TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Actions Need to Be Taken to Ensure Compliance With Prisoner Reporting Requirements and Improve Identification of Prisoner Returns

July 20, 2017

Reference Number: 2017-40-041

ACTIONS NEED TO BE TAKEN TO ENSURE COMPLIANCE WITH PRISONER REPORTING REQUIREMENTS AND IMPROVE IDENTIFICATION OF PRISONER RETURNS

Highlights

Final Report issued on July 20, 2017

Highlights of Reference Number: 2017-40-041 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Refund fraud associated with prisoner Social Security Numbers (SSN) remains a significant problem for tax administration. The IRS identified more than 24,000 fraudulent tax returns using a prisoner SSN in Calendar Year 2015. The refunds claimed on those tax returns totaled more than $1.3 billion.

WHY TIGTA DID THE AUDIT

This audit was initiated because prior TIGTA reports identified concerns with the IRS's efforts to identify and prevent prisoner tax fraud. The overall objective was to evaluate the effectiveness of the IRS's corrective actions to identify and reduce prisoner fraud.

WHAT TIGTA FOUND

IRS processes do not effectively ensure that the Federal Bureau of Prisons and the State Departments of Corrections comply with prisoner reporting requirements. TIGTA identified 861 prisons that reported to the Social Security Administration but did not report to the IRS. TIGTA also identified 272,931 prisoners who were in Federal Bureau of Prisons or State Departments of Corrections who were not reported to the IRS. Approximately $48 million in potentially fraudulent refunds were claimed by 16,742 individuals incarcerated in institutions that did not report to the IRS.

In addition, the process to validate and use prisoner data limits the IRS's ability to detect potentially fraudulent tax returns. For example, the IRS does not use prisoner records where the information provided by the reporting institutions for a prisoner is not valid to process tax returns. As such, any return filed using the mismatched prisoner information will not be evaluated for potential prisoner fraud. TIGTA identified 1,075 tax returns filed using mismatched prisoner information in which the reported income was not supported by third-party income documents. These 1,075 individuals received refunds totaling more than $3.1 million. In addition, the validation process incorrectly identified prisoner records as having a mismatch when the information matched IRS records. TIGTA identified 1,113 tax returns with refunds totaling more than $1.7 million that were not identified as prisoner tax returns as a result of this error.

Finally, some prisoner tax returns were not screened and verified for fraud. TIGTA identified 4,072 prisoner tax returns that reported income and withholding that were not supported by third-party income documents. These filers received potentially fraudulent refunds totaling more than $7.3 million.

WHAT TIGTA RECOMMENDED

TIGTA made eight recommendations to the IRS that included developing a master list of prison institutions nationwide for use in verifying prison institutions' compliance with reporting requirements and evaluating the inclusion of valid SSNs associated with records in the Prisoner Mismatch File for use in identifying prisoner tax returns. TIGTA also recommended the IRS coordinate with the Department of Treasury's Office of Tax Policy to consider a legislative proposal to allow the IRS to provide mismatch records to the prisons to resolve. Finally, TIGTA recommended the IRS include identity theft tax returns it identifies as filed using a prisoner SSN in its annual report to Congress and clearly define a prisoner for the purposes of fraud criteria as well as for the annual report.

The IRS agreed to five of the recommendations. It did not agree to pursue a legislative proposal to share mismatch records with prisons, include criminal investigation results in its annual report to Congress, and evaluate the effect of limiting verification to full-year prisoners.

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

July 20, 2017

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
              Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Actions Need to Be Taken to Ensure Compliance
              With Prisoner Reporting Requirements and Improve Identification of
              Prisoner Returns (Audit # 201640007)

This report presents the results of our review to evaluate the effectiveness of the Internal
Revenue Service's corrective actions to identify and reduce prisoner fraud. This audit was
included in our Fiscal Year 2016 Annual Audit Plan and addresses the major management
challenge of Fraudulent Claims and Improper Payments.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are being sent to the Internal Revenue Service managers affected by the
report recommendations. If you have any questions, please contact me or Russell P. Martin,
Assistant Inspector General for Audit (Returns Processing and Account Services).

Actions Need to Be Taken to Ensure Compliance With Prisoner Reporting Requirements and Improve Identification of Prisoner Returns

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Abbreviations

EFDS	Electronic Fraud Detection System
IRS	Internal Revenue Service
MOU	Memorandum of Understanding
PUPS	Prisoner Update Processing System
RRP	Return Review Program
SSA	Social Security Administration
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration

Background

Tax refund fraud associated with prisoners continues to remain a significant problem for tax administration. Figure 1 shows the number of fraudulent tax returns filed using a prisoner Social Security Number (SSN) that were identified by the Internal Revenue Service (IRS) in Calendar Years 2013 through 2015.

Figure 1: Fraudulent Tax Returns Filed Using a Prisoner SSN for Calendar Years 2013 Through 2015

Calendar Year	Fraudulent Tax Returns	Refunds Claimed (Millions)	Refunds Prevented (Millions)	Refunds Issued (Millions)
2013	71,561	$1,302	$1,282	$20
2014	55,753	$1,807	$1,803	$4
2015	24,258	$1,325	$1,324	$1

Source: IRS Criminal Investigation and IRS Wage and Investment Division.

Key legislation enacted in an effort to address fraud perpetrated by prisoners

- ***The Inmate Tax Fraud Prevention Act of 2008***[1] - signed October 15, 2008, requires the Secretary of the Treasury to provide an annual report to Congress on the filing of false or fraudulent tax returns by Federal and State prisoners. The most recent report, issued on September 7, 2016, reports on returns filed for Calendar Year 2015.

- ***The United States–Korea Free Trade Agreement Implementation Act***[2] - signed October 21, 2011, requires the Federal Bureau of Prisons and State Departments of Corrections to provide the IRS with an electronic list of all the prisoners incarcerated within their prison system for any part of the prior two calendar years or the current calendar year through August 31. The Federal Bureau of Prisons and the States are required to provide the list of prisoners to the IRS no later than September 15th each year.

  The IRS compiles a list of prisoners (the Prisoner File) received from the Federal Bureau of Prisons and State Departments of Corrections. The Prisoner File is the cornerstone of

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[1] Pub. L. No. 110-428, 122 Stat. 4839.
[2] Pub. L. No. 112-41, § 502.

the IRS's efforts to identify and prevent the issuance of fraudulent refunds to individuals filing false tax returns using a prisoner SSN, hereafter referred to as a prisoner tax return.

- ***The American Taxpayer Relief Act of 2012***[3] **-** enacted in January 2013, expanded the Secretary of the Treasury's authority to share false prisoner tax return information with Federal and State prisons and gave the IRS permanent authority to share such information.

- ***The Bipartisan Budget Act of 2013***[4] - enacted in December 2013, amended the Improper Payments Elimination and Recovery and Improvement Act[5] to give the Secretary of the Treasury the legal authority to obtain Prisoner Update Processing System (PUPS)[6] data from the Social Security Administration (SSA) and make it available for those programs in which prisoners are ineligible for benefits. The Act authorizes the IRS to compare the SSA prisoner information with any other Personally Identifiable Information derived from a Federal system of records. The Act further provides the IRS with the authority to provide information to the head of the Federal Bureau of Prisons and State Departments of Corrections regarding inmates whom the IRS has determined either may have been issued an improper payment or somehow facilitated the payment. The Congressional Budget Office estimated that giving the IRS the authority to use the PUPS data will help recover improper payments and save $242 million over the next 10 years, including $162 million in increased revenues attributable to preventing the payment of improper tax refunds.

The IRS first received the PUPS data in October 2015. However, the IRS was unable to use the data in its fraud detection processes for the 2016 Filing Season[7] because the data did not contain prisoners' incarceration release dates. The IRS needs the release date to determine whether the individual was incarcerated during the tax year of the tax return. The IRS worked with the SSA to have the release dates added to the PUPS data and began receiving the updated PUPS data in August 2016. The IRS will receive the PUPS data on a recurring basis and plans to use the data to supplement its current Prisoner File for use in fraud detection.

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[3] Pub. L. No. 112-240, 126 Stat. 2313.
[4] Pub. L. No. 113-67, § 204.
[5] Pub. L. No. 112-248, 126 Stat. 2390.
[6] The SSA has the authority to provide incentives to institutions who provide prisoner information. The SSA pays institutions for each individual identified in the information provided by the institution whose Social Security or Supplemental Social Security Income is suspended because the individual is incarcerated.
[7] The period from January through mid-April when most individual income tax returns are filed.

