Deductions*, *etc*. IRS management estimates that implementation for the overall automated process will be completed by January 15, 2026.

The IRS Submission Processing function estimates that amended individual tax return inventories will not be back to pre-Pandemic levels until August 2024. The Accounts Management function does not set goals specifically for amended individual tax returns inventories. Instead, Accounts Management leadership has set a goal to reduce the overall adjustment inventory to 1 million by the end of FY 2024. In our discussions with IRS management, they indicated that the inventories of amended individual returns remained high because of high attrition and staffing shortages.

Amended business returns inventory continues to increase

The IRS noted that the inventory of amended business tax returns had been significantly impacted by a surge in claims for the Employee Retention Credit. The Employee Retention Credit is a refundable tax credit intended for businesses and tax-exempt organizations that continued to pay employees during the Pandemic if they were fully or partially suspended due to a government order, they experienced a significant decline in gross receipts, or they were a recovery startup business during the relevant eligibility periods. While the credit is available to eligible employers that paid qualified wages to some or all employees after March 12, 2020, and before January 1, 2022, eligible businesses that did not claim the credit when they filed their original employment tax return can claim the credit by filing amended employment tax returns.

As of October 21, 2023, the IRS stated that there were 870,170 Employee Retention Credit cases in inventory. This represents 59 percent of all business amended tax returns in inventory. In September 2023, the IRS Commissioner paused the processing of Employee Retention Credit claims due to widespread fears of false or fraudulent claims being filed. This will allow the IRS to focus on other adjustment inventory cases.[16] We are conducting a separate review of the IRS's processes for identifying potentially false or fraudulent claims for the Employee Retention Credit on original and amended employment tax returns.[17]

Accounts Management Inventories Remain Above Pre-Pandemic Levels

Similar to our monitoring of the backlogs of tax return processing and tax account work, we have continued our coverage of the backlogs in the Accounts Management function. In May 2023, we reported that the Accounts Management function established a goal to reduce the adjustments inventory, including amended individual and business tax returns, to 1 million or less by the end of CY 2022; however, similar goals were not set for other Accounts Management function inventories.[18] Although a limited amount of time has passed since we issued our report, the backlog of Accounts Management inventory continues to be a concern.

As of October 28, 2023, there were 4.3 million Accounts Management cases, excluding amended returns, awaiting processing compared to 4.4 million as of October 29, 2022. Although the inventory has decreased, the age of cases in inventory has increased from 2.1 million aged cases to 2.8 million aged cases. The Accounts Management function has various criteria for its aged

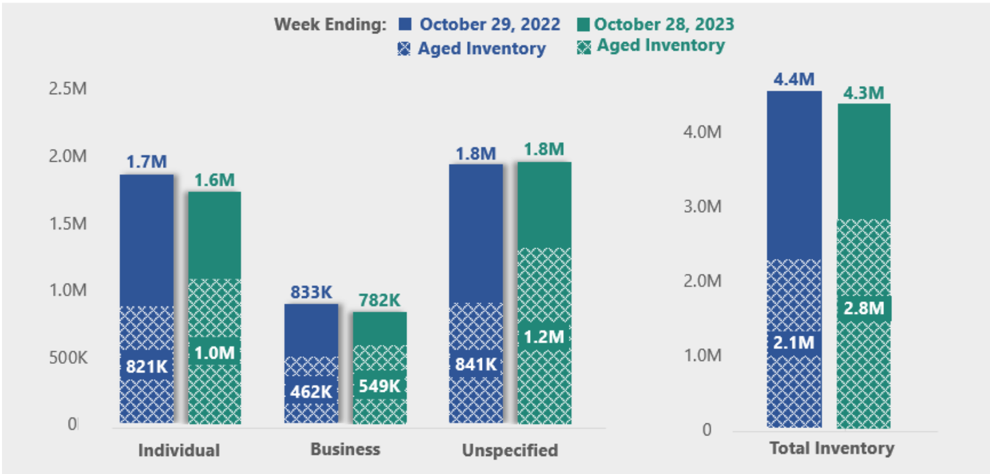
[16] This includes correspondence received from individual and business taxpayers, amended returns, and carryback claims.

