TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds Are Paid

February 26, 2018

Reference Number: 2018-40-015

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HIGHLIGHTS

EMPLOYER NONCOMPLIANCE WITH WAGE REPORTING REQUIREMENTS SIGNIFICANTLY REDUCES THE ABILITY TO VERIFY REFUNDABLE TAX CREDIT CLAIMS BEFORE REFUNDS ARE PAID

Highlights

Final Report issued on February 26, 2018

Highlights of Reference Number: 2018-40-015 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

In December 2015, Congress enacted the Protecting Americans from Tax Hikes (PATH) Act of 2015, which contains a number of integrity provisions intended to reduce improper Earned Income Tax Credit (EITC), Child Tax Credit (CTC), Additional Child Tax Credit (ACTC), and American Opportunity Tax Credit (AOTC) claims. These provisions are projected to save approximately $7 billion over 10 years by reducing fraud, abuse, and improper payments in refundable credit programs.

WHY TIGTA DID THE AUDIT

TIGTA continued its evaluation of the IRS's efforts to implement integrity provisions included in the PATH Act that are intended to reduce EITC, CTC, ACTC, and AOTC Improper payments.

WHAT TIGTA FOUND

Processes do not prevent the issuance of EITC and ACTC claims to taxpayers whose income is not supported. TIGTA identified 1.4 million tax returns with a discrepancy in wages reported on the tax return and wages reported on third-party Forms W-2, *Wage and Tax Statement*, that were not reviewed by the IRS prior to refunds being released on February 15, 2017. These taxpayers received approximately $8.2 billion in refunds that included $4.3 billion in the EITC and $1.7 billion in the ACTC. For 660,141 of these returns, the IRS received no third-party Forms W-2 prior to the refunds being released. These returns had refunds totaling almost $3.7 billion. IRS management indicated that these returns were not reviewed due to limited resources.

In addition, the IRS did not disallow almost $9.8 million in refundable credits associated with 4,509 tax returns with a retroactive refundable credit claim. The credits were incorrectly allowed because the Taxpayer Identification Number (TIN) assignment date was not available when some of these tax returns were processed and due to tax examiner error when reviewing retroactive claims.

Finally, for the 2017 Filing Season, the IRS did not program the Modernized e-File system to systemically verify the TIN issuance date for electronically filed prior year refundable credit claims. Instead, all electronically filed prior year tax returns are sent to the Error Resolution System function for employees to manually revalidate the TIN at a total estimated cost of $400,570.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS review the tax returns for which the IRS incorrectly allowed and denied the CTC, the ACTC, the EITC and the AOTC; program the Modernized e-File system to verify the TIN issuance date on prior year tax returns and reject retroactive claims; correct programming errors that resulted in incorrect calculation of Individual Taxpayer Identification Number issuance dates; and ensure that the IRS systems are updated with correct TIN issuance dates.

The IRS agreed with four recommendations and partially agreed with the remaining one. Related to the partially agreed recommendation, IRS management noted that limitations associated with the Modernized e-File system's ability to identify extensions of time to file could result in rejecting possible allowable claims. TIGTA agrees that without the ability to systemically identify an extension that changes the due date of the return, the IRS could in fact reject allowable claims. As such, TIGTA agrees with the IRS's alternative process of identifying claims and sending them for additional review to determine whether they are erroneous retroactive refundable credit claims.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

February 26, 2018

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Michael E. McKenney

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds Are Paid (Audit # 201740031)

This report presents the results of our review to evaluate the effectiveness of the Internal Revenue Service's efforts to implement select refundable credit integrity provisions in the Protecting Americans from Tax Hikes Act of 2015[1] that are intended to reduce Earned Income Tax Credit, Child Tax Credit, Additional Child Tax Credit, and American Opportunity Tax Credit improper payments. This audit is part of our Fiscal Year 2018 discretionary audit coverage and addresses the major management challenge of Reducing Fraudulent Claims and Improper Payments.

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

Copies of this report are also 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).

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

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Abbreviations

ACTC	Additional Child Tax Credit
AOTC	American Opportunity Tax Credit
ATIN	Adoption Taxpayer Identification Number
CTC	Child Tax Credit
E-File(d)	Electronically Filed
EITC	Earned Income Tax Credit
ERS	Error Resolution System
IRMF	Information Returns Master File
IRS	Internal Revenue Service
IRTF	Individual Return Transaction File
ITIN	Individual Taxpayer Identification Number
MeF	Modernized e-File
NAP	National Account Profile
PATH Act	Protecting Americans from Tax Hikes Act of 2015
RTS	Real-Time System
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number

Background

Refundable credits help low-income individuals reduce their tax burden. For example, the Earned Income Tax Credit (EITC), created in 1975, is used to offset the impact of Social Security taxes on low-income families and encourage them to seek employment rather than welfare.[1] Congress also created the Child Tax Credit (CTC) and the Additional Child Tax Credit (ACTC) because the individual income tax structure did not reduce an individual's tax liability enough to reflect a growing family's reduced ability to pay taxes as family size increased. Refundable credits can also provide incentives for other activities, such as obtaining a college education. The American Opportunity Tax Credit (AOTC) allows individuals to receive a credit for higher education expenses. Figure 1 shows the amount of the EITC, the ACTC, and the AOTC[2] claimed by taxpayers during Tax Year 2016.[3] These credits represent the three most common refundable credits the Internal Revenue Service (IRS) currently administers.

Figure 1: The EITC, the ACTC, and the AOTC Claimed by and Allowed to Individuals for Tax Year 2016

Refundable Credit	Tax Returns Claiming at Least One Refundable Credit[4]	Credit Claimed
EITC	26.4 million	$65.2 billion
ACTC	18.2 million	$24.6 billion
AOTC	8.4 million	$7.5 billion
Total	**53.0 million**	**$97.3 billion**

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the IRS Individual Return Transaction File (IRTF)[5] for Tax Year 2016, as of September 14, 2017.

Refundable credits present an increased risk for improper payments

Although refundable credits provide benefits to individuals, the unintended consequence of these credits is that they are often the targets of unscrupulous individuals who file erroneous claims. In particular, refundable tax credits present an additional avenue for individuals to commit filing fraud. The maximum benefits an individual will receive if a nonrefundable credit is claimed

[1] Tax Reduction Act of 1975 Section (§) 204, 26 U.S.C. § 32.
[2] These represent three of the most common refundable credits currently available to taxpayers.
[3] 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.
[4] More than one refundable credit may have been claimed on a tax return.
[5] The IRTF contains individual tax return data.

inappropriately is to fully offset his or her tax liability. Refundable credits do not have such limitations. In essence, individuals can obtain money that they did not earn and to which they are not entitled simply by claiming a refundable tax credit.

The IRS estimates that it improperly issued $16.8 billion in EITC payments in Fiscal Year[6] 2016. In April 2016,[7] we reported that the IRS's own enforcement data indicate that ACTC and AOTC improper payments are also substantial. We estimate that the potential ACTC improper payment rate for Fiscal Year 2016 is 25.2 percent, with potential improper payments totaling $7.2 billion, and the potential AOTC improper payment rate for Fiscal Year 2016 is 24.1 percent, with potential improper payments totaling $1.1 billion.

