



*Actions Are Needed to Better Identify
and Address Individuals Who File
Tax Returns Using Frivolous Arguments*

August 31, 2016

Reference Number: 2016-40-069

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

2 = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

ACTIONS ARE NEEDED TO BETTER IDENTIFY AND ADDRESS INDIVIDUALS WHO FILE TAX RETURNS USING FRIVOLOUS ARGUMENTS

Highlights

Final Report issued on August 31, 2016

Highlights of Reference Number: 2016-40-069 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Individuals or businesses who oppose the Federal tax laws may use a frivolous tax argument to enrich themselves or evade paying tax. Generally, a frivolous tax argument is based on a frivolous or incorrect interpretation of the Federal tax laws. Individuals and businesses use these incorrect interpretations to support their claims that they are not subject to Federal tax laws.

WHY TIGTA DID THE AUDIT

To date the IRS has identified 50 frivolous tax arguments used by taxpayers. During Fiscal Years 2012 through 2014, the IRS identified 36,648 frivolous tax returns in which the taxpayer used one or more of the 50 identified frivolous arguments. TIGTA performed this audit to assess the IRS's efforts to identify and prevent the avoidance of individual income tax based on frivolous tax arguments.

WHAT TIGTA FOUND

Potentially erroneous refunds were paid as a result of undetected or insufficiently addressed frivolous tax return claims. Specifically, IRS processes and procedures do not ensure that all tax returns claiming a potentially frivolous tax argument are identified. As a result, the IRS paid more than \$27.2 million in potentially erroneous refunds or tax credits to 1,938 taxpayers who claimed one or more frivolous tax arguments in Tax Year 2014. The IRS can assess a \$5,000 frivolous penalty for each of the 1,938 returns for which a valid return is not provided by the taxpayer. IRS

management informed us that the Frivolous Return Program (FRP) filters have been modified to ensure that returns with the same characteristics as those 1,938 confirmed as frivolous will be identified and referred to the FRP for additional frivolous filer review.

In addition, TIGTA identified that employees are not adequately trained to identify tax returns claiming frivolous tax return arguments. For example, 40 of the 50 frivolous arguments are identified as a result of an IRS employee's manual review of paper-filed tax returns or correspondence. The IRS informed us that prior to Calendar Year 2013 annual FRP training was provided to its employees responsible for reviewing tax returns and correspondence. The IRS has developed two online frivolous return training courses. However, employees working in those units most likely to identify frivolous returns and correspondence are not required to take the training courses.

Finally, the FRP Correspondence Unit employees incorrectly identified for destruction correspondence containing potentially frivolous arguments. Our review of the 155 pieces of correspondence found that 11 (7 percent) pieces of correspondence should have been worked as frivolous correspondence but were incorrectly identified for destruction.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS ensure that the annual evaluation of the FRP filter criteria includes the identification and assessment of all original and amended tax returns, regardless of dollar tolerance, that meet the filter criteria and ensure that appropriate action is taken to address the 1,938 tax returns the IRS confirmed as being frivolous. In addition, the IRS should correct computer programming errors and ensure that all employees receive annual training on the processes for identifying potentially frivolous tax returns.

IRS management agreed with all of TIGTA's recommendations.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 31, 2016

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM:

Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Actions Are Needed to Better Identify and
Address Individuals Who File Tax Returns Using Frivolous Arguments
(Audit # 201540022)

This report presents the results of our review to assess the Internal Revenue Service's efforts to identify and prevent the avoidance of individual income tax based on frivolous tax arguments. This audit is included in our Fiscal Year 2016 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included in Appendix VI.

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).



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Abbreviations

e-file, e-filed	Electronic Filing or Electronically Filed
FRP	Frivolous Return Program
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
OID	Original Issue Discount
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration



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Background

Individuals or businesses that oppose the Federal tax laws sometimes use frivolous¹ tax arguments to enrich themselves or evade paying tax. Generally, a frivolous tax argument is based on a frivolous or incorrect interpretation of the Federal tax laws. Individuals and businesses use these incorrect interpretations to support their claims that they are not subject to Federal tax laws. For example, an individual may claim that he or she is not required to file a tax return or pay income tax because the Federal income tax system is voluntary. These arguments can also be used to obstruct the Internal Revenue Service (IRS) in carrying out the administration of Federal tax laws.