The Return Review Program (RRP) replaces the Electronic Fraud Detection System (EFDS)[8] in identifying prisoner tax returns

The IRS has developed multiple processes in an effort to prevent the issuance of fraudulent refunds associated with prisoner tax returns including the use of EFDS filters, RRP[9] filters, and partnering with prison institutions.

EFDS prisoner tax return identification

The EFDS was the primary system used by the IRS to identify prisoner tax returns through the 2016 Filing Season. Tax returns were processed through the EFDS, whereby the primary and secondary SSNs listed on the tax return are matched to the Prisoner File to determine if the tax return is filed using a prisoner SSN. If the SSN on the tax return matches a prisoner on the Prisoner File, the EFDS would assign a prisoner indicator to the tax return. The IRS determined that numerous inefficiencies and operational challenges render the EFDS too risky to maintain, upgrade, or operate long term. As such, the IRS replaced the EFDS fraud detection processes with the RRP prisoner fraud processes at the end of Calendar Year 2016.

RRP prisoner tax return identification

The IRS launched a pilot test of the RRP in April 2014 to assess its effectiveness in identifying potential identity theft returns. As part of this RRP identity theft pilot, the IRS would assign a prisoner indicator if the RRP identified a prisoner tax return as involving potential identity theft. For Filing Season 2016, the IRS expanded the use of the RRP to include detection of first-person, non-identity theft fraud, such as income and withholding anomaly detection. The IRS retired the EFDS fraud detection processes on October 23, 2016.

Beginning with the 2017 Filing Season, the RRP is now the IRS's sole source for detecting potentially fraudulent prisoner tax returns. Tax returns with a prisoner indicator that meet specific criteria are sent for further evaluation to determine if the tax return is fraudulent. This evaluation includes an IRS tax examiner screening and verifying the wage and withholding information reported on the tax return. For example, in the screening process, a tax examiner reviews the tax return income and withholding information. If the tax examiner concludes that the tax return is potentially fraudulent, it is then sent for verification. In the verification process, a tax examiner attempts to contact the employer(s) to confirm the reported income and withholding. If the tax examiner is unable to verify the income and withholding with the employer, the refund is frozen to prevent issuance.

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[8] The EFDS consists of a series of filters the IRS designed to evaluate tax returns for potential fraud. It was the primary system the IRS used to identify tax returns filed using prisoner SSNs.
[9] An automated system used to enhance the IRS's capabilities to detect, resolve, and prevent criminal and civil noncompliance and identity theft, thereby reducing issuance of fraudulent tax refunds.

The IRS states that the RRP provides new and improved capabilities in its fraud detection and prevention processes. The RRP has real-time filtering capabilities and is designed to improve the IRS's ability to detect, resolve, and prevent fraud. For example, IRS management indicated that unlike the EFDS, the RRP has the capability to look over multiple prior years to see if an SSN listed on a tax return was associated with an individual incarcerated in the prior tax year or at some point in prior years, *i.e.*, the RRP has prisoner files loaded since Processing Year [10]2013.

The Blue Bag Program is a partnership with prison institutions

The Blue Bag Program is intended to identify potential tax-related fraud through State and Federal prison officials monitoring of prisoner communications, *i.e.*, tax returns and tax-related correspondence. When prison officials identify potential fraud, they forward the questionable tax returns or tax-related correspondence to the IRS for further review. For example, identified tax returns are routed to the IRS's Integrity and Verification Operation "funny box"[11] for screening and processing. Whereas, checks are routed to the Integrity and Verification Operation third-party check program. Depending on the outcome of the IRS's review of the check, it is either sent back to the inmate as good or kept by the IRS. All other correspondence received is sorted and sent to the appropriate areas within the IRS to be worked as normal correspondence.

IRS management indicated that there are currently 1,187 prisons that participate nationwide in its Blue Bag Program. The IRS reports that it received 984 pieces of correspondence in Fiscal Year[12] 2016 as a result of its Blue Bag Program.

A Treasury Inspector General for Tax Administration (TIGTA) report identified continual delays in completing agreements to share information with prisons, and reports to Congress were not timely or complete

TIGTA has issued three reports on the IRS's efforts to combat prisoner fraud since Congress enacted the Inmate Tax Fraud Prevention Act of 2008. Most recently, in September 2014,[13] we reported that the IRS has not:

- Shared fraudulent prisoner tax return information with the Federal Bureau of Prisons or State Departments of Corrections. We recommended that the IRS ensure that Memorandums of Understanding (MOU) for the sharing of prisoner tax return information be timely established with the Federal Bureau of Prisons and all State Departments of Corrections. The IRS agreed with our recommendation.

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[10] The calendar year in which the tax return or document is processed by the IRS.

[11] Paper tax returns that appear suspicious to IRS employees during the processing of the return.

[12] Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

[13] TIGTA, Ref. No. 2014-40-091, *Prisoner Tax Refund Fraud: Delays Continue in Completing Agreements to Share Information With Prisons, and Reports to Congress Are Not Timely or Complete* (Sept. 2014).

- Timely issued the required annual reports to Congress. In addition, the reports did not address the extent to which prisoners may be filing fraudulent tax returns using a different individual's SSN. We recommended that the IRS ensure that the required annual report on prisoner fraud is issued to Congress timely, and that processes are developed to identify tax returns filed that have the same characteristics of confirmed fraudulent prisoner tax returns and determine whether these tax returns should be included in the annual report to Congress. IRS management disagreed with our recommendation to identify other tax returns that have the same characteristics as confirmed fraudulent prisoner tax returns.

- Established processes to ensure that all prisoner tax returns are assigned a prisoner indicator. We recommended that the IRS correct a computer programming error that resulted in it not assigning a prisoner indicator to 3,139 tax returns we identified. The IRS disagreed with our recommendation.

Figure 2 details recommendations and actions taken to date to address the recommendations we made in our two earlier reports.[14]

Figure 2: Prior TIGTA Audit Recommendations and Actions Taken by the IRS to Address Recommendations

TIGTA Report	Recommendation	Actions Taken to Date
2011-40-009 Dec. 2010[15]	Ensure that all tax returns filed using a prisoner SSN are processed through the EFDS and receive a prisoner indicator.	Improvements were made to identify those individuals who are incarcerated, but no changes were made to the process to assign the prisoner indicator.
	Revise prisoner filters to verify the validity of the wages and withholding associated with prisoners incarcerated for a year who filed tax returns claiming a refund.	Filters are in place to verify the validity of wages and withholding associated with tax returns filed using a prisoner SSN. In addition, the IRS improved its processes for identifying individuals incarcerated for a full tax year.
	Develop a process to assess the reliability of data received from Federal and State prisons and communicate with prison facilities that provide missing or inaccurate information in an attempt to obtain corrected information.	The IRS identified structural or formatting errors and duplicated records in the 2012 Prisoner File. The IRS worked with the correctional systems to resolve the errors when possible.

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[14] We did not include recommendations addressed by the passage of legislation as we detail the specific legislative provisions earlier in our background section.

[15] TIGTA, Ref. No. 2011-40-009, *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (Dec. 2010).

TIGTA Report	Recommendation	Actions Taken to Date
2013-40-011 Dec. 2012[16]	Ensure that the validation and verification of future IRS Prisoner Files include a check for a prisoner using a deceased individual's identity information and a comparison of the Institution and Prisoner Files to ensure that all facilities that house prisoners reported them.	The IRS implemented processes to identify prisoner SSNs with a Date of Death. ***2*** *********************2****************************. *********************2*************************** *********************2*************************** *********************2***************************** Processes were also implemented in Calendar Year 2014 to ensure that prisons were reporting required prisoner information to the IRS.

Source: TIGTA analysis of actions taken in response to prior audit reports.

This review was a follow-up of the IRS's efforts to address conditions identified in TIGTA's September 2014 report. Our review was performed with information obtained from the IRS Wage and Investment Division Headquarters Return Integrity and Compliance Services function in Atlanta, Georgia, and the IRS Information Technology Applications Development function in New Carrollton, Maryland, during the period February through December 2016. 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. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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[16] TIGTA, Ref. No. 2013-40-011, *Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete* (Dec. 2012).

Results of Review

Processes Do Not Effectively Ensure That Federal and State Prisons Comply With Prisoner Reporting Requirements

Despite legislation requiring Federal Bureau of Prisons and State Departments of Corrections reporting of prisoners to the IRS each year since Calendar Year[17] 2012, no process has been established to ensure compliance with the requirement. Legislation requires the Federal Bureau of Prisons and State Departments of Corrections to annually provide the IRS, in an electronic format, a list of prisoners incarcerated within their prison system beginning September 2012. The list is to include all prisoners incarcerated within their prison system for any part of the two calendar years or the calendar year through August 31 of each year.