[17] TIGTA, Audit No. 202340030, *Continued Review of Employee Retention Credit Claims - Follow-Up*.

[18] TIGTA, Report No. 2023-46-026, *Additional Actions Are Needed to Reduce Accounts Management Function Inventories to Below Pre-Pandemic Levels* (May 2023).

work, ranging from four to 180 days in inventory. Figure 6 shows a comparison of Accounts Management cases as of October 2022 to October 2023.

Figure 6: Comparison of Accounts Management Cases as of October 2022 to October 2023



Source: Accounts Management Inventory Report as of October 28, 2023, and October 29, 2022. The unspecified column contains both individual and business cases that are not identified separately on the IRS's inventory report. Totals may not add due to rounding.

IRS management disagreed with our prior recommendation to establish goals for each of the Accounts Management function's inventory types and develop a plan for addressing those goals to ensure a timely return to pre-Pandemic inventory levels. IRS management stated that limited resources and the numerous types of inventories do not allow for goals to be established for each of the inventory categories. Further, management indicated that the Accounts Management function is balancing its resources to deliver customer service goals, *e.g.*, for toll-free, while addressing paper inventories in a first-in, first-out order as opposed to reaching a set goal by inventory type.

When we discussed the current inventory and actions being taken to reduce it, IRS management noted that the Accounts Management function started its hiring for FY 2024 earlier than in the previous fiscal year. As of October 5, 2023, the Accounts Management function has onboarded 5,159 (97 percent) customer service representatives of the FY 2024 hiring goal of 5,315. In addition, the Accounts Management function lowered its Level of Service goals for answering calls during October through December 2023. Management indicated that this would allow more employees to focus on inventory closures. The Accounts Management function continues to have a goal to reduce the adjustments inventory to 1 million, including amended returns, by the end of FY 2024.

In March 2022, we estimated that the Accounts Management function could close all of the cases in its inventory as of October 1, 2021, in approximately seven months if all of its customer service representatives and tax examiners were dedicated to working this inventory.[19] We recommended and IRS management agreed to evaluate establishing two distinct IRS programs

[19] TIGTA, Report No. 2022-46-027, *Program and Organizational Changes Are Needed to Address the Continued Inadequate Tax Account Assistance Provided to Taxpayers* (Mar. 2022).

as part of its reorganization under the Taxpayer First Act – one dedicated to answering toll-free telephone calls, and one dedicated to working Accounts Management inventory – with adequate staffing to provide appropriate service to taxpayers using each channel.[20] On December 13, 2023, the IRS Commissioner announced a new organizational structure, including that there will be a new Chief, Taxpayer Service. The IRS Commissioner also indicated that this new leadership structure will give further insight on whether other organizational changes are needed in the future. With these changes, the IRS should reconsider establishing two distinct programs in the Accounts Management function as we previously recommended.

Overpayments Are Being Erroneously Held From Issuance to Some Taxpayers

During our assessment of the backlogs, we identified taxpayer concerns regarding delays in receiving refunds. Our review identified 121,449 Tax Year 2020 tax accounts with overpayments being held totaling $783.3 million as of May 25, 2023. We found that these issues were caused by programming changes.

Credit transcripts were incorrectly routed delaying taxpayer refunds

Our review identified 103,431 Tax Year 2020 tax accounts with overpayments being held totaling $736 million as of May 25, 2023. In these cases, an erroneous transcript was generated and incorrectly routed to the Return Integrity Verification Operations (RIVO) for resolution.[21] However, these tax accounts did not contain issues that needed to be resolved by RIVO. As a result, the IRS's resolution of the overpayments was delayed, and the overpayments were held from issuance to these taxpayers because the IRS did not have a referral process for transcripts generated to RIVO in error. This occurred because of a programming change that the IRS submitted in January 2020 to prevent the erroneous generation of transcripts to RIVO failed to implement fully, which resulted in the continued erroneous generation of these transcripts to RIVO instead of the Accounts Management function.