Internal Revenue Bulletin Notice 2010-33, issued on April 26, 2010, lists the 50 frivolous tax positions identified by the IRS to date.² In January 2015, the IRS issued the newest version of its publication entitled, *The Truth About Frivolous Tax Arguments*, which describes the most common frivolous arguments and includes numerous court cases that demonstrate that the courts continue to determine these arguments are incorrect interpretations of the Federal Tax laws. The IRS's publication also clearly states that just because an argument is not included in the document does not mean it is not frivolous. In Fiscal Years³ 2012 through 2014, the IRS reported that it identified 36,648 returns filed in which the taxpayer used one or more of the 50 identified frivolous arguments. Figure 1 provides the volume of frivolous returns the IRS identified in Fiscal Years 2012 through 2014.

**Figure 1: Frivolous Returns Identified
Fiscal Years 2012 Through 2014**

Fiscal Year	Frivolous Returns Identified
2012	11,067
2013	14,283
2014	11,298

Source: *The IRS Frivolous Return Program (FRP)*.

¹ Having no sound basis (as in fact or law); lacking in seriousness.

² See Appendix V for a description of the 50 most common frivolous tax arguments.

³ 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.



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Internal Revenue Code (I.R.C.) Section (§) 6702⁴ provides for the assessment of a \$5,000 penalty for filing frivolous tax returns or other specified frivolous submissions⁵ that are based on a position that the Secretary of the Treasury has identified as frivolous or reflects a desire to delay or impede the administration of Federal tax law. This penalty can be applied to the filing of a frivolous original or amended tax return. Frivolous correspondence can also be subject to the frivolous return penalty if the correspondence claims to be “in lieu of” a tax return or informal refund claim. The IRS reported that it assessed 5,711 frivolous filing penalties in Fiscal Year 2014. Figure 2 provides a comparison of the number of frivolous filing penalties assessed in Fiscal Years 2012 through 2014.

**Figure 2: Frivolous Penalties Assessed
Fiscal Years 2012 Through 2014**

Fiscal Year	Number of Penalties Assessed	Dollars Assessed
2012	25,546	\$127.7 million
2013	15,448	\$77.2 million
2014	5,711	\$28.5 million

Source: *The IRS's FRP.*

Those who use frivolous arguments can also be assessed a variety of other penalties including an accuracy-related penalty,⁶ a civil fraud penalty,⁷ an erroneous refund claim penalty,⁸ or a failure to file penalty.⁹ The Tax Court may also impose a penalty up to \$25,000 against taxpayers who make frivolous arguments in court. Taxpayers relying on these frivolous positions can also face criminal prosecution for: (1) attempting to evade or defeat tax under I.R.C. § 7201, for which the maximum penalty is \$100,000 (\$500,000 for a corporation) and imprisonment for up to five years; and (2) willful failure to file a return under I.R.C. § 7203, for which the maximum fine is \$25,000 (\$100,000 for a corporation) and imprisonment for up to a year.

Taxpayers who meet all of the requirements described in Revenue Procedure 2012-43 may request a frivolous filing penalty reduction by submitting Form 14402, *Internal Revenue Code (IRC) Section 6702(d) Frivolous Tax Submissions Penalty Reduction*. The requirements for a

⁴ As amended by Pub. L. No. 109-432, 120 Stat. 2922, 2960-62 (2006).

⁵ These include frivolous requests for a collection due process hearing, application for installment agreement or offer in compromise, or taxpayer assistance order.

⁶ The IRS can apply an accuracy-related penalty for careless, reckless, or intentional disregard of the rules and regulations.

⁷ The IRS can assert a civil fraud penalty when there is clear and convincing evidence to prove that some part of the underpayment of tax was due to fraud.

⁸ The IRS can assess a penalty for excessive refund or credit claims other than Earned Income Tax Credit claims that have no reasonable basis.

⁹ The IRS can assess a penalty on taxpayers who fail to file their tax return timely.



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penalty reduction include: (1) all tax returns must be filed and all taxes due must have been paid; (2) all valid or applicable tax returns for the six prior tax years must be filed; (3) all tax liabilities must be paid in full or the taxpayer is in compliance with a full payment installment agreement; and (4) an employer must have paid all required Federal employment taxes for the current quarter and prior two quarters. During Fiscal Year 2014, the IRS processed 785 Forms 14402.