In December 2012, in response to a TIGTA recommendation, the IRS implemented procedures in an effort to ensure that prisons were reporting required prisoner information to the IRS. The IRS's procedures include sending letters to the contact person for the Federal Bureau of Prisons and each State Department of Corrections and ensuring that electronic files are received from the Federal Bureau of Prisons and each State Department of Corrections. If an agency does not timely report data, the IRS reminds the agency of its legal requirement. The IRS also compares year-to-year data of institutions within each Department of Corrections.

A match of prisons reporting to the SSA and reporting to the IRS shows differences in prison reporting

The procedures the IRS established in response to a prior TIGTA recommendation do not ensure that the Federal Bureau of Prisons and the State Departments of Corrections are reporting prisoners from all of the institutions within their jurisdiction. For example, the most basic verification process would include the compilation of a master list of prisons required to report. The list would then be used to monitor and identify prisons not reporting. The IRS has no such list.

Our comparison of the PUPS file as of September 2015 to the IRS's Processing Year 2015 Prisoner File identified prisons that reported to the SSA that did not report to the IRS. For example, we identified more than 4 million prisoners listed in the PUPS data who were not listed in the IRS Prisoner File. These prisoners are associated with 5,720 institutions that did not report prisoners to the IRS in Calendar Year 2015. It should be noted that a total of 4,859 of these

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[17] The 12-consecutive-month period ending on December 31.

institutions are city or county institutions that are not currently required to submit prisoner information to the IRS.[18] However, the remaining 861 institutions were required to report information to the IRS. These institutions included both the Federal Bureau of Prisons and State Departments of Corrections facilities and included 272,931 prisoners.

Our analysis of the more than 4 million prisoner records reported to SSA but not in the IRS Prisoner File identified 16,742 tax returns were filed using the SSN of one of the 4 million prisoners. Each of these tax returns reported income and withholding that was not supported by a third-party income document such as Form W-2, *Wage and Tax Statement*, or Form 1099-MISC, *Miscellaneous Income*. These individuals received potentially fraudulent refunds totaling more than $48 million. We provided the 16,742 potentially fraudulent returns to the IRS for its review. IRS management stated that 3,474 were detected as potentially fraudulent by other fraud filters for review. The IRS indicated that 2,098 (60.4 percent) of the 3,474 reviewed were confirmed as fraudulent, and 1,376 (39.6 percent) were determined to not be fraudulent and were reviewed for potential identity theft. For the remaining 13,268, the IRS did not identify the return as a prisoner return and, as such, these returns were not subjected to additional review to assess potential fraud associated with approximately $41.6 million in refunds issued.

The IRS Return Integrity and Compliance Services, Business Performance Lab performed an independent analysis of the institutions that we identified in the PUPS data for which the IRS did not receive information. The IRS noted that many of the institutions that did not report in the 2015 Prisoner File in fact reported prisoner data to the IRS for Processing Year 2016. However, IRS management did state that they are using the PUPS data as part of the 2017 Filing Season prisoner identification process. Management noted that they are conducting analysis to compare the Processing Year 2017 IRS Prisoner File with the most recent PUPS data received February 2017. The IRS's goal is to assess whether the PUPS data have the capability to supplement the IRS's own data collection and potentially replace it in the future.

Recommendation

Recommendation 1: The Commissioner, Wage and Investment Division, should develop a master list of prison institutions nationwide for use in verifying Federal Bureau of Prisons and State Departments of Corrections compliance with legislative reporting requirements.

> **Management's Response:** The IRS agreed with this recommendation. IRS management is compiling a list of all State and Federal correctional institutions that will be used as a checklist when evaluating compliance with legislated reporting requirements.

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[18] Although these city or county institutions were not provided to the IRS, using the PUPS file provides further ways to identify potential fraudulent tax returns filed by prisoners.

*****2****** Prisoner Tax Returns Were Not Identified During the Annual Fraud Detection Maintenance Period

Our review of Processing Year 2015 tax returns identified 52,687 **2** tax returns with refunds totaling more than $151 million that were not screened through IRS fraud detection filters during processing. These tax returns were processed during the EFDS and the RRP annual maintenance period. The annual maintenance period is when the IRS shuts down the EFDS and the RRP from approximately *********2************** each year to perform system changes and updates for the upcoming filing season. It should be noted that, during the annual maintenance period, the IRS ***************************************2*************************************** ***********************************2****************************. However, the IRS ***********2*****************. Our review identified that, of the 52,687 **2** returns, 226 were prisoner tax returns with refunds totaling $303,142.[19] Because these 226 tax returns were not screened through fraud detection filters, the tax returns were not identified as a prisoner tax return for additional review.

We provided the IRS with the results of our analysis on August 18, 2016. IRS management agreed with our assessment but noted that the Dependent Database system[20] was still operational for identity theft detection, and the Automated Questionable Credit program[21] was operational. In addition, IRS employees processing **2** returns can set suspicious returns aside for further analysis. However, in response to our concerns, IRS management stated that they have developed filters within the Dependent Database to identify **2** tax returns filed ***2***** for additional review when there is a discrepancy between the reported income and third-party documents. IRS management stated that they are still evaluating the filters to ensure that they are performing as intended.

The Process to Validate and Use Prisoner Data Limits the Ability to Detect Potentially Fraudulent Prisoner Tax Returns

Before adding the prisoner data that the IRS receives to its Prisoner File, the IRS assesses the validity of the *************2********** provided by the reporting institution for each prisoner. The IRS only includes those prisoner records in its Prisoner File for which the **2*** ********2************** match the IRS records. Records that do not match are added to a Prisoner Mismatch File. As a result, any tax return filed using an SSN on the Prisoner Mismatch File will not be identified as a prisoner return for assignment of a prisoner indicator or evaluated using the prisoner fraud filters. The Processing Year 2015 Prisoner Mismatch File contains more

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[19] We used the date the return was received by the IRS in our analysis.
[20]***2*************************************** ******************2*************.
[21]***2*************************************** ****************2**********.

than 1.1 million records. It should be noted that existing legislation does not allow the IRS to share these mismatches with the transmitting prison.

Our match of the 1.1 million SSNs in the IRS's 2015 Prisoner Mismatch File identified:

- 471,864 (41 percent) of the 1.1 million records contained a valid SSN, *i.e.*, SSN was issued by SSA, in IRS files. It should be noted that for these 471,864 SSNs, the SSN was **********2****************************. These could be indicative of a prisoner's use of a stolen SSN.

- 233,724 (50 percent) of the 471,864 SSNs were used as either the primary taxpayer or the spouse on a tax return filed during Processing Year 2015. As we previously noted, a ***********************2***************** was used on these returns. Further analysis of the 233,724 tax returns identified 1,075 returns on which the reported income was not supported by third-party income documents. These 1,075 taxpayers received refunds which totaled more than $3.1 million. We provided the 1,075 returns to IRS management for review. As of February 9, 2017, the IRS has reviewed 220 of the 1,075 returns and confirmed 129 returns (58.6 percent) with refunds totaling $188,523 as fraudulent. The IRS determined that 88 (40 percent) of the 220 were not fraudulent. The IRS is still making a fraud determination on 3 (1.4 percent) returns. The IRS did not screen the remaining 855 returns we identified or verify the income to determine if the return was potentially fraudulent.

IRS management stated that, while the IRS is committed to fully leveraging the prisoner information received from the Federal Bureau of Prisons and State Departments of Corrections, it is not certain at this time whether this effort would benefit from using the Prisoner Mismatch File. Management noted that some of the returns with an *******************2******* ****2******, although not identified as a prisoner-filed tax return, were identified via the IRS's other fraud filters for review.

*The validation process incorrectly identified prisoner records as not having a ********2********************

Our further analysis of the 1.1 million records included in the 2015 Prisoner Mismatch File identified 4,158 records in which the IRS incorrectly concluded that the ******2******** **2**** provided by the Federal Bureau of Prisons and State Departments of Corrections did not match IRS records. As a result, any tax return filed using one or more of these SSNs will not be assigned a prisoner indicator or evaluated using the prisoner fraud filters.