Refundable credit integrity provisions were enacted in an effort to reduce fraudulent and improper payments

On December 18, 2015, Congress enacted the Protecting Americans from Tax Hikes Act of 2015 (PATH Act),[8] which includes program integrity provisions specifically intended to reduce fraudulent and improper EITC, CTC, ACTC, and AOTC payments. These integrity provisions are projected to save roughly $7 billion over 10 years by reducing fraud, abuse, and improper payments in refundable credit programs. For example, provisions expanded the IRS's ability to verify earned income before refundable claims are paid and provide the IRS with the authority to disallow credits claimed on tax returns when the Taxpayer Identification Number (TIN)[9] was not issued by the due date of the tax return. The majority of the program integrity provisions were not effective until January 1, 2016. Figure 2 provides the integrity provisions of the PATH Act that we evaluated in this review, along with the effective date of each provision.

[6] 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.
[7] TIGTA, Ref. No. 2016-40-036, *Without Expanded Error Correction Authority, Billions of Dollars in Identified Potentially Erroneous Earned Income Credit Claims Will Continue to Go Unaddressed Each Year* (Apr. 2016).
[8] Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015).
[9] A TIN is an identifying number used on a tax return and may be a Social Security Number, an Individual Taxpayer Identification Number, or an Adoption Taxpayer Identification Number.

Figure 2: PATH Act Integrity Provisions

Provision	Description	Effective Date
Section 201: **Modification of filing dates of returns and statements relating to employee wage information and nonemployee compensation to improve compliance.**	This provision modifies the due dates of third-party income documents related to wage information and nonemployee compensation on Forms W-2, *Wage and Tax Statement*, and other third-party income documents such as Form 1099-MISC, *Miscellaneous Income (Info Only)*, to January 31. This provision also provides additional time for the IRS to review refund claims based on the EITC and the ACTC in order to reduce fraud and improper payments. No refund based on claims for the EITC or the ACTC shall be made to a taxpayer before February 15.	January 1, 2016 (2017 Filing Season)[10]
Sections 204–206: **Prevention of retroactive claims.**[11]	These provisions prevent retroactive claims for the EITC, the CTC/ACTC, and the AOTC for years before the Social Security Numbers (SSN), the Individual Taxpayer Identification Numbers (ITIN),[12] or the Adoption Taxpayer Identification Numbers (ATIN)[13] were issued.	December 18, 2015 (2016 Filing Season)

Source: PATH Act of 2015.

A prior TIGTA review identified that the IRS did not effectively implement the PATH Act refundable credit integrity provisions

In July 2017,[14] we reported that the IRS did not have the information it needed to determine whether TINs used to claim the CTC, the ACTC, the EITC, and the AOTC were timely issued. As a result, the IRS paid more than $34.8 million to 15,744 taxpayers who filed a Tax Year 2014 tax return during the 2016 Filing Season. Each of the refundable credit claims associated with the 15,744 tax returns we identified should have been disallowed by the IRS as required by the PATH Act. We recommended that the IRS take steps to recover the more than $34.8 million in

[10] The period from January through mid-April when most individual income tax returns are filed.
[11] A retroactive claim involves the filing of an original or amended prior year tax return that is processed in the current processing year, *e.g.*, an original Tax Year 2014 tax return filed during the 2017 Filing Season.
[12] An ITIN is a nine-digit number issued by the IRS to individuals who are required to have a TIN for tax purposes but who do not have or are not eligible to obtain an SSN. An ITIN begins with the number nine and contains unique numbers in the fourth and fifth digits that indicate the number is an ITIN.
[13] An ATIN is a temporary identification number issued by the IRS for a child in a domestic adoption when the adopting taxpayers do not have or are unable to obtain the child's SSN.
[14] TIGTA, Ref. No. 2017-40-042, *Processes Do Not Maximize the Use of Third-Party Income Documents to Identify Potentially Improper Refundable Credit Claims* (July 2017).

erroneous EITCs, CTCs, ACTCs, and AOTCs. IRS management agreed with our recommendation.

In addition, we reported that IRS processes do not maximize the use of third-party income documents to identify potentially improper refundable credit claims. Our review identified that although the IRS established processes to hold all refunds that include the EITC or the ACTC until February 15, 2017, as required, processes do not ensure that all EITC and ACTC claims with unsupported income are reviewed before refunds are paid. In addition, we found that the IRS has not developed processes to effectively use Forms 1099-MISC that report nonemployee compensation to validate reported income.

We recommended that the IRS continue to evaluate opportunities to use Forms 1099-MISC in conjunction with Forms W-2 to validate EITC and ACTC claims. We also recommended that, for the purpose of informing Congress on the benefit of the early availability of third-party documents, the IRS conduct a study to quantify the number of EITC and ACTC claims that the IRS identifies with unreported, underreported, and overreported income. The study should include information as to the number and amount of identified claims the IRS was able to address using existing authority, *i.e.*, through an audit, in comparison to the total number and amount of claims identified. The IRS agreed with our recommendations. The study was completed in August 2017 and found that earlier systemic verification provides benefits including additional Integrity and Verification Operations case selection and additional cases identified as identity theft or fraudulent, which protected more revenue than in Processing Year 2016.[15]

This review was performed with information obtained from IRS Wage and Investment Division's Return Integrity and Compliance Services function in Atlanta, Georgia, during the period December 2016 through October 2017. 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.

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

Results of Review

Wage Reporting Noncompliance Significantly Reduces the Ability to Identify Potentially Erroneous Refundable Tax Credit Claims

Our analysis of 8.4 million Tax Year 2016 electronically filed (e-filed) tax returns filed[16] as of February 15, 2017, with an EITC and/or an ACTC claim identified 1.5 million returns for which there was a discrepancy *******2******* between wages reported on the return to wages reported on third-party Forms W-2 received by the IRS.[17] Further analysis of the 1.5 million returns found that the IRS identified for further fraud or examination review 70,406 (4.7 percent) of these returns during processing. However, for the remaining more than 1.4 million returns, the IRS performed no review before the refunds were released on February 15, 2017, despite the fact that there was an income reporting discrepancy. Refunds associated with these tax returns totaled approximately $8.2 billion, which included $4.3 billion in EITC and $1.7 billion in ACTC claims. It should be noted that for 660,141 of these tax returns, with refunds totaling $3.7 billion, the IRS received no third-party filed Forms W-2 before the refunds were released. Figure 3 shows the type of income discrepancy on the 1.4 million returns that the IRS did not select for fraud or examination review.

[16] The 8.4 million returns represent all tax returns for which the only source of income reported by the filers was wages.
[17] Our analysis only included tax returns with a refund claim of at least $1,500. *************2*************** ***2*** *******2******. The discrepancies we identified with these returns could involve reporting noncompliance on the part of employers.

Figure 3: Tax Year 2016 Tax Returns With a Wage Discrepancy That Were Not Selected for Either Fraud or Examination Review

Wage Discrepancy Type	Returns	Refunds Received	EITC Received	ACTC Received
No Form W-2 received supporting income reported	660,141	$3,677,959,455	$1,887,374,101	$753,548,029
Forms W-2 received:				
More Income Reported	564,030	$3,301,856,462	$1,740,520,912	$667,754,220
Less Income Reported	199,678	$1,174,233,333	$664,462,990	$231,319,669
Total	**1,423,849**	**$8,154,049,250**	**$4,292,358,003**	**$1,652,621,918**

*Source: TIGTA analysis of Individual Master File,[18] Information Returns Master File (IRMF),[19] and Form W-2 data for tax returns processed as of February 15, 2017, for which wages are the only reported income and ***2*** **********2**********.*

IRS management agreed with our analysis, stating that based on the limited employer-submitted wage data available on February 15, 2017, it looks like a large volume of tax returns would appear to be suspicious. However, IRS management indicated that these returns were not reviewed due to limited resources.