Overpayments are being erroneously held from issuance to some taxpayers whose account had an abatement of Failure to File penalty

On August 24, 2022, the IRS issued Notice 2022-36, *Penalty Relief for Certain Taxpayers Filing Returns for Taxable Years 2019 and 2020*, providing penalty relief to people and businesses who file certain 2019 or 2020 returns late. The Office of Servicewide Penalties implemented a programming change on August 25, 2022, to provide relief as detailed in the IRS notice, by abating applicable penalties assessed and refunding or crediting the taxpayers as appropriate without any need for taxpayers to submit a request.

Our review identified 18,018 Tax Year 2020 tax accounts with overpayments totaling $47.3 million that were being held from issuance as of May 25, 2023. These overpayments resulted from payments or credits to the tax accounts for which the IRS abated penalties. For example, the taxpayers paid the penalty, but the payments were not systemically released for refund to the taxpayer after the IRS abated the penalty.

[20] Pub. L. No. 116-25, 133 Stat. 981 (codified in scattered sections of 26 U.S.C.).

[21] RIVO identifies and intercepts refunds from returns with questionable wage and/or withholding claims, which may include identity theft-related issues.

Recommendation 1 (E-Mail Alert): On June 6, 2023, we notified the Director, Customer Account Services, Wage and Investment Division, of our concerns regarding the overpayments being erroneously held. We recommended that the IRS identify a process to review and release the overpayments that are being erroneously held. We also recommended that the IRS request programming changes, if needed, to ensure that all accounts with overpayments are identified and release the overpayments where warranted.

> **Management's Response to E-Mail Alert:** IRS management agreed with our assessment and stated that they noticed the programming error in CY 2023. The programming updates were implemented on July 28, 2023. However, the programming update did not resolve the issue.
>
> IRS management also agreed with our assessment that overpayments related to abated penalties for taxpayer relief were erroneously held from refunding. The issue was sent to the Information Technology organization, and it was able to release 11,712 of the 18,018 overpayments, through a systemic recovery in October 2023. For the remaining 6,306 overpayments, the IRS will develop a plan to manually review these accounts and take appropriate actions. Finally, the IRS indicated that they implemented programming updates to prevent the generation of transcripts that led to the erroneous hold on overpayments on January 8, 2024.

Recommendation 2: The Commissioner, Wage and Investment Division, should perform an analysis of Tax Year 2019 tax accounts with abated Failure to File penalties due to Notice 2022-36, to identify additional tax accounts for which overpayments are being held from issuance and take the actions needed to systemically release the overpayments where warranted.

> **Management's Response:** IRS management agreed with the recommendation and Tax Year 2019 accounts were included in the analysis and systemic recovery implemented in October 2023. As of October 25, 2023, the IRS indicated that they identified 101 affected accounts and the refunds were released.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the IRS's efforts to address backlogs of unworked inventories at its Tax Processing Centers during the 2023 Filing Season and the effect on taxpayers. To accomplish our objective, we:

- Assessed the IRS's efforts to address the backlogs of unworked inventories affecting both individual and business taxpayers.
- Assessed the IRS's progress to staff the Tax Processing Centers to meet workload demands and address backlogged inventories.
- Assessed and monitored current Accounts Management and amended return inventories to evaluate the IRS's efforts to address the backlogs of tax account and amended return inventories.