According to IRS management, **************2**************** in the prisoner data resulted in an incorrect match to the National Account Profile.[22] A total of 1,113 returns were

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[22] The National Account Profile is a compilation of selected entity data from various Master Files. It includes all valid and invalid individual taxpayer entity information for all taxpayers on the Individual Master File.

filed with refunds totaling more than $1.7 million that were not identified as a prisoner tax return as a result of the 4,158 records being incorrectly identified as having a mismatch. IRS management indicated that programming changes were made in November 2016 to eliminate special characters and spaces in the names provided in the prisoner data before matching the data to the National Account Profile to determine validity.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 2: Evaluate the inclusion of valid SSNs associated with records in the Prisoner Mismatch File for use in identifying prisoner tax returns to assign an indicator and evaluate for fraud potential.

> **Management's Response:** The IRS agreed with this recommendation. The IRS implemented corrections to programming that affected the 2017 Prisoner File and resolved the record mismatches caused by the presence of special characters and spaces in record fields in November 2016. The IRS also modified its statistical analysis software to compensate for the special characters and spaces within the fields, resulting in more valid matches to the National Account Profile database. This has reduced the volume of mismatched records; however, the IRS does not intend to assign a prisoner code to records that remain in the Prisoner Mismatch File. Although these remaining records would not be coded as potential prisoner accounts, it is important to note that returns filed using any SSN on the Prisoner Mismatch File go through the same rigorous data mining, scoring, and evaluation that is performed on all other returns by the IRS's fraud detection systems.

Legislative Recommendation

Recommendation 3: In coordination with the Department of Treasury's Office of Tax Policy, consider a legislative proposal to allow the IRS to provide mismatch records to the Federal Bureau of Prisons and State Departments of Corrections in an effort to resolve the mismatch in future submissions.

> **Management's Response:** The IRS disagreed with this recommendation. The IRS responded that it has concluded, from discussions with correctional institutions, that providing mismatch records to the prisons will not ensure the accuracy of their prisoner file submissions in subsequent years. The IRS believes that receiving prisoner data directly from the SSA will mitigate errors associated with mismatches. Incorporating the SSA data into its annual construction of the Prisoner File is an action the IRS is taking now and will provide immediate benefits, whereas requesting a legislative change for a process it does not believe would yield justifiable results is a time-consuming process with an uncertain outcome for success. For these reasons, a legislative change is not something that should be pursued.

Office of Audit Comment: In its response, the IRS cites the basis for its disagreement as discussions with correctional institutions. When we requested documentation supporting these discussions, IRS management provided general information based on informal contacts with correctional institutions. The information did not provide any indication that correctional institutions raised concerns that providing mismatch records would not ensure accuracy of their prison file submissions. Finally, the IRS cites that a time-consuming process would be needed to provide mismatch records to the submitting prisons. We are unclear as to what would be time-consuming since the IRS identifies the mismatch records as part of its normal validation process. Once identified, an additional step would be needed to electronically transmit the mismatch records back to the prison to be addressed.

The Federal Bureau of Prisons and Most State Departments of Corrections Elect Not to Participate in the Prisoner Data-Sharing Initiative

In response to the American Taxpayer Relief Act of 2012, the IRS developed a process to share fraudulent prisoner tax return information with the Federal Bureau of Prisons and State Departments of Corrections. The IRS refers to this program as the *Federal, State, and District of Columbia Correction Systems American Taxpayer Relief Act Memorandum of Understanding Initiative Program.* However, no significant data have been shared to date.[23]

The results of an IRS study dated June 29, 2016, concluded that the Federal Bureau of Prisons and most State Departments of Corrections do not find this initiative to be of benefit. For example:

- The Federal Bureau of Prisons found that it may be able to use ***2*** filed tax returns, but it finds ****2*** filed returns to be insufficient on their own to support administrative sanctions on a prisoner. The Federal Bureau of Prisons also noted that it has not successfully used the Federal tax information provided to date for administrative sanctions against prisoners and it does not wish to receive additional information.

- Many State Departments of Corrections also perceive little benefit to their participation. Per the study, State Departments of Corrections believe the potential benefits may be limited and may be outweighed by other strategies and methods the IRS has deployed to detect and deter tax fraud and identity theft by fraudsters using prisoner SSNs. For example, State Departments of Corrections informed the IRS they prefer the IRS's Blue Bag Program that does not involve disclosure of Federal tax information by the IRS and does not require signing a MOU.

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[23] In August 2015, the IRS disclosed 16 tax returns to the Federal Bureau of Prisons as part of a test pilot, but the Federal Bureau of Prisons has chosen not to pursue an MOU with the IRS.

We met with representatives from the Alabama, Colorado, Montana, and South Carolina Departments of Corrections and found that only one (Colorado) plans to move forward with participation in this initiative. The three other States explained that a lack of resources and competing priorities as well as difficulty meeting the stringent security requirements for maintaining the tax data prevent participation in the program.

The IRS should improve its efforts to increase participation in the Blue Bag Program

Our review identified that actions need to be taken to increase Federal Bureau of Prisons and State Departments of Corrections participation in the Blue Bag Program. As we detailed earlier in our report, the Blue Bag Program enables the Federal Bureau of Prisons and State Departments of Corrections to send questionable tax-related material to the IRS for review prior to delivering it to the intended recipient. Each year, the IRS sends letters to the heads of the Federal Bureau of Prisons and State Departments of Corrections thanking them for the prior year's participation in the Blue Bag Program and requesting they continue to promote the program to all institutions in their jurisdiction. The letter stresses the importance of increasing the outreach of the Blue Bag Program. The IRS explains in its letter that the program not only benefits tax administration by preventing fraudulent refunds but also benefits the institutional system by reducing gang activity, drug sales, and other criminal activities in prisons that fraudulent refunds often support.

We found that 2,836 State Department of Corrections and Federal Bureau of Prisons institutions reported prisoners for Processing Year 2015. However, despite the IRS's sending of letters to solicit participation, only 1,187 (42 percent) of the 2,836 institutions participate in the Blue Bag Program. When we spoke with officials from the Federal Bureau of Prisons and the Alabama and Colorado Departments of Corrections, they spoke highly of the Blue Bag Program. The officials from the Federal Bureau of Prisons explained that the program is advantageous as it allows prison staff to send all tax-related material to the IRS instead of attempting to work through the correspondence themselves.

While the IRS has developed an outreach strategy to encourage participation in the Blue Bag Program, this strategy does not ensure that individual prisons receive information about the program. Instead, the IRS notifies the heads of the Federal Bureau of Prisons and State Departments of Corrections with the expectation that these individuals will notify other institutions within their jurisdiction of the IRS's Blue Bag Program. This creates additional work for the heads to further distribute this information and leaves a greater potential that institutions that otherwise might participate are unaware of the Blue Bag Program.

Recommendation

Recommendation 4: The Commissioner, Wage and Investment Division, should expand the communication strategy for the Blue Bag Program to ensure that all Federal Bureau of Prisons and State Departments of Corrections institutions are made aware of the program.

> ***Management's Response:*** The IRS agreed with this recommendation. IRS management is compiling a list of all State and Federal correctional institutions that will be used to identify those participating in the Blue Bag Program. This checklist will be reviewed to determine participation before the annual solicitation letter is sent to the State or Federal correctional agencies. The IRS will continue to follow protocol in working with their central offices, which allows them the opportunity to convey consistent procedures throughout their organizations.

Reporting to Congress on False or Fraudulent Tax Returns Using Prisoner Social Security Numbers Continues to Be Incomplete

Although the IRS timely provided the Calendar Year 2014 and 2015 annual reports to Congress on the filing of false or fraudulent tax returns by Federal and State prisoners, it continues to not report the full extent of tax filing fraud using prisoner SSNs or the extent to which prisoners continue to perpetrate tax refund fraud. Our review identified 51,510 tax returns processed in Calendar Year 2015 claiming refunds totaling approximately $978 million that were filed using prisoner SSNs and confirmed by the IRS as identity theft.[24] However, the IRS does not include this information in its annual report to the Congress.

The IRS also does not report known instances in which prisoners file identity theft tax returns using prisoner and non-prisoner SSNs. Below are recent examples in which prisoners were the victims of identity theft or committed identity theft while incarcerated for another crime:

- *On September 26, 2016, Brandon Banks was sentenced to 15 months for conspiracy to commit wire fraud as well as an additional 24 months for the aggravated identity theft, to be served consecutively. Cal Williams was sentenced to serve a 24-month term of probation. In handing down the sentence, Judge Hoyt ordered Banks and Williams to pay restitution to the IRS in the amount of $69,827 and $3,742, respectively. The men were convicted of using personal identifying information stolen from Harris County inmates to submit false and fraudulent individual income tax returns to the IRS. Both men admitted they used the names, dates of birth, and SSNs of unsuspecting Harris*

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[24] This figure represents the net refund amount as 51,378 tax returns claimed refunds totaling $979,025,429 and 132 tax returns claimed either zero dollars or a balance due totaling $137,237.