Late and missing Forms W-2 reduce the IRS's ability to verify EITC and ACTC claims before refunds are paid

The effectiveness of IRS efforts to verify wages reported on tax returns claiming the EITC and the ACTC is directly dependent on employers timely filing Forms W-2. For example, the wages reported by the individuals filing the 660,141 tax returns we identified with no Forms W-2 received by the IRS were associated with 357,335 employers. As of February 15, 2017, the IRS had not received any Forms W-2 from 319,880 (90 percent) of the 357,335 employers.

Our match of Forms W-2 received by the IRS as of April 20, 2017, to the employers associated with the wages reported on the more than 1.4 million returns we identified resolved the income discrepancy for 573,623 (40 percent) of the tax returns, which included 311,533 returns previously identified as having no Forms W-2 received by the IRS. This means that the employers did not comply with the required January 31 reporting date, but the IRS had received a Form W-2 by April 20, 2017. Although the IRS eventually received these Forms W-2, they were received by the IRS subsequent to processing the tax returns associated with them. The remaining 850,226 (60 percent) tax returns continued to have a discrepancy between the wages

[18] The IRS database that maintains transactions or records of individual tax accounts.
[19] Creates a Master File of current tax year information returns and maintains access to nine prior years.

reported on the tax return and Forms W-2 submitted by employers. Figure 4 shows the type of income discrepancy we identified on these 850,226 tax returns.

Figure 4: Tax Year 2016 E-Filed Tax Returns With a Wage Discrepancy As of April 20, 2017

Discrepancy Type	Tax Returns	Refunds Received	EITC Received	ACTC Received
No Form W-2	320,233	$1,747,453,241	$909,648,737	$374,295,714
Forms W-2 Received:				
More Income Reported	314,792	$1,836,028,647	$978,154,952	$379,877,381
Less Income Reported	215,201	$1,268,834,380	$713,003,765	$251,364,756
Total	**850,226**	**$4,852,316,268**	**$2,600,807,454**	**$1,005,537,851**

*Source: TIGTA analysis of Individual Master File, IRMF, and Form W-2 data for tax returns processed as of February 15, 2017, for which wages are the only reported income and *************2*************.*

IRS management stated that only 21 percent (27,137 of 127,065) of the total employers who filed Forms W-2 as of May 17, 2017, submitted their forms before February 28, 2017 (just under two weeks after the February 15 refund release date). The IRS indicated that from its review, it appears that employers with large employee counts filed timely, while smaller companies filed later. The IRS reviewed some of the accounts of the employers we provided and confirmed that its ability to systemically verify income reported on these tax returns was incomplete due to employers not submitting Forms W-2. IRS management further stated that systemic income verification cannot be accurately performed for filers that report income if not all employers have reported timely.

The IRS still does not have sufficient tools to address identified EITC and ACTC claims with income discrepancies

The amounts individuals can receive for both the EITC and the ACTC are based on income reported on their tax returns. According to the IRS, approximately $1 billion (6 percent) of improper EITC payments result from income misreporting. However, as we continue to report, IRS compliance resources are limited. Consequently, the IRS does not address the majority of potentially erroneous EITC claims despite having established processes that identify billions of dollars in potentially erroneous EITC payments.

To address concerns regarding the IRS's ability to reduce refundable credit improper payments, Congress included a provision in the PATH Act that provides additional time for the IRS to review refund claims based on the EITC and the ACTC in order to reduce fraud and improper payments. No refund based on claims for the EITC or the ACTC shall be made to a taxpayer before February 15. However, the PATH Act did not expand the IRS's authority to deny EITC and ACTC claims with unsupported income. As such, the IRS must continue to audit these EITC and ACTC claims.

According to IRS management, all EITC and ACTC claims are verified against Forms W-2 data to identify claims that have unsupported income. Tax returns that are identified as potentially fraudulent are addressed as part of the IRS's fraud prevention programs. The remaining tax returns with an income discrepancy are addressed as part of the IRS's overall Questionable Refund Program.[20] Management stated that tax returns evaluated through the Questionable Refund Program are referred to the Examination function or Automated Questionable Credits Program.[21] However, management indicated that only those tax returns with a refund greater than an established dollar tolerance are selected for review by the Examination function or the Automated Questionable Credits Program. As a result, only those EITC and ACTC claims that contain an income discrepancy and have a refund above the established dollar tolerance will be subject to additional review before the refund is paid.

It should be noted that we determined that all of the more than 1.4 million tax returns we identified that the IRS did not review before issuing the refund met the Automated Questionable Credits Program or Examination function selection tolerances for Processing Year 2017. In addition, our comparison of the 70,406 tax returns with discrepancies for which the IRS took further action showed that these returns had the same characteristics of returns that were not referred to the Examination function or the Automated Questionable Credits Program. We are conducting a separate audit to assess the impact of employer late filing of Forms W-2 on the IRS's overall fraudulent tax return detection. This audit will also address IRS actions to increase employer compliance with Forms W-2 reporting.

Some Retroactive Refundable Tax Credit Claims Were Not Disallowed As Required or Were Disallowed in Error

Our review of tax returns processed as of April 20, 2017, identified a total of 487,422 Tax Year 2013 through Tax Year 2015 tax returns with a CTC, ACTC, EITC, and AOTC claim that were processed during the 2017 Filing Season, *i.e.*, a retroactive claim. A total of 18,949 (3.9 percent) involved a claim for a tax period before the TIN was issued. The IRS correctly disallowed $34.1 million in refundable credits associated with 14,440 (76.2 percent) of the 18,949 tax returns. However, the IRS incorrectly allowed almost $9.8 million in refundable credits associated with the remaining 4,509 (23.8 percent) tax returns. Figure 5 provides the

[20] The Questionable Refund Program is a nationwide, multifunctional program designed to identify fraudulent tax returns, to stop the payment of fraudulent refunds, and to refer identified fraudulent refund schemes to Criminal Investigation field offices.

[21] Tax examiners in the Automated Questionable Credits Program review tax accounts and determine if appropriate documentation exists for the credit(s) claimed.

results of our analysis of Tax Year 2013 through Tax Year 2015 tax returns processed during the 2017 Filing Season with a TIN that was not timely issued.

Figure 5: Tax Years 2013 Through 2015 Refundable Credit Claims With Untimely Issued TINs Processed During the 2017 Filing Season

	Tax Returns[22]	Credit
ACTC		
Tax Returns With TINs Not Issued Prior to Due Date of Return	14,835	$21,046,115
Disallowed	11,625	$16,953,956
Not Disallowed	3,210	$4,092,159
CTC		
Tax Returns With TINs Not Issued Prior to Due Date of Return	5,612	$4,835,271
Disallowed	4,393	$3,968,331
Not Disallowed	1,219	$866,940
EITC		
Tax Returns With TINs Not Issued Prior to Due Date of Return	5,724	$17,171,986
Disallowed	3,993	$12,579,634
Not Disallowed	1,731	$4,592,352
AOTC		
Tax Returns With TINs Not Issued Prior to Due Date of Return	892	$848,336
Disallowed	655	$630,779
Not Disallowed	237	$217,557

Source: TIGTA analysis of the National Account Profile(NAP),[23] the IRTF, and the Individual Master File as of April 20, 2017.