Performance of This Review

This review was performed at the Wage and Investment Division, Submission Processing function in Kansas City, Missouri; Austin, Texas; and Ogden, Utah, during the period January through December 2023. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major contributors to the report were Diana Tengesdal, Assistant Inspector General for Audit (Returns Processing and Account Services); Darryl Roth, Director; Jane Lee, Audit Manager; Brieane Hamaoka, Acting Audit Manager; Cally Sessions, Lead Auditor; Zachary Caraccilo, Auditor; and Branden Dreher, Auditor.

Data Validation Methodology

During this review, we obtained extracts from the Individual Master File for Tax Year 2020 and the National Account Profile for Processing Year 2023 that were available on the TIGTA Data Center Warehouse. Before relying on the data, we ensured that each file contained the specific data elements we requested. In addition, we selected random samples of each extract and verified that the data in the extracts were the same as the data captured in the Integrated Data Retrieval System. We also performed analysis to ensure the validity and reasonableness of our data, such as ranges of dollar values and obvious invalid values. Based on the results of our tests, we believe that the data used in our review were reliable.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: timely and accurately addressing the backlogs of tax returns and other correspondence, and assessing compliance with files and records at the Tax Processing Centers to prevent inadvertent disclosures of taxpayer information. We evaluated these controls by meeting with IRS management, reviewing IRS procedures, and reviewing IRS reports.

Appendix II

Outcome Measures

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

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 103,431 Tax Year 2020 tax accounts with overpayments totaling $736 million that were being held from these taxpayers as of May 25, 2023 (see Recommendation 1).

Methodology Used to Measure the Reported Benefit:

We obtained extracts from the Individual Master File for Tax Year 2020 as of May 25, 2023, and the National Account Profile for Processing Year 2023 as of March 30, 2023. Our computer analyses identified 103,431 Tax Year 2020 tax accounts with overpayments totaling $736,035,765 for which an erroneous transcript was generated and incorrectly routed to RIVO. However, the accounts did not contain issues that needed to be resolved by RIVO. As a result, IRS resolution was delayed, and the overpayments were held from issuance to these taxpayers because the IRS did not have a referral process for transcripts generated to RIVO in error.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; 11,712 Tax Year 2020 tax accounts with overpayments totaling $21.9 million that were erroneously held from issuance as of May 25, 2023 (see Recommendation 1).

Methodology Used to Measure the Reported Benefit:

We obtained extracts from the Individual Master File for Tax Year 2020 as of May 25, 2023, and the National Account Profile for Processing Year 2023 as of March 30, 2023. Our computer analyses identified 18,018 Tax Year 2020 tax accounts with overpayments that were being erroneously held from issuance as of May 25, 2023. These tax accounts had Failure to File penalties that were assessed and subsequently abated due to relief provided for Notice 2022-36. The issue was sent to the Information Technology organization, and it was able to release 11,712 overpayments totaling $21,896,185 through a systemic recovery in October 2023.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 6,306 Tax Year 2020 tax accounts with overpayments totaling $25.4 million that were being erroneously held from issuance as of May 25, 2023 (see Recommendation 1).

Methodology Used to Measure the Reported Benefit:

We obtained extracts from the Individual Master File for Tax Year 2020 as of May 25, 2023, and the National Account Profile for Processing Year 2023 as of March 30, 2023. Our computer analyses identified 18,018 Tax Year 2020 tax accounts with overpayments that were being erroneously held from issuance as of May 25, 2023. These tax accounts had Failure to File penalties that were assessed and subsequently abated due to relief provided for Notice 2022-36. Of these, the Information Technology organization was able to release 11,712 overpayments through a systemic recovery in October 2023. For the remaining overpayments, the IRS did not systemically release the overpayments totaling $25,411,028 to 6,306 taxpayers. The IRS is in the process of developing a plan to manually review these accounts.

Appendix III

List of TIGTA Reports Related to the Backlogs for Calendar Years 2021 Through 2023

TIGTA has issued six reports regarding the IRS's efforts to address the backlogs of its unworked inventories at its Tax Processing Centers and overaged Accounts Management inventories.