County inmates and others in Houston to submit false tax returns claiming refunds of several thousand dollars.[25]

- *On August 19, 2016, Daniel Coats of Turlock, California was sentenced by the United States District Court to one and one-half years in prison and ordered to pay $8,938 in restitution for his role in a conspiracy to defraud the United States by filing false claims for Federal tax refunds. According to court documents, beginning in 2011, Coats and three fellow inmates in the California Correctional Center in Susanville obtained the personal identification information of other inmates and provided it to co-defendants outside the prison. The co-defendants then used that information to prepare and file false income tax returns with the IRS, claiming refunds to which the inmates were not entitled. Coats also filed three false tax returns in his own name. In all, the conspiracy resulted in at least 247 false claims for income tax returns in Tax Years 2008 through 2011. Although the IRS stopped some of these refunds, approximately 138 fraudulent refunds totaling approximately $219,984 were issued.[26]*

In September 2014, we reported that the annual report to Congress does not address, as the legislation requires, the extent of tax fraud committed by prisoners using the SSNs of other individuals. This report also included examples of prisoners, similar to those previously discussed, who were convicted of using the identities of other individuals to file fraudulent tax returns while incarcerated. We recommended that the IRS develop processes to identify tax returns filed that have the same characteristics as confirmed fraudulent prisoner tax returns, including those fraudulent tax returns identified as part of the IRS's other fraud detection programs, and determine whether these tax returns should be included in the annual report to Congress.

The IRS disagreed with our recommendation, stating that the methodology used in the annual report to Congress is consistent with the methodology used in reports of previous years. IRS management stated that the IRS reports all known false and fraudulent returns filed by prisoners as required by the statute. As we previously discussed, the IRS's statement is not accurate. What the IRS reports is the number of tax returns filed in which a prisoner SSN is either the primary or secondary taxpayer listed on the tax return. This reporting was not complete as it did not include the 51,510 tax returns.

In response to our raising this issue again, IRS management noted that inmates are frequently also victims of identity theft, which can lead to an overstatement of fraudulent returns filed by prisoners. To ensure accuracy in reporting, the IRS accounts for returns when there is more than a circumstantial relationship to the identified prisoner.

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[25] U.S. Department of Justice Press Release, *Two Sentenced for Using Harris County Inmate Stolen Identities to Commit Tax Fraud*, (September 26, 2016).
[26] U.S. Department of Justice Press Release, *State Prison Inmate in Tax Fraud Ring Sentenced to 18 Months in Federal Prison*, (August 19, 2016).

RRP criteria to identify a prisoner return is different from previous criteria used in the EFDS

The RRP no longer limits identification of prisoner returns to the current year Prisoner File as was the criteria used in the EFDS. IRS management indicated that the RRP system uses both the current year and prior year Prisoner Files when identifying and evaluating tax returns for fraud potential. For example, for returns filed in Processing Year 2016, the IRS used the 2016 Prisoner File as well as the Processing Year 2012 through Processing Year 2015 subsequent year Prisoner File. IRS management explained that using all available Prisoner File data provides enhanced prisoner analytics by using the incarceration date and release dates from the most recent Prisoner File available to determine an individual's prisoner status at the time the tax return is filed.

We agree that the use of multiyear Prisoner File data has the ability to enhance the RRP prisoner fraud detection analytics. However, we are concerned that the IRS's expanded definition of a prisoner can result in inconsistent reporting to Congress. Prior to the use of the RRP, the IRS assigned a prisoner indicator to only those returns filed using the SSNs of individuals incarcerated during the tax year. Only tax returns with a prisoner indicator are evaluated for prisoner fraud. As such, the annual report to the Congress quantified the number of false or fraudulent tax returns filed using SSNs of individuals who were incarcerated in a given tax year.

As explained by IRS management, the IRS has expanded its efforts to identify prisoner tax returns to include individuals who were incarcerated in prior years or who are incarcerated at the time the tax return is filed. It should be noted that an individual can be incarcerated on the date a return is filed and not be incarcerated during the tax year for which the return is being filed. The RRP uses this expanded definition of a prisoner to place a prisoner indicator on tax returns. As a result, the next annual report to the Congress will no longer be comparable to prior calendar year reports limiting Congress' ability to evaluate the IRS's efforts to reduce prisoner fraud over time. Moving forward, the IRS should clearly define a prisoner for purposes of determining prisoner fraud as well as for the annual report to Congress. If the IRS changes the definition of a prisoner for the purposes of the annual report to the Congress, the IRS needs to ensure that the report fully explains how the IRS has redefined prisoner fraud.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 5: Include information in the annual report to Congress on all tax returns, including identity theft tax returns, the IRS identifies through its fraud detection processes as being filed using a prisoner SSN.

> **Management's Response:** The IRS agreed with this recommendation. The IRS plans to amend its reporting process to address returns identified as having been filed using a prisoner SSN and include that information in the annual report to Congress.

Recommendation 6: Ensure the annual report includes information regarding individuals identified as part of its criminal investigations that perpetrated tax refund fraud while incarcerated by either filing tax returns in their own name or using the identities of other individuals.

> **Management's Response:** The IRS disagreed with this recommendation. The IRS responded that criminal investigation timelines, in general, are outside the scope of information covered in the annual report. Data from criminal investigation cases are not normally shared and monitoring could be resource intensive. Further, the activity resulting from criminal investigations is publicly available at the time of indictment, as are the results of prosecution upon case adjudication.

> **Office of Audit Comment:** The IRS is not restricted from including information on closed criminal investigations involving prisoner fraud. Including this information would provide Congress with additional perspective on the extent of prisoner tax fraud and actions taken on the part of IRS to identify and address this fraud.

Recommendation 7: Clearly define a prisoner for the purposes of determining prisoner fraud as well as for the annual report to Congress.

> **Management's Response:** The IRS agreed with this recommendation. The IRS has refined its methodology for identifying tax returns potentially filed by prisoners; however, the IRS's definition of prisoner fraud remains consistent with the definition stated in the 2012 Report to Congress and used each year since.

Some Prisoner Tax Returns Were Not Screened and Verified for Fraud

Our review of Processing Year 2015 tax returns identified 11,655 tax returns that claimed wages as their source of income and were identified by the IRS as a prisoner tax return. However, the IRS did not screen or verify these returns for fraud. The IRS did not screen or verify these returns because its fraud detection programs only screen and verify prisoner tax returns when the individual was incarcerated for the full tax year unless the tax return has other high-risk fraud characteristics. Management indicated that they only screen and verify identified prisoner tax returns for individuals incarcerated for a full tax year because prisoners incarcerated for the full tax year are unable to treat their earnings as earned income to qualify for the Earned Income Tax Credit. For 11,651 (99.9 percent) of the 11,655 returns we identified, the individual was not incarcerated for a full year.

However, our further analysis found that 4,072 (34.9 percent) of 11,651 tax returns reported income and withholding that were not supported by third-party income documents. These filers received potentially fraudulent refunds totaling more than $7.3 million. We brought our concerns to management's attention on November 14, 2016. According to IRS management, many of the records in its Prisoner File are for a short duration and the IRS cannot justify treating them like a full-year prisoner. However, management stated that these returns were still

evaluated for both fraud and identity theft potential by the EFDS, the RRP, and the Dependent Database systems. In addition, IRS management stated that they were always evaluating business rules, filters, and models to identify and prevent fraud by all filers.

Recommendation

Recommendation 8: The Commissioner, Wage and Investment Division, should evaluate the effect of the IRS's decision to limit the verification of prisoner tax returns to only those filed using the SSN of full year prisoners on the IRS's identification of potentially fraudulent tax returns.

> **Management's Response:** The IRS disagreed with this recommendation. The IRS responded that many of the records in the IRS's prisoner file reflect short durations of incarceration and do not justify the same treatment as that applied to a return filed by a full-year prisoner. These returns of less than full-year prisoners are still evaluated for both fraud and identity theft potential by the IRS's fraud detection systems. Additionally, as fraud continues to evolve, the IRS evaluates its business rules, filters, and models to identify and prevent fraud by all filers.