We shared the results of our analysis of Tax Years 2013 through 2015 tax returns with IRS management. According to IRS management, the credits were incorrectly allowed because some of the tax returns were processed before the TIN assignment date was available on the NAP on

[22] One tax return can have more than one type of credit claimed.
[23] The NAP is a compilation of selected entity data from various IRS Master Files. It includes Social Security Administration data and cross-reference data, making it possible to verify taxpayers who have no IRS primary Master File account. The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

January 9, 2017. Credits were also incorrectly allowed because IRS employees did not follow internal guidance for processing retroactive claims in the Error Resolution System[24] (ERS). IRS management indicated that they will coordinate with other functions within the Wage and Investment Division to correct the accounts we identified.

Some taxpayer retroactive claims were erroneously disallowed

Our review also identified 289 tax returns for which the IRS incorrectly disallowed credits totaling $489,423. For each of these claims, the taxpayer's TIN was timely issued and he or she was entitled to the refundable credit(s) claimed. According to IRS management, these errors resulted from IRS employees not following procedures to verify the TIN issuance date before allowing the credits. IRS management stated that they will coordinate with other functions within the IRS Wage and Investment Division to correct the 289 tax returns we identified.

Management has yet to address retroactive claims paid in error that TIGTA identified during the 2016 Filing Season

In July 2017,[25] we reported that the IRS paid more than $34.8 million to 15,744 taxpayers who filed a Tax Year 2014 tax return during the 2016 Filing Season. Each of the refundable credit claims associated with the 15,744 tax returns we identified should have been disallowed by the IRS as required by the PATH Act. We recommended that the IRS take steps to recover the more than $34.8 million in erroneous EITCs, CTCs, ACTCs, and AOTCs. IRS management agreed with our recommendation. However, IRS management indicated that, as of October 5, 2017, the IRS has assessed only $16,631 of the more than $34.8 million in CTCs, ACTCs, EITCs, and AOTCs it paid in error. IRS management stated that they have tested adjustments on six tax returns and found that the adjustments have posted correctly. The delay in posting the assessments on the remaining tax accounts results from IRS management's request for IRS Counsel approval of the notice it plans to send taxpayers on September 8, 2017. IRS management also noted that prior to receiving Counsel's response, the Taxpayer Advocate requested a formal opinion as to the IRS's authority to use math error authority to recover these erroneous credits. IRS management informed us that once the formal opinion is received, the IRS will start processing the credits that were erroneously allowed. IRS management indicated that they plan to process 1,000 returns a week and will adjust volumes accordingly to ensure that all 15,744 returns we identified are processed prior to February 15, 2018.

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[24] Provides for the correction of errors associated with input submissions. The error inventory is managed on an ERS database, and corrected documents are validated by the Generalized Mainline Framework system.
[25] TIGTA, Ref. No. 2017-40-042, *Processes Do Not Maximize the Use of Third-Party Income Documents to Identify Potentially Improper Refundable Credit Claims p. 5* (July 2017).

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Review the 4,509 tax returns we identified for which the IRS incorrectly allowed the CTC, ACTC, EITC, and AOTC and take the steps necessary to recover the almost $9.8 million paid to taxpayers in error.

> ***Management's Response:*** The IRS agreed with this recommendation and plans to take the appropriate actions to correct the affected accounts.

Recommendation 2: Review the 289 tax returns we identified for which the IRS incorrectly denied the CTC, ACTC, EITC, and AOTC and take the steps necessary to ensure that these taxpayers receive the $489,423 in credits to which they are entitled.

> ***Management's Response:*** The IRS agreed with this recommendation and plans to take the appropriate actions to correct the affected accounts.

Error Resolution Function Resources Were Expended Reviewing Valid Prior Year Refundable Tax Credit Claims

Our review identified that the IRS did not program the Modernized e-File (MeF) system to systemically verify the issuance date of TINs reported on prior year tax returns to the NAP. Instead, all retroactive e-filed tax returns were forwarded to the IRS's ERS function, where tax examiners manually validated the TIN issuance date. It should be noted that although e-filed retroactive claims required manual verification, the IRS implemented a process to systemically verify TINs reported on paper retroactive returns to the NAP. Those tax returns for which the systemic verification identified that the TIN was not timely issued are forwarded to the IRS's ERS function for additional review. Once erroneous credit claims are identified by an ERS tax examiner for both paper and e-filed tax returns, the refundable credit claims are disallowed and a notice is sent to the taxpayer explaining the reason for the adjustment.

It should be noted that, unlike paper tax returns, the IRS has the ability to reject e-filed tax returns identified with error conditions such as retroactive refundable credit claims with a TIN that was not timely issued. Rejecting the tax return gives the taxpayer the opportunity to correct the claim. In addition, systemically verifying the TIN on refundable credit claims in the MeF system would have prevented the IRS from needlessly expending ERS function resources reviewing valid claims. For example, our review identified 158,328 e-filed tax returns with a retroactive refundable claim filed and for which the TIN was issued prior to the due date of the return (*i.e.*, a valid claim), but the returns were sent to the ERS for manual review at a cost of more than $400,000. Figure 7 provides the details of our estimate of resources needlessly expended to review these 158,328 tax returns.

Figure 7: Estimated Cost to Manually Process E-Filed Retroactive Claims With Timely Issued TINs

	Number of Tax Returns	Cost Per Tax Return	Total Cost
Total E-Filed Retroactive Claims	162,388	$2.53	$410,842
E-Filed Claims With a TIN Issued Prior to the Due Date of Return	158,328	$2.53	$400,570
E-Filed Claims With a TIN Not Issued Prior to the Due Date of Return	4,060	$2.53	$10,272

Source: TIGTA analysis of the NAP, the IRTF, and the Individual Master File as of April 20, 2017. Cost per tax return was provided by IRS management.

When we discussed our concerns with IRS management, they indicated that the request for e-file programming changes for the 2017 Filing Season mistakenly did not include criteria for its MeF system to evaluate the TIN issuance date for retroactive CTC, ACTC, EITC, or AOTC claims. When IRS management became aware of the gap in the computer programming, they decided to implement alternate processes to evaluate the TIN issuance date for all retroactive claims, *i.e.*, e-filed and paper claims, and identify questionable tax returns for manual review in its ERS function. IRS management stated that the alternate process is working according to specification and, as such, all TINs used to file retroactive CTC, ACTC, EITC, and AOTC claims will continue to be validated using the alternative process through Processing Year 2018. IRS management provided the following reasons for not programming the MeF system to address e-filed retroactive claims during Processing Year 2018:

- *Changing the MeF system to address retroactive claims will only affect Tax Year 2015 tax returns because the MeF system only accepts current year tax returns and two prior tax years in a single processing year, i.e., Tax Years 2015, 2016, and 2017 in Processing Year 2018*. IRS management indicated that it corrected MeF programming to systemically validate Tax Year 2016 claims for the 2017 Filing Season. As such, Tax Year 2015 is the only year for which retroactive e-filed returns will continue to be manually reviewed. However, we estimate that the IRS could spend more than $89,000 in Processing Year 2018 to manually process valid Tax Year 2015 retroactive claims.