Promoters of frivolous positions can face civil and criminal penalties

Individuals known as promoters encourage others to file returns with frivolous arguments and promote their schemes using websites. Often these individuals profit from promoting frivolous tax schemes. Persons, including tax return preparers, who promote frivolous positions and those who assist taxpayers in claiming tax benefits based on frivolous positions may face civil and criminal penalties and can also be enjoined¹⁰ by a court pursuant to I.R.C. §§ 7407 and 7408. Penalties for promoting or assisting in claiming a frivolous tax position include: (1) a penalty under I.R.C. § 6700 for promoting abusive tax shelters that is equal to 50 percent of the gross income derived from such activity by the person on which the penalty is imposed; (2) a \$1,000 penalty for each document filed, per person per period, under I.R.C. § 6701 for aiding and abetting the understatement of tax; and (3) criminal prosecution under I.R.C. § 7206, for which the penalty is a fine of up to \$100,000 and imprisonment for up to three years, for assisting or advising about the preparation of a false return or other document under Internal Revenue laws.

Identification of tax returns claiming frivolous tax arguments

The IRS relies on its employees and electronic filters to identify individual and business returns and correspondence that may contain a frivolous argument. The employees who identify these types of tax returns or correspondence work in the IRS Receipt and Control, Data Transcription, Code and Edit, Accounts Management, Collection, and Examination functions. These employees review paper tax returns and correspondence and are provided internal guidelines that detail how to identify and process returns and correspondence with frivolous arguments. The internal guidelines also provide common examples of frivolous arguments.

In addition to employee reviews of tax returns and correspondence and normal tax return processing checks and verifications, the IRS has also developed frivolous return identification filters within its Electronic Fraud Detection System¹¹ to identify frivolous return filings made by individuals filing either electronically filed (e-filed) returns or paper returns. To identify frivolous claims made by businesses, the IRS has developed frivolous return identification filters within its Dependent Database.¹² As a result of these filters, the IRS confirmed 230 individual

¹⁰ Given a legal order preventing the individual from engaging in a specified activity.

¹¹ A fraud detection system used by the Wage and Investment Division, Integrity and Verification Operation, and the IRS Criminal Investigation Division to detect fraudulent refund claims.

¹² A risk-based audit selection tool used by the IRS to identify tax returns for audit that is made up of a collection of information databases.



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tax returns and 618 business tax returns that contained potential frivolous tax arguments in Calendar Year 2015.

Potentially frivolous tax return filings and correspondence identified are forwarded to the FRP in the IRS Ogden, Utah, Campus¹³

The FRP is responsible for determining if identified returns and correspondence meet frivolous return criteria. For those confirmed as frivolous, the FRP is also responsible for contacting the taxpayer to obtain a valid return and assessing applicable penalties. The FRP consists of three primary functions – a clerical unit, a correspondence unit, and two units responsible for reviewing frivolous return and correspondence cases. Figure 3 shows the processes (*i.e.*, manual and electronic) used to identify potentially frivolous returns and correspondence for each of the current 50 frivolous tax positions identified to date by the IRS.

**Figure 3: Processes Used to Identify
Potentially Frivolous Returns and Correspondence**

Process to Identify Potentially Frivolous Filings and Correspondence	Actions Taken	Frivolous Arguments Identified
Employees manually review paper-filed tax returns and correspondence during tax return processing and/or post-processing to identify indicators ¹⁴ that the taxpayer is potentially taking a frivolous position.	Potentially frivolous returns and correspondence are placed in receptacles called “funny boxes” for further review by Campus FRP coordinators.	40
E-filed and paper-filed tax returns are identified during processing by normal processing controls designed to detect potentially erroneous claims.	Potentially erroneous returns are suspended from processing for further review. This review determines whether the claim is erroneous or frivolous.	5
E-filed and paper-filed tax returns are identified by specialized frivolous return filters during tax return processing. ¹⁵	Potentially frivolous returns are suspended from processing and forwarded to the FRP for further review. ¹⁶	5

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of IRS processes to detect potentially frivolous returns.