> **Office of Audit Comment:** The IRS provided us with no information supporting its claim that individuals incarcerated for less than a full-year do not justify the same type of screening and verification. In fact, as we cite in our report, we identified over 4,000 tax returns involving the use of a prisoner SSN incarcerated less than a full-year in which the income and withholding reported on the tax return were not supported by third-party income documents.

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the effectiveness of the IRS's corrective actions to identify and reduce prisoner fraud. To accomplish our objective, we:

I. Assessed the IRS's compliance with the Inmate Tax Fraud Prevention Act of 2008[1] requirement to provide an annual report on prisoner fraud to Congress.

  A. Determined if the IRS timely provided the Calendar Year 2014 and 2015 reports to Congress.

  B. Performed data analysis using the IRS's EFDS data extract and TIGTA's Data Center Warehouse[2] data for Processing Year[3] 2015 to identify prisoner tax returns identified as identity theft.

  C. Performed data analysis using the IRS's RRP data extract and TIGTA's Data Center Warehouse data for Processing Year 2015 to identify prisoner tax returns identified as identity theft.

II. Determined the status and effectiveness of the sharing of false or fraudulent tax returns filed by prisoners with Federal and State prisons.

  A. Obtained copies of the completed MOUs and determined if the MOUs had been signed with all Federal Bureau of Prisons and State Departments of Corrections.

  B. Determined what data have been shared with prisons.

  C. Contacted prisons that have elected to not participate in the program to determine their reason for not participating.

  D. Contacted prisons that declined to participate in the program after submitting the MOU to determine their reason for declining.

  E. Assessed the effectiveness of the IRS's strategy to promote the Blue Bag Program to increase institution participation.

    1. Determined if the IRS has developed an outreach strategy. We obtained and evaluated the adequacy of plans for expanding the Blue Bag Program.

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[1] Pub. L. No. 110-428, 122 Stat. 4839.

[2] The Data Center Warehouse is a collection of IRS databases containing various types of taxpayer account information that is maintained by TIGTA for the purpose of analyzing data for ongoing audits.

[3] The calendar year in which the tax return or document is processed by the IRS.

2. Determined if the IRS has a process to identify the universe of prisons to contact for participation in the program.

3. Determined the IRS's procedures for working correspondence and tax returns received through the Blue Bag Program.

4. Evaluated the IRS's process for reviewing and taking actions on correspondence and tax returns received from prisons.

III. Determined the adequacy of actions taken to improve the completeness and reliability of the IRS Prisoner File.

A. Interviewed IRS personnel to determine IRS efforts to ensure that all State Department of Corrections and all Federal prisons provide information for incarcerated individuals.

1. Determined if the IRS has a list of the Federal prisons and all State prisons.

2. Determined if the IRS reached out to Federal prisons and State prisons that are not providing information for incarcerated individuals.

3. Determined if the IRS had processes in place to evaluate the completeness of each Federal or State prisons' reporting.

B. Evaluated the actions taken by the IRS to analyze the reliability and usefulness of the SSA prisoner data.

C. Compared the SSA Prisoner File and data on incarceration institutions to identify institutions not included in the IRS's Prisoner Institution file. We quantified the number of prisoner SSNs from these institutions that were used to file a tax return.

D. Analyzed the SSA prisoner data to determine the prisoners not included on the IRS's Prisoner File.

1. Determined if these prisoners filed tax returns for Tax Year[4] 2014.

2. Determined if these prisoner returns received refunds and the validity of their refund claims.

a. Performed data mining to determine if income claimed on the tax returns is supported by Forms W-2, *Wage and Tax Statement,* or Form 1099 series of information returns with the IRS.

b. Identified tax returns filed by prisoners for which there is no support for the income claimed on the tax return.

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[4] A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

   c. Determined if refunds were issued to tax returns filed by prisoners for which there was no support for the income claimed on the tax return.

   d. Quantified the amount of potentially fraudulent refunds filed by prisoners who are on the SSA Prisoner File but not on the IRS Prisoner File.

IV.   Determined the adequacy of the IRS's processes for using prisoner information to identify fraudulent tax returns filed using a prisoner SSN.

   A. Determined the improvements the IRS made to the process to identify individuals who are incarcerated and assigned prisoner indicators to the tax returns filed using an SSN that is included on the Prisoner File.

     1. Interviewed IRS management to determine if any changes have been made to improve the process to identify individuals who are incarcerated and assign prisoner indicators.

     2. Performed data analysis using TIGTA's Data Center Warehouse Individual Return Transaction File and the Prisoner File to identify tax returns filed using an SSN on the Prisoner File in Processing Year 2015.

     3. Requested a data extract of the EFDS for all tax returns filed that have the prisoner indicator for Processing Year 2015.

     4. Determined if there were any returns in the EFDS data extract that were not identified in our data analysis and determined why they were not identified.

     5. Determined if there were any prisoner returns that we identified that were not included in the EFDS data extract and determined why they were not identified.

     6. Identified tax returns that have a prisoner indicator in the EFDS.

       a. Determined if tax returns filed using prisoner SSNs were sent to screening.

         1. Identified prisoner tax returns that did not indicate they were selected for screening.

         2. Identified all full-year prisoner tax returns that were selected for screening.

         3. From the prisoner tax returns that were selected for screening, determined if the tax return was selected for verification.

           a. Identified tax returns that were released from verification.

           b. Identified tax accounts in which a refund hold was placed on the account.

           c. Identified tax accounts showing the refund was stopped.

> d. Identified tax accounts that indicated the refund was issued when a refund hold had been placed on the account and quantified the amount of refunds released.

B. Assessed the effectiveness of the IRS's RRP at identifying prisoner returns in Processing Years 2015 and 2016 by determining the criteria used by the RRP to identify prisoner returns in Processing Year 2015.

C. Determined the effectiveness of the IRS's use of the Prisoner Mismatch File.

1. Evaluated the accuracy of the Prisoner Mismatch File by matching the file to the National Account Profile. We followed up with the IRS for any records on the Prisoner Mismatch File in which the SSN and name match to the National Account Profile to determine why the record is on the Prisoner Mismatch File.

2. Determined if the SSNs on the Prisoner Mismatch File are issued SSNs.

3. Performed data analysis using TIGTA's Data Center Warehouse Individual Return Transaction File and the Prisoner Mismatch File to identify tax returns filed using an SSN on the Prisoner Mismatch File in Tax Year 2014.

4. Determined if tax returns identified in Step IV.C.3. posted to the Individual Master File.

5. Determined if the SSNs identified in Step IV.C.4. had identity theft indicators on the tax account.

6. Determined if the SSNs identified in Step IV.C.4. had fraud indicators on the tax account.

7. For those tax returns that were not identified as identity theft or fraud:

   a. Performed data mining to determine if income claimed on the tax returns is supported by Forms W-2 or Form 1099 series of information returns filed with the IRS.

   b. Identified tax returns filed by prisoners for which there was no support for the income claimed on the tax return.

   c. Determined if refunds were issued to tax returns filed by prisoners for which there was no support for the income claimed on the tax return.

   d. Quantified the amount of potentially fraudulent refunds filed by prisoners who are on the Prisoner Mismatch File but not on the IRS Prisoner File.

Data validation methodology

During this review, we relied on data received from the IRS from the EFDS and RRP system for Processing Year 2015. We also relied on the Prisoner File and Prisoner Mismatch File from the

IRS for Processing Year 2015. We also relied on SSA prisoner records received by the IRS in October 2015. We obtained extracts from the IRS's Individual Master File and Returns Transaction File databases for Processing Year 2015 that were available on TIGTA's Data Center Warehouse. We also obtained income documentation from the Information Returns Master File for Forms W-2 from TIGTA's Data Center Warehouse. We obtained extracts of various Forms 1099 such as Form 1099-INT, *Interest Income*, and Form 1099-MISC, *Miscellaneous Income*. 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 IRS's Integrated Data Retrieval System.[5] We also performed analysis to ensure validity and reasonableness of our data such as ranges of dollar values, transaction dates, and tax periods. Based on the results of our testing, 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: processes ensuring that the provisions of the Inmate Tax Fraud Prevention Act of 2008 and the American Taxpayer Relief Act of 2012[6] were implemented, processes to evaluate the completeness and reliability of the IRS Prisoner File, and the IRS's processes for using prisoner information to identify fraudulent tax returns filed using a prisoner SSN. We evaluated these controls by obtaining information from IRS management about the status of data sharing with the Federal Bureau of Prisons and with the States and about the status of the annual prisoner fraud report to Congress. We compared the IRS Prisoner File to SSA prisoner records to evaluate the completeness and reliability of the IRS Prisoner File. We also analyzed data received from the IRS's EFDS as well as the Individual Return Transaction File and the Prisoner File to determine whether tax returns filed using a prisoner SSN are being identified.