- *Updating the MeF system to address retroactive claims is considered a major change to the system layout and, as such, would introduce risk and vulnerabilities to the system*. We are unsure of the risk or vulnerabilities to which IRS management is referring. The MeF system already validates TINs used on tax returns to the NAP. For example, the MeF system uses the NAP to validate the accuracy of the taxpayer's name and TIN and to determine if the TIN is still active for use in filing a tax return. In addition, the IRS already rejects e-filed tax returns for conditions in which the information on the tax return does not match the NAP. Developing additional business rules to reject CTC, ACTC, EITC, and AOTC claims when a TIN was not issued timely would appear to be no different than adding criteria to reject a tax return for any other NAP mismatch condition.

- *The IRS considers a tax return with a TIN not issued prior to the due date of the return a "processable" tax return and, therefore, IRS management does not believe it is appropriate to reject the CTC, ACTC, EITC, or AOTC claim.* IRS management's position is not consistent with current MeF system processing. For example, the IRS rejects e-filed EITC claims when the name and TIN provided for the taxpayer, the taxpayer's spouse, or the EITC qualifying child does not match IRS records. The tax return is rejected back to the taxpayer with a notification informing the taxpayer that he or she is not eligible to claim the EITC because one or more of the TINs provided is invalid. This process provides the taxpayer the opportunity to perfect the TIN in question or adjust the EITC claim. The IRS uses its existing math error authority[26] as justification for rejecting these claims. By comparison, a TIN that was not issued prior to the due date of the return is invalid for the purpose of claiming the CTC, ACTC, EITC, and AOTC.

It should be noted that in addition to the resources needlessly expended, the IRS will continue to expend additional resources to address e-filed tax returns that were not correctly processed by ERS function tax examiners. As previously discussed, we identified 4,509 e-filed tax returns with $9.8 million in claims that were not correctly disallowed as a result of employee error that the IRS must now expend additional resources to recover. The IRS must also expend additional resources to ensure that taxpayers receive the $489,423 in credits to which they are entitled for the 289 tax returns we identified for which the IRS incorrectly disallowed the refundable tax credit claims.

Tax examiners did not always send the correct notification to taxpayers whose refundable credits were denied

Our analysis also identified that ERS tax examiners did not always send taxpayers the correct notice explaining why their refundable credit claim was disallowed. As of April 20, 2017, the IRS sent an incorrect notice to 113 taxpayers. For example, these notices incorrectly informed taxpayers that their claim was denied because the taxpayer, spouse, or one or more of the dependents claimed for the credit did not have an assigned TIN by the due date of the tax return when their claim was actually denied for a different reason, such as the spouse or dependent TIN was missing from the tax return or the TIN provided was invalid. Sending an incorrect notice to taxpayers can result in additional burden for taxpayers who contact the IRS to determine why they did not receive the refund they were expecting.

[26] Math error authority allows the IRS to deny questionable or unsubstantiated claims for certain refundable credits arising out of mathematical or clerical errors. This is accomplished by sending notice to taxpayers explaining the changes. Taxpayers then have 60 days, after notice is sent, to request an abatement of the tax if they disagree with the correction. Failure to do so results in an assessment that cannot be challenged in Tax Court.

IRS management stated that errors in processing some credit claims, including the sending of incorrect notices, occurred because IRS employees did not follow internal guidance for processing retroactive claims. IRS management indicated that they will improve employee training related to retroactive CTC, ACTC, EITC, and AOTC claims for the 2018 Filing Season.

Recommendation

Recommendation 3*:* The Commissioner, Wage and Investment Division, should program the MeF system to verify the TIN issuance date on prior year tax returns and implement processes to reject retroactive CTC, ACTC, EITC, and AOTC claims filed using a TIN that was not issued before the due date of the tax return.

> ***Management's Response:*** The IRS partially agreed with this recommendation. IRS management responded that upon the passage of the PATH Act of 2015, it established processes for validating the issuance dates of TINs used to claim the applicable credits and comparing the TIN issuance dates to the return due dates. Information on extended due dates for prior year returns is not available to the MeF system for tax periods prior to the year being processed during the current filing season. Additional research is required to ascertain whether timely requests for extensions of time to file were submitted and, if so, whether the issuance dates are prior to the extended due dates. The MeF system was programmed for the 2016 Filing Season to identify returns for which additional research is needed. However, the IRS disagreed that rejecting these returns is the appropriate solution because it is possible that allowable claims could be erroneously rejected.
>
> ***Office of Audit Comment:*** The PATH Act specifies that TINs must be issued before the due date of the tax return. As such, it is imperative that the IRS has processes and procedures that identify extensions and use the due date associated with the extensions when determining if retroactive claims are valid. With the current MeF system limitations, this can only be accomplished by identifying e-filed claims and sending them for additional review to determine whether they are erroneous retroactive refundable credit claims. Therefore, we agree with the IRS's alternative process to verify these claims.

The Methodology for Correcting the Individual Taxpayer Identification Number Issuance Date Continued to Result in Errors

In July 2017, we reported that the IRS did not begin capturing the issuance date for an ITIN until January 2014, when it began using the ITIN Real-Time System (RTS).[27] For ITINs issued before January 2014, the IRS could only determine a general time frame in which an ITIN was issued.

[27] The ITIN RTS is used to assign ITINs to people with tax consequences who do not have and are not eligible for an SSN.

In March 2016, to address the inability to identify the issuance date for ITINs issued prior to January 2014, the IRS implemented a process to estimate the assignment date for all ITINs issued before January 2014. This process is as follows:

- For ITINs issued from Calendar Year 1996 to June 2006, the IRS estimated the ITIN issuance date to be 14 calendar days from the date the Form W-7, *Application for IRS Individual Taxpayer Identification Number*, was received by the IRS. The IRS used 14 calendar days because that was the standard time to process a Form W-7 during that time frame.
- For ITINs issued from June 2006 to January 2014, the IRS estimated the issuance date based on the date the ITIN Issuance Notice was sent to the applicant.

Subsequent to developing this process, the IRS identified that its methodology for estimating the ITIN issuance date was not always accurate because the IRS also issues an ITIN Assignment Notice when the taxpayer changes his or her name or address. The IRS worked with its Information Technology organization staff to research specific criteria necessary to correct the erroneous assignment dates. According to IRS management, corrections were made to the erroneous assignment dates on December 22, 2016.

We assessed the IRS's efforts to correct the erroneous assignment dates and determined that 40,043 assignment dates were still incorrect subsequent to December 22, 2016, with 1,047 having no assignment date present on the NAP. However, additional analysis of the 315,546 prior year tax returns processed as of April 20, 2017, with TINs issued before the due date of the tax return found that none of the 40,043 ITINs with incorrect assignment dates were listed on the 315,546 tax returns.