¹³ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

¹⁴ These indicators could include statements indicating the taxpayer is a sovereign citizen, references to Constitutional Amendments, and disagreements with the Government or the Federal tax system.

¹⁵ A tax return with a frivolous argument can be identified by more than one electronic filter.

¹⁶ Individual tax returns are systemically released for processing after a specified period of time if no additional action is taken on the return. Business tax returns must be manually released for processing.



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FRP review and processing of frivolous tax returns

The FRP first reviews potentially frivolous returns for similar criteria that would relate to multiple frivolous return filings which may indicate the involvement of a promoter. The FRP uses the returns that can be linked to a promoter as evidence to pursue prosecution. By identifying and pursuing the promoter, the IRS can stop future frivolous filings. All returns determined to not be frivolous are released for processing. Returns that are determined to be frivolous are controlled and worked by the FRP unit.

For tax returns confirmed as frivolous, the FRP unit sends a Computer Paragraph 72, *Exam Frivolous Filer Notice*, or Letter 3176, *Response to Frivolous Documents/Returns Received From Taxpayers*, to the filer of the frivolous return. This correspondence explains to the taxpayer what a frivolous position is and informs the taxpayer that he or she claimed a frivolous position on his or her tax return. The letter also notifies the taxpayer that the IRS will assess a \$5,000 penalty if the return is not corrected within 30 days of receiving the notice. During Calendar Year 2015, the IRS sent 5,973 frivolous return letters to taxpayers.

If the taxpayer timely responds to the IRS notice or letter, the FRP reviews the corrected return provided by the taxpayer. In some instances, taxpayers provide additional information supporting their argument. The IRS will determine the legitimacy of the taxpayer's argument if such an argument is still presented. If the IRS still considers the return to be frivolous or if the taxpayer fails to respond to the IRS notice or letter within 30 days, the IRS audits the tax return. Once the audit is complete, the IRS recomputes the amount of tax and penalties, if applicable, owed by the taxpayer and sends the taxpayer Letter 525, also known as the 30-day letter. Letter 525 explains the proposed adjustments to the taxpayer's return. The taxpayer can agree to the adjustments or appeal the adjustments within 30 days of receipt of the letter.

FRP review and processing of frivolous correspondence

The FRP is responsible for evaluating correspondence referred by other IRS functions to determine if the taxpayer's statements are frivolous. Correspondence that is determined to not be frivolous is returned to the referring IRS function for action. If the FRP determines the correspondence is in fact frivolous, an FRP employee researches IRS records in an attempt to identify the taxpayer. If the taxpayer associated with the correspondence cannot be identified the correspondence is destroyed. If the taxpayer can be identified, an FRP employee will research the taxpayer's tax account to determine if another IRS function has an open case relating to this taxpayer. If another IRS function is working a case, the FRP employee enters the correspondence information into the FRP database¹⁷ and forwards the correspondence to the appropriate IRS function with a notation that it has been evaluated by the FRP. Frivolous correspondence falls into three main categories:

¹⁷ A database of all correspondence and tax returns determined to be frivolous. This database is used by the FRP to track the resolution of frivolous correspondence and return cases.



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- Frivolous correspondence that has no relevance to an open IRS case related to the taxpayer or tax period in question – information is input to the FRP database and the correspondence is destroyed.
- Frivolous correspondence that is relevant to an open IRS case related to the taxpayer or tax period in question – information is input to the FRP database for audit trail purposes and forwarded to the IRS function working the related criminal or civil action. Examples of frivolous correspondence related to an ongoing IRS action include a Uniform Commercial Code Financing Statement¹⁸ containing an IRS employee name or a frivolous form of payment.
- Frivolous correspondence that contains legitimate information or a legitimate concern in addition to frivolous statements – the information is researched and updated on the FRP database and the Integrated Data Retrieval System¹⁹ and the legitimate issue is worked or referred as appropriate. For example, correspondence containing certain key words or characteristics are forwarded to the IRS Office of Chief Counsel Disclosure Office for consideration as a Freedom of Information Act request as required by law.