- TIGTA, Report No. 2021-46-023, *Results of the 2020 Filing Season and Effects of COVID-19 on Tax Processing Operations* (Mar. 2021).
- TIGTA, Report No. 2021-46-064, *Efforts of the COVID-19 Pandemic on Business Tax Return Processing Operations* (Sept. 2021).
- TIGTA, Report No. 2022-46-027, *Program and Organizational Changes Are Needed to Address the Continued Inadequate Tax Account Assistance Provided to Taxpayers* (Mar. 2022).
- TIGTA, Report No. 2022-46-057, *Delays in Management Actions Contribute to the Continued Tax Processing Center Backlogs* (Sept. 2022).
- TIGTA, Report No. 2023-46-007, *Backlogs of Tax Returns and Other Account Work Will Continue Into the 2023 Filing Season* (Dec. 2022).
- TIGTA, Report No. 2023-46-026, *Additional Actions Are Needed to Reduce Accounts Management Function Inventories to Below Pre-Pandemic Levels* (May 2023).

Appendix IV

Management's Response to the Draft Report

COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

February 28, 2024

MEMORANDUM FOR MATTHEW A. WEIR
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kenneth C. Corbin Digitally signed by Kenneth C. Corbin Date: 2024.02.28 10:54:00 -05'00'
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The IRS Continues to Reduce Backlog Inventories in the Tax Processing Centers (Audit # 202340610)

Thank you for the opportunity to review and provide comments on the subject draft report. We appreciate the acknowledgement of actions taken by the IRS in response to the unprecedented impact of the COVID-19 pandemic and its continued effect on our inventories of tax returns, other tax documents, and taxpayer correspondence. Since mid-2020, when our facilities reopened, we faced and addressed significant obstacles to processing these inventories by equipping our employees to perform their duties remotely. We also hired additional employees to address the accumulated inventories. Initiatives were launched to modernize workstreams that permit both the electronic submission of documents by taxpayers and for that work to be processed electronically. This allows submissions to go into inventory immediately and lets us maintain one inventory, workable in a first-in, first-out order, that is accessible by all employees working the respective programs, regardless of their physical location.

Our modernization efforts are continuing during 2024. We are scanning and converting paper tax returns to electronic format, building on the 1.5 million returns that were scanned in 2023. The digitalization efforts also include amended returns, a manually intensive program. We continue to modernize amended return processing by working with industry partners to develop programming requirements and standards that will more fully automate the process.

Innovative tools like FixERS, which automate the resolution of error conditions on returns that prevent them from processing through to completion and would otherwise require review and action by an employee, were developed and placed into service to expedite the processing of returns where the error condition can be corrected without manual review. This reduces overall inventory and permits employees to focus on more complex issues.

The 2023 filing season began as our operations continued recovering from the impact of the COVID-19 pandemic. We eliminated the backlog of returns awaiting processing by the end of January 2023, and we are encouraged to be starting the 2024 filing season with traditional, pre-pandemic levels of inventory in the return processing operations. We fully anticipate resolving aged inventories, such as unpostable transactions and taxpayer correspondence, during 2024.

Our responses to your specific recommendations are enclosed. If you have any questions, please contact me, or a member of your staff may contact, Dietra D. Grant, Director, Customer Account Services, at 470-639-3504.

Attachment

Attachment

Recommendations

RECOMMENDATION 1(E-Mail Alert)
On June 6, 2023, we notified the Director, Customer Account Services, Wage and Investment Division, of our concerns regarding the overpayments being erroneously held. We recommended that the IRS identify a process to review and release the overpayments that are being erroneously held. We also recommended that the IRS request programming changes, if needed, to ensure that all accounts with overpayments are identified and release the overpayments where warranted.

CORRECTIVE ACTION
We agree. Information Technology performed a systemic recovery in October 2023 and released 11,712 of the 18,018 identified overpayments. We will develop a plan to manually review and take appropriate actions for the remaining 6,306 accounts. On January 8, 2024, we implemented programming updates to prevent the generation of transcripts that led to the erroneous hold on overpayments.