We shared our concerns with the accuracy of computer programming to generate the ITIN issuance date with the IRS. IRS management stated that for those ITINs with a missing assignment date on the NAP, they will collaborate with their Information Technology organization staff to determine the appropriate requirements and corrective actions needed to identify the population of ITINs with a missing assignment date. Once they are identified, the IRS will update the NAP to include the correct assignment date for those ITINs. IRS management stated that for the remaining 38,996 population of ITINs with an incorrect assignment date, this occurred due to incorrect programming. The IRS will work with its Information Technology organization staff to review the programming used to generate the ITIN assignment date and determine the appropriate modifications to identify and generate the correct assignment date per the requirements. The IRS will then update the corrected ITIN assignment date to the NAP.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 4***:*** Correct programming errors that resulted in the incorrect calculation of ITIN issuance dates and ensure that the RTS and the NAP are updated with the correct issuance date.

> ***Management's Response:*** The IRS agreed with this recommendation. IRS management plans to identify and correct the programming errors to ensure that the RTS and the NAP contain the correct ITIN issuance dates. Completion of these actions will require Information Technology resources, which are subject to budgetary constraints and limited resources.

Recommendation 5: Identify all ITINs with a missing issuance date on the NAP and ensure that the NAP is updated with the correct issuance date.

> ***Management's Response:*** The IRS agreed with this recommendation. IRS management responded that completion of this action will require Information Technology resources, which are subject to budgetary constraints and limited resources.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the effectiveness of the IRS's efforts to implement select refundable credit integrity provisions in the PATH Act[1] intended to reduce EITC, CTC/ACTC, and AOTC improper payments. These included provisions to prevent the issuance of credits when the reported income is not supported and individuals do not have a timely issued TIN. To accomplish our objective, we:

I. Determined if the IRS developed effective processes and procedures for the 2017 Filing Season to identify and prevent the issuance of EITC, CTC/ACTC, and AOTC claims on amended and original prior year tax returns by taxpayers with SSNs, ITINs, and ATINs that were not issued by the due date of the tax return.

   A. Performed computer analysis on prior year original tax returns processed during the 2017 Filing Season that claimed the ACTC, AOTC, CTC, and EITC to identify tax returns with TINs that were not issued by the due date of the tax return.

      1. Identified prior year tax returns from the IRTF that claimed the credits.

         a. Identified the primary TIN, secondary TIN, and the dependent TINs used to claim the credits and matched the TINs to the NAP to determine the issuance date of the TIN.

         b. Identified TINs that were not issued by the due date of the tax return.

         c. For prior year original tax returns for which the TIN was not issued by the due date of the tax return and the credit was not disallowed, matched to the Individual Master File to determine if the credit was allowed during processing of the tax return. We quantified the amount of credit allowed in error.

         d. For prior year original tax returns for which the TIN was issued by the due date of the tax return and the credit was erroneously disallowed, determined the number of tax returns with credits that were disallowed in error and the amount disallowed in error.

II. Determined if the IRS developed effective processes and procedures to identify and prevent the issuance of EITC and ACTC claims when the income reported on the tax return is not supported by Forms W-2, *Wage and Tax Statement*.

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

A. Obtained Return Integrity and Compliance Services examination statistics from the IRS including the total Questionable Refund Program inventory and the number of tax returns in inventory that are from the Return Review Program Systemic Verification process.

B. Performed data analysis using TIGTA's Data Center Warehouse[2] IRTF to identify tax returns processed claiming the EITC or the ACTC and reporting wages as income on the tax return for Tax Year 2016.

C. Identified tax returns that were processed prior to February 15.

   1. Determined if the tax returns were reviewed by the IRS for identity theft or fraud and if they were selected for the Automated Questionable Credits Program or examination.

   2. Eliminated tax returns selected for further review by the IRS.

   3. Using the population of tax returns not selected for further review by the IRS, compared wages claimed on tax returns to the IRMF for information returns that are available as of February 15 to determine if income on the tax return is supported.

      a. Identified tax returns for which there were no Forms W-2 on the IRMF. We quantified the amount of credits paid (the EITC and the ACTC) when there were no income documents to support the income.

      b. Identified tax returns for which the income claimed was more than that reported on Forms W-2. We quantified the impact of overclaiming income.

      c. Identified tax returns for which the refund was released and the income claimed was less than reported on Forms W-2 or Forms 1099-MISC, *Miscellaneous Income*, on the IRMF. We quantified the impact of underclaiming income.

D. Evaluated the impact of late-filed Forms W-2 on the IRS's ability to verify income used to support EITC and ACTC claims before February 15.

   1. Using Forms W-2 obtained from the IRMF, identified forms filed after January 31, 2017.

   2. Identified forms associated with tax returns identified in Step II.C.3 for which the income on the tax return was not supported by forms available prior to February 15.

[2] The Data Center Warehouse provides data and data access services through the TIGTA intranet.

3. Determined if the income on the tax returns identified in Step II.C.3 is supported using all Forms W-2 available on the IRMF, *i.e.*, those available before February 15 and those that were filed late.

4. Determined if the employers who filed Forms W-2 that came in after February 15 received extensions to file their information documents.

III. Determined if the ITIN Issuance Date field was correct on the ITIN RTS, the NAP, and the Master File.

A. Evaluated the accuracy of the ITIN issuance date in the RTS.

1. Obtained documentation of the programming used to estimate the ITIN issuance date.

2. Interviewed IRS management to understand the steps taken to estimate the ITIN issuance date.

3. Evaluated the criteria used to ensure that the criteria provides a reasonable estimate of the ITIN issuance date.

4. Determined if the ITIN issuance date in the RTS is accurate.

B. Verified whether the ITIN issuance dates were correct on the NAP.

C. Determined the impact of ITINs with incorrect issuance dates on retroactive claims of the CTC, ACTC, EITC, and AOTC.

Data validation methodology

During this review, we relied on data extracts obtained from the IRS's Individual Master File, the IRTF databases for Processing Year 2017, and the NAP data for Processing Year 2017 that were available on TIGTA's Data Center Warehouse. We also used data from the IRS's ITIN RTS as of March 2017. 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[3] and the ITIN RTS. We also performed analysis to ensure the 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

[3] IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

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: controls over the IRS's processing of retroactive tax returns with newly issued TINs (ATINs, ITINs, and SSNs) claiming refundable credits and the IRS's process for capturing the correct issuance dates for TINs. We evaluated these controls by interviewing IRS management, performing analysis of issuance dates of TINs from the NAP and individual tax return data from the IRTF and the Individual Master File located on TIGTA's Data Center Warehouse.

Appendix II

Major Contributors to This Report

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)
Deann L. Baiza, Director
Kathleen A. Hughes, Audit Manager
Tracy M. Hernandez, Lead Auditor
Ngan B, Tang, Senior Auditor
Linda M. Valentine, Senior Auditor

Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Services and Enforcement
Director, Return Integrity and Compliance Services, Wage and Investment Division
Director, Submission Processing, Wage and Investment Division
Director, Office of Audit Coordination

Appendix IV

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; 3,210 taxpayers who received ACTCs totaling $4,092,159 on their Tax Years 2013 through 2015 tax returns using SSNs, ITINs, or ATINs that were not issued by the due date of the tax returns[1] (see page 8).