Identification of new frivolous tax arguments

The IRS Office of Chief Counsel is responsible for determining whether new positions or arguments used by taxpayers to avoid paying taxes or to obtain fraudulent refunds meet frivolous argument criteria as set forth in the I.R.C. IRS employees who identify tax returns with potentially new frivolous arguments should forward the tax returns to an FRP Senior Technical Advisor for evaluation. If the FRP Senior Technical Advisor agrees that the argument meets FRP criteria, the return is forwarded to IRS Wage and Investment Division²⁰ management for further evaluation. If IRS Wage and Investment Division management concurs with the FRP Senior Technical Advisor's assessment, the return is forwarded to the IRS Office of Chief Counsel for its review. Once the Office of Chief Counsel has determined an argument is frivolous under the I.R.C., the IRS can consider all tax returns filed with that argument as frivolous. During the last three years, six potentially new frivolous tax arguments have been forwarded for evaluation. The Office of Chief Counsel determined that three of the six arguments met the criteria of a frivolous argument.

This review assessed the IRS's processes and procedures for identifying potentially frivolous tax returns for additional review. We evaluated the IRS's processes for identifying tax returns claiming the 40 arguments identified via manual review of paper-filed returns and correspondence and the five arguments for which the IRS has developed electronic frivolous tax

¹⁸ A legal form filed by a creditor to give notice that it has or may have an interest in the personal property of the debtor.

¹⁹ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

²⁰ At the time we began our audit, the FRP was part of the IRS Small Business/Self-Employed Division.



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return filters as part of the FRP. We excluded those five arguments that are identified via normal IRS erroneous tax return filing processing controls because TIGTA performs separate reviews that assess IRS efforts to identify erroneous tax return filings. We plan to conduct a subsequent review to assess actions the IRS takes once tax returns and correspondence are identified and confirmed as frivolous.

This review was performed with information obtained from the IRS Office of Chief Counsel; the Small Business/Self-Employed Division, Examination function; the Information Technology Division's Applications Development Data Delivery Services function; and the Wage and Investment Division, Return Integrity and Compliance Services function. In addition, we conducted testing at the FRP located in the IRS's Ogden, Utah, Campus. This review was performed during the period January 2015 through April 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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Results of Review

Potentially Erroneous Refunds Were Paid As a Result of Undetected or Insufficiently Addressed Frivolous Tax Return Claims

IRS processes and procedures do not ensure that all tax returns claiming a potentially frivolous tax argument are identified so that appropriate action can be taken to secure a valid return or audit the frivolous return to recompute the amount of tax owed and to impose applicable frivolous return penalties. Our review identified that the electronic frivolous return filters do not always detect all original and amended tax returns claiming frivolous arguments. There were tax returns with characteristics of a frivolous return filing that were not identified for further review because they did not meet the established dollar tolerances. In addition, the IRS does not use the same electronic frivolous return filters used for original tax filings when reviewing amended returns. We were unable to quantify the impact of this because a computer programming error caused the Credit Reference Number²¹ for some refundable credits to drop from the tax return record when the amended return adjustments posted to the IRS Individual Master File.²²

Electronic frivolous return filters do not detect all original filed tax returns claiming potential frivolous arguments

Our analysis of Tax Year 2014 individual and business tax returns identified 262,121 potentially frivolous tax returns that were not detected by the IRS's FRP filters despite these tax returns having the characteristics filters are intended to identify. As a result, these returns were not reviewed to confirm frivolous activity. Further analysis of the 262,121 returns found that 39,277 (15 percent) tax returns claiming more than \$3.6 billion in potentially erroneous tax refunds or credits were detected by some other IRS program as a potentially erroneous tax return filing. For example, if a tax return claims a frivolous argument but is identified prior to the return being sent through frivolous filters as involving identity theft the return will be sent to the IRS functional area that works identity theft cases. We plan to assess the accuracy of the IRS's processing of these types of claims in our subsequent review. For the remaining 222,844 we found that:

- 221,771 (99.5 percent) tax returns claiming more than \$260 million in potentially erroneous refunds or tax credits were below the IRS's dollar tolerance for referring the return to the FRP for frivolous filer review. For example, the IRS does not select potentially frivolous tax returns for additional review if specific entries on the tax return

²¹ A credit reference number tells the IRS which credits were claimed on the amended return.

²² IRS database that maintains transactions or records of individual tax accounts.