IMPLEMENTATION DATE
August 15, 2024

RESPONSIBLE OFFICIAL
Director, Accounts Management, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2
The Commissioner, Wage and Investment Division, should perform an analysis of Tax Year 2019 tax accounts with abated Failure to File penalties due to Notice 2022-36, to identify additional tax accounts for which overpayments are being held from issuance and take the actions needed to systemically release the overpayments where warranted.

CORRECTIVE ACTION
We agree. Tax Year 2019 accounts were included in the analysis and systemic recovery implemented in October 2023. As of October 25, 2023, we identified 101 affected accounts and the refunds were released.

IMPLEMENTATION DATE
Implemented

2

RESPONSIBLE OFFICIAL
Director, Accounts Management, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

Appendix V

Glossary of Terms

Term	Definition
Accounts Management Function	An IRS function where employees handle taxpayer contacts by answering tax law/account inquiries and adjusting tax accounts. In addition, the function is responsible for providing taxpayers with information on the status of their returns/refunds and for resolving the majority of issues and questions to settle their accounts.
Campus Support Site	IRS locations that handle incoming and outgoing mail operations where Tax Processing Centers have closed. Campus Support Sites are located in Fresno, California; Chamblee, Georgia; Florence, Kentucky; Andover, Massachusetts; Holtsville, New York; Philadelphia, Pennsylvania; and Memphis, Tennessee.
Direct Hire Authority	Provides agencies the ability to hire individuals into permanent and nonpermanent positions more efficiently during a severe shortage of candidates or during a critical hiring need.
Document Locator Number	A 14-digit number assigned to each return or payment received, consisting of a file location code, tax class, document code, Julian date, blocking series, serial number, and tax year.
Error Resolution Cases	Tax returns identified with an error condition are suspended from processing and sent to the Error Resolution function for correction by a tax examiner.
Error Resolution System	An online computer application used by tax examiners to correct errors identified on individual or business tax returns during processing.
Filing Season	The period from January through mid-April when most individual income tax returns are filed.
Rejects	Individual or business tax returns that cannot be processed, usually due to missing or incorrect information. Tax examiners correspond with the taxpayer to clarify an entry on a return. When the taxpayer responds, the tax examiner will resolve the issue and the return will continue processing.
Service Center Recognition/Image Processing System	A data capture, management, and storage system that uses high-speed scanning and digital imaging technology to process tax documents.
Submission Processing Function	The data processing arm of the IRS. The sites process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Suspended Returns	Tax returns suspended from normal processing due to any number of issues, *e.g.*, correspondence with the taxpayer to obtain missing information or attachments, the return needs review by another function, or the return needs more research to be processed.

Term	Definition
Tax Processing Center	The location where the IRS processes paper and electronic submissions, corrects errors, and forwards data to the Computing Centers for analysis and posting to taxpayer accounts.
Taxpayer Assistance Center	Local offices nationwide staffed by IRS employees who are trained to provide a variety of services including answering tax account questions, taking cash payments, and authenticating the identity of individuals who have been identified as potential victims of tax-related identity theft.
Unpostable Cases	Transactions that will not post to the taxpayer's account because they failed validity checks. The unpostable condition must be resolved to complete processing of the transaction.

Appendix VI

Abbreviations

CY	Calendar Year
FY	Fiscal Year
IRS	Internal Revenue Service
PY	Processing Year
RIVO	Return Integrity and Verification Operations
TIGTA	Treasury Inspector General for Tax Administration

To report fraud, waste, or abuse,
contact our hotline on the web at www.tigta.gov or via e-mail at oi.govreports@tigta.treas.gov.

To make suggestions to improve IRS policies, processes, or systems affecting taxpayers, contact us at www.tigta.gov/form/suggestions.

Information you provide is confidential, and you may remain anonymous.