Methodology Used to Measure the Reported Benefit:

We identified 164,764 Tax Years 2013 through 2015 tax returns that claimed the ACTC in Calendar Year 2017 and determined the TINs used as the primary taxpayer, secondary taxpayer, or dependents to claim the ACTC by analyzing the IRS's IRTF. We identified the issuance date of the TINs from the IRS's NAP. We analyzed the issuance dates to determine if the TINs used as the primary taxpayer, secondary taxpayer, or dependents to claim the ACTC were issued by the due date of the return. We identified the TINs that were not issued by the due date of the tax return.

If the primary or secondary taxpayer TIN was not issued by the due date of the return, no ACTC should be paid on the tax return. For those returns on which an eligible dependent TIN was not issued by the due date of the return, we computed the amount of the ACTC associated with that dependent. We matched those returns to the Master File to only keep those returns that posted as original returns. We determined that $4,092,159 in ACTCs was paid to 3,210 individuals using TINs that were not issued by the due date of the Tax Years 2013 through 2015 tax returns.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; 1,219 taxpayers who received $866,940 in CTCs on their Tax Years 2013 through 2015 tax returns using SSNs, ITINs, or ATINs that were not issued by the due date of the tax returns (see page 8).

[1] We considered the due date of the returns for those that filed extensions to be October 15. We did not take into consideration taxpayers who may have further extensions due to being in a disaster area or a combat zone. The actual amount of potentially erroneous refunds that the IRS protects is contingent upon the extent to which taxpayers are able to substantiate their tax return.

Methodology Used to Measure the Reported Benefit:

We identified 182,049 Tax Years 2013 through 2015 tax returns that claimed the CTC in Calendar Year 2017 and determined the TINs used as the primary taxpayer, secondary taxpayer, or dependents to claim the CTC by analyzing the IRS's IRTF. We identified the issuance date of the TINs from the IRS's NAP. We analyzed the issuance dates to determine if the TINs used as the primary taxpayer, secondary taxpayer, or dependents to claim the CTC were issued by the due date of the returns. We identified the TINs that were not issued by the due date of the tax returns.

If the primary or secondary taxpayer TIN was not issued by the due date of the return, no CTC should be paid on the tax return. For those returns on which the dependent TIN was not issued by the due date of the return, we computed the amount of the CTC associated with that dependent. We matched those returns to the Master File to only keep those returns that posted as original returns. We determined that $866,940 in CTCs was paid to 1,219 individuals using SSNs, ITINs, or ATINs that were not issued by the due date of the Tax Years 2013 through 2015 tax returns.

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; 1,731 taxpayers who received $4,592,352 in EITCs on their Tax Years 2013 through 2015 tax returns using SSNs, ITINs, or ATINs that were not issued by the due date of the tax returns (see page 8).

Methodology Used to Measure the Reported Benefit:

We identified 275,597 Tax Year 2013 through 2015 tax returns that claimed the EITC in Calendar Year 2017 and determined the TINs used as the primary taxpayer, secondary taxpayer, or dependents to claim the EITC by analyzing the IRS's IRTF. We identified the issuance date of the TINs from the IRS's NAP. We analyzed the issuance dates to determine if the TINs used as the primary taxpayer, secondary taxpayer, or dependents to claim the EITC were issued by the due date of the returns. We identified the TINs that were not issued by the due date of the tax returns.

If the primary or secondary taxpayer SSN was not issued by the due date of the return or the primary or secondary taxpayer had an ITIN, no EITC should be paid on the tax return. For those returns on which the dependent SSN was not issued by the due date of the return or the dependent had an ITIN or ATIN, we computed the amount of the EITC associated with that dependent. We determined that $4,592,352 in EITCs was paid to 1,731 individuals using SSNs or ITINs that were not issued by the due date of the Tax Years 2013 through 2015 tax returns.

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; 237 taxpayers who received $217,557 in AOTCs on their Tax Years 2013 through 2015 tax returns using SSNs, ITINs, or ATINs that were not issued by the due date of the tax returns (see page 8).

Methodology Used to Measure the Reported Benefit:

We identified 52,831 Tax Years 2013 through 2015 tax returns that claimed the AOTC in Calendar Year 2017 and determined the TINs used as the primary taxpayer, secondary taxpayer, or dependents to claim the AOTC by analyzing the IRS's IRTF and Master File. We identified the issuance date of the TINs from the IRS's NAP. We analyzed the issuance dates to determine if the TINs used as the primary taxpayer, secondary taxpayer, or dependents to claim the AOTC were issued by the due date of the returns. We identified the TINs that were not issued by the due date of the tax returns.

If the primary or secondary taxpayer TIN were not issued by the due date of the return, no AOTC should be paid on the tax return. For those returns on which the dependent TIN was not issued by the due date of the return, we computed the amount of the AOTC associated with that dependent. We determined that $217,557 in AOTCs was paid to 237 individuals using TINs that were not issued by the due date of the Tax Years 2013 through 2015 tax returns.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 289 taxpayers who were incorrectly disallowed $489,423 in refundable credits and received incorrect notices for Tax Years 2013 through 2015 tax returns (see page 8).

Methodology Used to Measure the Reported Benefit:

We identified returns claiming the ACTC, CTC, AOTC, and EITC for Tax Years 2013 through 2015 in Calendar Year 2017 and determined the TINs used as the primary taxpayer, secondary taxpayer, or dependents to claim a credit by analyzing the IRS's IRTF and Master File. We identified the issuance date of the TINs from the IRS's NAP. We analyzed the issuance dates to determine if the TINs used as the primary taxpayer, secondary taxpayer, or dependents to claim a refundable credit were issued by the due date of the return.

If all TINs were issued by the due date of the return, the refundable credit(s) should not have been disallowed based on the TIN's issuance date. We determined that 289 taxpayers were incorrectly disallowed $489,423 in refundable credits, and the IRS sent an incorrect notice based on a TIN issuance date.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 40,043 ITINs with incorrect assignment dates (see page 14).

Methodology Used to Measure the Reported Benefit:

We identified 18,664,338 Forms W-7, *Application for IRS Individual Taxpayer Identification Number*, with an ITIN assignment date missing or prior to January 2014. We used the IRS's RTS data download provided as of March 2017. We generated an ITIN assignment date based on the IRS's methodology and matched it against the NAP. We identified 40,043 ITINs that had an incorrect assignment date.

Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

January 18, 2018

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds are Paid (Audit # 201740031)

Thank you for the opportunity to review and comment on the subject draft report. The Protecting Americans from Tax Hikes (PATH) Act of 2015[1] introduced certain provisions intended to reduce improper payments that became effective for the 2016 tax year. One such provision, Section 201, changed the due date for filing Form W-2, *Wage and Tax Statement*, Form W-3, *Transmittal of Wage and Tax Statements*, and Form 1099-MISC, *Miscellaneous Income,* reporting non-employee compensation, to January 31. Prior to passage of the PATH Act, the due date for these forms was the last day of February for paper filings, and March 31 for electronic filings. Section 201 also prevented the payment of refunds that include claims for the Earned Income Tax Credit (EITC) or the Additional Child Tax Credit (ACTC), prior to February 15 for calendar-year taxpayers.