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[5] IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
[6] Pub. L. No. 112-240, 126 Stat. 2313.

Actions Need to Be Taken to Ensure Compliance With Prisoner Reporting Requirements and Improve Identification of Prisoner Returns

Appendix II

Major Contributors to This Report

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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:

- Cost Savings (Funds Put to Better Use) – Potential; more than $151 million in tax refunds issued for 52,687 tax returns that were not identified by the IRS during its Processing Year[1] 2015 annual fraud detection maintenance period (see page 9).

Methodology Used to Measure the Reported Benefit:

We identified tax returns requesting refunds that were received during the IRS's EFDS and RRP annual maintenance period using the Individual Return Transaction File as of December 31, 2015. We analyzed the Individual Master File[2] to identify those tax returns processed and posted to the Individual Master File between*********2***********, and received a tax refund. We identified 52,687 tax returns that were processed, posted to the Individual Master File, and received a tax refund during the maintenance periods of **************2********************. These individual received refunds totaling $151,045,221. The actual amount of potentially fraudulent refunds that the IRS protects is contingent upon the extent which taxpayers are able to substantiate their tax return.

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; almost $2.7 million in potentially fraudulent tax refunds issued for 858 tax returns that were filed using SSNs used by prisoners that were not included in the IRS's Processing Year 2015 Prisoner File (see page 9).

Methodology Used to Measure the Reported Benefit:

We obtained an extract of the IRS's Processing Year 2015 Prisoner Mismatch File containing 1,147,050 records. We eliminated 589,808 records in which the SSN was 000000000. We matched the 557,242 records to the National Account Profile to identify those SSNs that were valid SSNs issued by the SSA. We identified 471,864 SSNs that were valid SSNs issued by the

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[1] The calendar year in which the tax return or document is processed by the IRS.
[2] The IRS database that maintains transactions or records of individual tax accounts.

SSA. We determined that 233,724 SSNs were used as a primary taxpayer or a secondary taxpayer on a tax return filed in Processing Year 2015.

We determined that 60,824 tax returns claimed a refund for Tax Year 2014, with Single or Head of Household filing status. We matched these tax returns to the Information Returns Transaction File to determine if there were third-party income documents to support the wages claimed on the tax return. We identified 1,075 tax returns receiving refunds totaling $3,104,830 that had no support in the Information Returns Transaction File for the wages claimed on the tax return. We eliminated 129 tax returns with refunds totaling $188,523 that were previously identified as fraudulent by the IRS from the outcome. We also eliminated 88 tax returns with refunds totaling $251,693 that the IRS determined were not fraudulent.

Type and Value of Outcome Measure:

- Reliability of Information – Actual; 4,158 records in which the IRS incorrectly concluded that the *******2********* provided by the Federal Bureau of Prisons and State Departments of Corrections did not match IRS records (see page 9).

Methodology Used to Measure the Reported Benefit:

We obtained an extract of the IRS's Processing Year 2015 Prisoner Mismatch File containing 1,147,050 records. We eliminated 589,808 records in which the SSN was 000000000. We matched the 557,242 records to the National Account Profile to identify those SSNs that were valid SSNs issued by the SSA. We identified 471,864 SSNs that were valid SSNs issued by the SSA. We compared the **************2**************** SSN on the Processing Year 2015 Prisoner Mismatch File to ***********************2************ SSN on the National Account Profile. We identified 4,158 SSNs listed on the Processing Year 2015 Prisoner Mismatch File in which the *************2****************** matched the National Account Profile.

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; $78,150 in potentially fraudulent tax refunds issued for 50 tax returns using SSNs provided by the Federal Bureau of Prisons and State Departments of Corrections for which the IRS incorrectly concluded that the **2** ********2********** did not match information on the National Account Profile (see page 9).

Methodology Used to Measure the Reported Benefit:

We obtained an extract of the IRS's Processing Year 2015 Prisoner Mismatch File containing 1,147,050 records. We eliminated 589,808 records in which the SSN was 000000000. We matched the 557,242 records to the National Account Profile to identify those SSNs that were valid SSNs issued by the SSA. We identified 471,864 SSNs that were valid SSNs issued by the

SSA. We compared ***********2******************** SSN on the Processing Year 2015 Prisoner Mismatch File to the **************2************** SSN on the National Account Profile. We identified 4,158 SSNs listed on the Processing Year 2015 Prisoner Mismatch File in which the **************2************** matched the National Account Profile. We matched these 4,158 SSNs to the Processing Year 2015 Individual Returns Transaction File and identified 1,113 tax returns claiming refunds totaling $1,739,365.

We used IRS enforcement data to estimate the portion of the 1,113 tax returns we identified that are potentially fraudulent. For Processing Year 2015, the IRS identified 543,543 refund tax returns filed using prisoner SSNs that claimed refunds totaling approximately $3,102,000,000. The IRS identified 24,258 fraudulent tax returns with refunds totaling approximately $1,325,000,000 using prisoner SSNs. Based on this, 4.5 percent of refund tax returns filed by prisoners were determined to be fraudulent with 42.71 percent of refunds found to be fraudulent. However, we determined that 22 of the 543,543 tax returns filed using prisoner SSNs each claimed a refund over $1 million. We believe this explains the high percentage of the dollar amount of refunds found to be fraudulent.

To be conservative, we determined that the average refund for the 1,113 tax returns that we identified was $1,563. We applied the 4.5 percent of tax returns filed using a prisoner SSN that the IRS determined to be fraudulent to the 1,113 tax returns that we identified. We estimate that 50 tax returns using SSNs provided by the Federal Bureau of Prisons and State Departments of Corrections for which the IRS incorrectly concluded that the **************2********** did not match information on the National Account Profile are fraudulent. We applied the average refund to these 50 tax returns and estimate that $78,150 in potentially fraudulent refunds were issued.

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; more than $7.3 million in potential fraudulent tax refunds issued from 4,072 tax returns the IRS identified as filed using prisoner SSNs and set a prisoner indicator but the IRS did not screen or verify for fraud (see page 17).

Methodology Used to Measure the Reported Benefit:

We obtained an extract of 544,897 tax returns identified as having prisoner SSNs by the EFDS in Processing Year 2015. We matched these tax returns to the Processing Year 2015 Individual Return Transaction File. We selected Tax Year 2014 refund tax returns with a Single or Head of Household Filing Status claiming only wages as their source of income. We identified 282,494 tax returns meeting these criteria. We matched the 282,494 tax returns to the Individual Master File to ensure that the tax return posted to the taxpayer's account. We compared the wages claimed on the tax return to third-party income documents on the Information Returns Transaction File to determine if there was support for the income claimed on the tax return. We identified 4,072 tax returns that claimed wages as the source of income but there was no support for the wages and withholding. These taxpayers claimed refunds totaling $7,362,035.14.

Actions Need to Be Taken to Ensure Compliance With Prisoner Reporting Requirements and Improve Identification of Prisoner Returns

Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

MAY 2 5 2017

MEMORANDUM FOR MICHAEL E. MCKENNEY
                 DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kenneth C. Corbin
                Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Actions Need to be Taken to Ensure
                Compliance with Prisoner Reporting Requirements and Improve
                Identification of Prisoner Returns (Audit # 201640007)

Thank you for the opportunity to review and comment on the subject draft report. We appreciate the Treasury Inspector General for Tax Administration's observations and acknowledgement of our efforts to implement 26 U.S.C. § 6116 - *Requirement for Prisons Located in the United States to Provide Information for Tax Administration*. To reduce and work toward eliminating tax refund fraud perpetrated by prisoners, the IRS developed processes that leverage the electronic analysis of tax returns by our fraud detection systems and promote dialogue and collaboration with federal and state correctional institutions. Each year, the IRS receives lists of incarcerated individuals from the Federal Bureau of Prisons and State Departments of Corrections. We use this information to compile the Prisoner File, which is used to identify returns filed using prisoner Social Security Numbers and to prevent the issuance of refunds for claims determined to be improper or fraudulent.