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are below a certain dollar tolerance despite the returns having the same characteristics of identified and confirmed frivolous tax returns. When we brought this to IRS management's attention, they indicated that due to limited resources the IRS cannot review all tax returns identified as claiming a potentially frivolous argument. As such, the IRS uses dollar tolerances to help ensure that its limited resources are used to review those claims that will result in the highest potential return on investment.

- 1,073 (0.5 percent) tax returns claiming more than \$23 million in potentially erroneous tax refunds or credits that met the IRS dollar tolerances but were not detected by the IRS filters. As a result, these returns were not referred to the FRP for additional frivolous filer review as required. According to the IRS, returns processing issues and calculation errors resulted in these returns not being detected by the FRP filters. IRS management indicated that programming changes have been implemented to correct these errors.

Figure 4 shows the results of our analysis of undetected potentially frivolous returns in Tax Year 2014.

**Figure 4: Analysis of Undetected Potentially
Frivolous Tax Returns in Tax Year 2014**

Frivolous Argument	Total Returns	Returns Above Tolerance	Dollars Above Tolerance	Returns Below Tolerance	Dollars Below Tolerance
Fuel Tax Credit Claims	**2**	**2**	**2**	**2**	**2**
Original Issue Discount (OID) Claims (business only)	**2**	**2**	**2**	**2**	**2**
Reparation Claims	**2**	**2**	**2**	**2**	**2**
Lifetime Social Security Claims	**2**	**2**	**2**	**2**	**2**
In Lieu of an Individual Tax Return Claims	**2**	**2**	**2**	**2**	**2**
Total Returns/Dollars Not Identified by FRP Filters	262,121	1,491	\$31.5 million	260,630	\$3.9 billion
(Less Returns Identified by Other IRS Programs)	(39,277)	(418)	(\$8.3 million)	(38,859)	(\$3.6 billion)
Total Undetected Tax Returns	222,844	1,073	\$23.2 million	221,771	\$260.6 million

Source: TIGTA analysis of Tax Year 2014 returns containing frivolous return characteristics.



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IRS management's review of the 222,844 returns we identified as not being detected by the FRP filters confirmed that 1,938 returns claiming more than \$27.2 million were in fact a frivolous claim.

- 719 returns claiming \$16.7 million that were above the dollar tolerances.
- 1,219 returns claiming \$10.5 million that were below the dollar tolerances.

In addition, the IRS can assess a \$5,000 frivolous penalty for each of the 1,938 returns for which a valid return is not provided by the taxpayer.²³ These penalties can serve as a deterrent for individuals who may otherwise continue to attempt to use frivolous tax arguments to avoid paying income tax. IRS management informed us that the FRP filters have been modified to ensure that returns with the same characteristics as those 1,938 confirmed as frivolous, including the 1,219 that were below the dollar tolerances, will be identified and referred to the FRP for additional frivolous filer review.

Not all individual tax returns identified as having a potentially frivolous OID argument are forwarded to the FRP unit for action

Generally, an individual claiming a frivolous OID argument files a return reporting false income (e.g., "Other" or "Miscellaneous" income) and claims false income tax withholding approximately equal to the amount of falsely reported income. Although the return reports income, the taxpayer does not calculate any tax due. Some of the returns also have Form 1099-OID, *Original Issue Discount*, Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, or other false financial instruments included.

The IRS has developed complex electronic filters to identify individual tax returns that claim a potentially frivolous OID argument. These filters consist of more than 800 separate criteria that evaluate the risk that the tax return includes a frivolous OID argument. All individual returns screened using these filters are given a risk score. Similar to the dollar tolerances previously discussed, the IRS has established a risk cutoff score. All returns with a risk score above this cutoff score are forwarded to the FRP where they are reviewed to determine if they are in fact a frivolous claim.

The IRS reported that during Processing Year²⁴ 2014, a total of 197,527 individual tax returns were scored using the individual OID filters. According to the IRS, 10,775 returns had a score above the risk cutoff score and were sent to FRP for further review. The IRS provided us a file of the remaining 186,752 returns. We removed 10,453 tax returns filed for tax years other than 2013 and 486 duplicate return filings. Our analysis of the 175,813 Tax Year 2013 returns with a score below the risk cutoff score found that 126,613 returns (72 percent) with refunds totaling

²³ The actual amount of erroneous refunds the IRS paid as a result of undetected frivolous tax returns and the actual amount of frivolous tax return penalties the IRS can assess is dependent on the results of the IRS's resolution of potentially frivolous tax returns.