For the 2016 filing season, the IRS began using the systemic verification process within our fraud detection system, the Return Review Program (RRP), to assess the fraud potential of all individual income tax returns claiming refunds. Systemic verification compares available wage and other income data provided by third-party reporters on information returns to the information reported on tax returns. With systemic verification, we leverage the data from information returns to make better-informed decisions on the risk level of potential fraud on each tax return. It is important to note that systemic verification of wage data is performed on all returns claiming refunds, not just those with refunds comprised of the EITC or ACTC. The systemic verification process works independently of the procedures we implemented to hold EITC and ACTC refunds until February 15.

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

To maximize the benefits obtained from systemic verification, on August 13, 2015, the IRS removed Treasury Regulation § 1.6081-82, which provided for an automatic 30-day extension of time to file Form W-2, and replaced it with temporary Treasury Regulation § 1.6081-8[2]. The temporary regulation eliminated the automatic 30-day extension for Form W-2. The intended result was to realize increased volumes of Forms W-2 received earlier in the year when the data has significant value during return processing. The passage of the PATH Act on December 18, 2015, which accelerated the filing deadline for all Form W-2 submissions, further assisted our efforts in increasing the volume of wage data available earlier in the filing season.

The January 31 due date became effective for the applicable information returns required to be filed for the 2016 tax year. We worked with the Social Security Administration (SSA) to ascertain that Forms W-2 could be filed by employers as early as December 2016 and would be transmitted daily to the IRS. Recognizing the significant impact the change of the filing due date and the elimination of automatic extensions could have on the payer community, the IRS also engaged stakeholders with educational outreach and communications. This ensured employers were aware well ahead of the end of the tax year that their information returns would be due by January 31, 2017. These actions led to the IRS, by February 15, 2017, receiving data from the SSA for more than 214 million Form W-2 filings. That represents a more than two-fold increase over the number received at the same point in time the previous year.

Although systemic verification was first used in 2016, the accelerated due date for Form W-2, combined with the required hold placed on the population of refunds claiming EITC or ACTC, permitted us to perform baseline analyses on the ability to use it for authenticating the identities of taxpayers filing returns, as well as to use it as one of many tools in detecting potential fraud. We are leveraging the results of our analyses of the 2017 filing season results to further refine fraud detection models and improve our ability to detect and stop more attempted fraud in 2018. It is important to note that, of the 1.5 million returns identified during the audit as having wage discrepancies of *******2******* between the amount reported on the returns and the Form W-2 data the IRS had received by February 15, all had been processed through our fraud filters and models, in addition to systemic verification, with 70,406 being identified for further review. As more Form W-2 data was received, by April 20, 2017, the population of discrepancy returns had decreased by 573,623. Employer non-compliance with their Form W-2 filing requirements cannot lead to the instant conclusion that the tax returns of the employees are fraudulent.

It is also necessary to recognize, as reflected in the report, that the legal authority does not exist for the IRS to increase a taxpayer's liability when income documents do not reconcile with the return. Whether the discrepancy results in an additional tax assessment or the reduction of allowable credits, deficiency procedures must be

[2] 80 FR 48433, 48435, August 13, 2015

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followed and they are the costliest treatment processes available for addressing questionable returns in terms of both human resource needs and processing costs. Although all the discrepancy returns identified met the selection tolerances for the Automated Questionable Credit Program or the Examination function, if the resources are not available to absorb the work, not all of it will be addressed. With the significant budget reductions experienced by the IRS since 2010, those reductions are evident in decreased staffing levels for all programs, including those most critical for stopping and treating potential fraud. The inability to address lower-risk work is a tangible effect of reduced funding.

Unlike Section 201 of the PATH Act, Sections 204 through 206, pertaining to ineligibility for retroactive claims of the EITC, ACTC, and the American Opportunity Tax Credit for tax years ending prior to the issuance of the applicable Taxpayer Identification Numbers, became effective immediately upon passage of the legislation on December 18, 2015. Consequently, this posed a significant challenge for the IRS as neither critical data nor the programming needed for systemic identification and treatment of these claims was in place. Workaround solutions were developed to meet the immediate need to be able to detect and identify such claims. Concurrently, we also met with SSA officials to execute an information exchange agreement that permitted us to receive Social Security Number (SSN) issuance dates. We also worked internally with system programmers to populate reference databases with both the SSN and Individual Taxpayer Identification Number issuance dates so that our processing systems could detect potentially unallowable retroactive claims and refer them for further review. During this process, approximately 40,000 accounts out of 21 million affected, less than two-tenths of one percent, did not receive a correct issuance date. We are working to correct those errors.

We agree with the recommendations and the associated outcome measures. Attached are our comments and proposed actions to respond to your recommendations. If you have any questions, please contact Michael Beebe, Director, Return Integrity and Compliance Services, Wage and Investment Division, at 470-639-3250.

Attachment

Attachment

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1
Review the 4,509 tax returns we identified in which the IRS incorrectly allowed the CTC, the ACTC, the EITC, and the AOTC and take the steps necessary to recover the almost $9.8 million paid to taxpayers in error.

CORRECTIVE ACTION
We agree with this recommendation and will take the appropriate actions to correct the affected accounts.

IMPLEMENTATION DATE
October 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.

RECOMMENDATION 2
Review the 289 tax returns we identified in which the IRS incorrectly denied the CTC, the ACTC, the EITC, and the AOTC and take the steps necessary to ensure that these taxpayers receive the $489,423 in credits to which they are entitled.

CORRECTIVE ACTION
We agree with this recommendation and will take the appropriate actions to correct the affected accounts.

IMPLEMENTATION DATE
October 15, 2018

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

RECOMMENDATION 3

The Commissioner, Wage and Investment Division, should program the MeF system to verify the TIN issuance date on prior year tax returns and implement processes to reject retroactive CTC, ACTC, EITC, and AOTC claims filed using a TIN that was not issued before the due date of the tax return.

CORRECTIVE ACTION

We partially agree with this recommendation. Upon passage of the Protecting Americans from Tax Hikes (PATH) Act of 2015,[3] we established processes for validating the issuance dates of the Taxpayer Identification Numbers (TINs) used to claim the applicable credits, and comparing them to the return due dates. For tax periods prior to the year being processed during the current filing season, information on extended due dates for prior-year returns is not available to the Modernized e-File (MeF) system. Additional research is required to ascertain timely requests for extensions of time to file were submitted and, if so, whether the issuance dates are prior to the extended due dates. The MeF system was programmed for the 2016 filing season to identify returns where additional research is needed. We disagree; however, that rejecting these returns is the appropriate solution as it is possible allowable claims could be erroneously rejected.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

N/A

Recommendations

The Commissioner, Wage and Investment Division, should

RECOMMENDATION 4

Correct programming errors that resulted in incorrect calculation of ITIN issuance dates and ensure that the RTS and the NAP are updated with the correct issuance date.

CORRECTIVE ACTION

We agree with this recommendation. The programming errors will be identified and corrected to ensure the Real-Time System and the National Accounts Profile contain

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

the correct Individual Taxpayer Identification Number issuance dates. Completion of this action will require Information Technology resources, which are subject to budgetary constraints and limited resources. We cannot provide an implementation date for completion.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
Director, Submission Processing, 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 5
Identify all ITINs with a missing issuance date on the NAP and ensure that the NAP is updated with the correct issuance date.

CORRECTIVE ACTION
We agree with this recommendation. Completion of this action will require Information Technology resources, which are subject to budgetary constraints and limited resources. We cannot provide an implementation date for completion.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
Director, Submission Processing, 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.