We are pleased to report that the IRS has begun receiving monthly prisoner data from the Social Security Administration (SSA) via the Do Not Pay Office of the Bureau of the Fiscal Service. For the six-month period ending April 2017, we received 5.4 million prisoner records from the SSA. However, some data elements needed for tax administration have not been needed by the SSA and were not collected. We are working with the SSA to have the data collected and included in future data files. As the report mentions, the SSA collects data from more sources than IRS and we are evaluating how this data can replace or supplement our own prisoner data collection efforts.

We have communicated with representatives from every state and federal correctional agency to educate them on the problem of prisoners committing tax fraud and to

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discuss strategies for its prevention. Further, we have implemented many improvements to our prisoner tax compliance strategies that have achieved the following results:

- Fraudulent returns submitted by prisoners have fallen from a high of 186,482 returns in 2011 to 24,258 in 2015, an 87 percent reduction from its peak in 2011.

- We stopped over 99.9 percent of the $1.325 billion in fraudulent refunds claimed by prisoners in 2015.

- In Fiscal Year 2016, there were 1,187 prisons participating in our Blue Bag Program and, from them, we received 984 pieces of correspondence containing tax-related documents and refund checks for evaluation as evidence of potential fraud.

- The Federal Bureau of Prisons agreed to expand the Blue Bag Program by promoting it to all their facilities in Filing Season 2017.

- We created and placed in service supplemental prisoner-fraud detection filters to screen tax returns when our primary systems are taken offline for annual maintenance.

There is an annual six-step process to ensure accurate and timely information is received for compilation of the Prisoner File used for prisoner fraud detection. First, lessons learned from the prior year's data collection and analysis efforts are reviewed. Outreach is performed to ensure the timely receipt of state and federal files. Follow-up requests are made if the correctional agency is non-responsive. Data cleansing is done and correctional agencies are contacted, as necessary, to resolve any detected data anomalies. We also review and compare annual submissions to account for each prison from which we expect a report. Finally, we deliver the completed Prisoner File to our electronic detection systems prior to the start of the upcoming filing season.

It is also important to note that, while the report covers returns received and processed during 2015, other significant changes have been implemented that improve our fraud detection capabilities for all returns. Most notably has been the Systemic Verification process incorporated into the Return Review Program (RRP). With the implementation of the RRP in 2015, we used Form W-2, *Wage and Tax Statement*, data voluntarily provided to the IRS early in the filing season, to supplement information received from the SSA, and compared that third-party data to information provided on tax returns to evaluate their authenticity. During 2015 and 2016, the data received early was limited; however, the Systemic Verification process we established and perfected in those years contributed to the success we achieved in 2017 when the Protecting Americans From Tax Hikes Act[1] established a due date of January 31 for filing Form W-2. With improved data availability, we made better determinations on returns filed by the rightful

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[1] Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015).

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taxpayers, and devoted more attention and resources to those returns that could not be authenticated and were questionable.

As evidenced by the amount of potentially fraudulent refund claims by prisoners that were stopped in 2015, we have significantly improved our ability to detect prisoner fraud from when we first started collecting prisoner data over ten years ago. At that time, many state correctional agencies did not provide us with data and our ability to analyze and use what we received was minimal. As fraud patterns evolve, we will continue to build upon the fraud detection framework we have developed to improve our ability to evaluate, detect, and address fraud threats.

Attached are our comments and proposed actions to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Michael Beebe, Director, Return Integrity and Compliance Services, Wage and Investment Division, at (470) 639-3505.

Attachment

Attachment

Recommendation

RECOMMENDATION 1
The Commissioner, Wage and Investment Division, should develop a master list of prison institutions nationwide for use in verifying Federal Bureau of Prisons and State Departments of Corrections compliance with legislative reporting requirements.

CORRECTIVE ACTION
We agree with this recommendation. We are compiling a list of all state and federal correctional institutions that will be used as a checklist when evaluating compliance with legislated reporting requirements.

IMPLEMENTATION DATE
May 15, 2018

RESPONSIBLE OFFICIAL
Director, Return Integrity and Compliance Services, Wage and Investment Division

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

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 2
Evaluate the inclusion of valid SSNs associated with records in the Prisoner Mismatch File for use in identifying prisoner tax returns to assign an indicator and evaluate for fraud potential.

CORRECTIVE ACTION
We agree with this recommendation and, in November 2016, implemented corrections to programming that affected the 2017 Prisoner File and resolved the record mismatches caused by the presence of *******2********** in record fields. We also modified our statistical analysis software to compensate for the *****2******** within the fields, resulting in more valid matches to the National Account Profile database. This has reduced the volume of mismatched records; however, we do not intend to assign a prisoner code to records that remain in the Prisoner Mismatch File. Although these remaining records would not be coded as potential prisoner accounts, it is important to note that returns filed using any Social Security Number (SSN) on the Prisoner Mismatch File go through the same rigorous data mining, scoring, and evaluation that is performed on all other returns by our fraud detection systems.

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IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director, Return Integrity and Compliance Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
N/A

Legislative recommendation

RECOMMENDATION 3
In coordination with the Department of Treasury's Office of Tax Policy, consider a legislative proposal to allow the IRS to provide mismatch records to the Federal Bureau of Prisons and State Departments of Corrections in an effort to resolve the mismatch in future submissions.

CORRECTIVE ACTION
We disagree with this recommendation. From our discussions with correctional institutions, we have concluded that providing mismatch records to the prisons will not ensure the accuracy of their prisoner file submissions in subsequent years. We believe that receiving prisoner data directly from the Social Security Administration (SSA) will mitigate errors associated with mismatches. Incorporating the SSA data into our annual construction of the Prisoner File is an action we are taking now and will provide immediate benefits, whereas requesting a legislative change, for a process we do not believe would yield justifiable results, is a time-consuming process with an uncertain outcome for success. For these reasons, a legislative change is not something that should be pursued.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

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Recommendation

RECOMMENDATION 4
The Commissioner, Wage and Investment Division, should expand the communication strategy for the Blue Bag Program to ensure that all Federal Bureau of Prisons and State Departments of Corrections institutions are made aware of the program.

CORRECTIVE ACTION
We agree with this recommendation. A list of all state and federal correctional institutions is being compiled and will be used to identify those participating in the Blue Bag Program. This checklist will be reviewed to determine participation before the annual solicitation letter is sent to the state or federal correctional agencies. The IRS will continue to follow protocol in working with their central offices, which allows them the opportunity to convey consistent procedures throughout their organizations.

IMPLEMENTATION DATE
May 15, 2018

RESPONSIBLE OFFICIAL
Director, Return Integrity and Compliance Services, Wage and Investment Division

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

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 5
Include information in its annual report to Congress on all tax returns, including identity theft tax returns, it identifies through its fraud detection processes as being filed using a prisoner SSN.

CORRECTIVE ACTION
We agree with this recommendation. We will amend our reporting process to address returns identified as having been filed using a prisoner SSN, and include that information in the annual report to Congress.

IMPLEMENTATION DATE
May 15, 2018

RESPONSIBLE OFFICIAL
Director, Return Integrity and Compliance Services, Wage and Investment Division

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

RECOMMENDATION 6
Ensure the annual report includes information regarding individuals identified as part of its criminal investigations that perpetrated tax refund fraud while incarcerated by either filing tax returns in their own name or using the identities of other individuals.

CORRECTIVE ACTION
We disagree with this recommendation. Criminal investigation timelines, in general, are outside the scope of information covered in the annual report. Data from criminal investigation cases are not normally shared and monitoring could be resource intensive. Further, the activity resulting from criminal investigations is publicly available at the time of indictment, as are the results of prosecution upon case adjudication.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 7
Clearly define a prisoner for the purposes of determining prisoner fraud as well as for the annual report to Congress.

CORRECTIVE ACTION
We agree with this recommendation. The IRS has refined its methodology for identifying tax returns potentially filed by prisoners; however, our definition of prisoner fraud remains consistent with the definition stated in the 2012 Report to Congress, and used each year since.

IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director, Return Integrity and Compliance Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
N/A

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RECOMMENDATION 8
The Commissioner, Wage and Investment Division, should evaluate the effect of the IRS's decision to limit the verification of prisoner tax returns to only those filed using the SSN of full year prisoners on the IRS's identification of potentially fraudulent tax returns.

CORRECTIVE ACTION
We disagree with this recommendation. Many of the records in our prisoner file reflect short durations of incarceration and do not justify the same treatment as that applied to a return filed by a full-year prisoner. These returns of less than full-year prisoners are still evaluated for both fraud and identity theft potential by our fraud detection systems. Additionally, as fraud continues to evolve, we evaluate our business rules, filters and models to identify and prevent fraud by all filers.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A