²⁴ The calendar year in which the tax return or document is processed by the IRS.



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\$2.7 billion were detected by some other IRS program as a potentially erroneous tax return filing. For example, if a tax return contains characteristics of a frivolous argument but is identified prior to the return being sent through frivolous filters as involving identity theft, the return will be sent to the IRS functional area that works identity theft cases. For the remaining 49,200 returns, we found that:

- 38,351 returns with refunds totaling ***2*** had a risk score of zero indicating the risk that the return has a frivolous OID claim is low.
- 10,849 returns with refunds totaling more than ***2*** were identified as having characteristics of a potentially frivolous OID claim. However these returns were not sent to the FRP for further review because the score was below the risk cutoff score. As a result, these returns were not reviewed to confirm frivolous activity.

When we brought our concerns to management's attention they indicated that because they do not have unlimited resources, the IRS selects for additional action only those returns with the highest risk that the return is frivolous. Management also indicated that while the 10,849 returns identified as having characteristics of a potentially frivolous OID claim may have some elements that meet the filter criteria, management's review of these claims did not identify OID filing patterns. In addition, management stated that because these returns did not meet any other fraud criteria it appears the returns had a very low likelihood of being fraudulent.

Subsequent to the completion of our review, IRS management informed us that the IRS discontinued using the more than 800 separate individual OID return criteria at the end of Calendar Year 2015. According to IRS management, the volume of confirmed frivolous returns identified by the filters no longer justified the resources needed to maintain the existing OID filters. It should be noted that the IRS confirmed that 514 of the 10,775 returns with a risk score above the cutoff score in Processing Year 2014 were in fact frivolous. The 514 returns had refunds totaling \$5.1 billion.

Management informed us that they replaced the complex electronic OID filters with alternative filters in its Discoverer system²⁵ in an attempt to identify individual returns claiming potentially frivolous OID arguments during Calendar Year 2016. Management explained that the eventual goal is to program the OID FRP filters into the Return Review Program²⁶ for Calendar Year 2017. It should be noted at no point during our review did management detail their plans to replace the extensive OID filters they had developed. As such, we have initiated a separate review to evaluate the IRS cost/benefit analysis used to support their statement that the volume

²⁵ An Oracle product that provides intuitive ad-hoc query, reporting, analysis, and Web-publishing tools that enables business users to gain immediate access to information from data warehouses and online transaction processing systems.

²⁶ An automated system used to enhance IRS capabilities to detect, resolve, and prevent criminal and civil noncompliance and identity theft, thereby reducing issuance of fraudulent tax refunds. It is used to work prerefund cases within the IRS organization.



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of confirmed frivolous returns identified by the OID filters no longer justified the resources needed to maintain the filters as well as assessing the effectiveness of the replacement process.

Processes do not ensure that all amended tax returns claiming potentially frivolous arguments are identified for further review

The IRS's amended tax return processes and procedures do not ensure that amended returns claiming potentially frivolous arguments are identified for additional review by the FRP. For example, the IRS's use of a dollar tolerance for amended tax return filings results in frivolous claims not being identified. For example, our analysis of a judgmental sample of 43 amended individual tax returns²⁷ with a Fuel Tax Credit²⁸ claim found:

- Nine returns with claims totaling **2** were above the dollar tolerance to select the return for further review yet four of the nine returns were not referred to the Examination function as required. The IRS agreed that these four returns should have been referred and has since referred the returns to its Examination function. Tax returns with potentially frivolous Fuel Tax Credit claims are manually reviewed to determine if the claim is above a certain dollar tolerance.²⁹ Claims above the IRS dollar tolerance are referred to the IRS Examination function. Once examined, returns meeting certain criteria are then forwarded to the FRP to determine if the taxpayer has in fact made a frivolous argument.
- Thirty-four returns with claims totaling ***2*** were below the dollar tolerance for selecting the return for further review. As such, these returns were not referred to the IRS Examination function. This is despite the tax return having characteristics common with a frivolous Fuel Tax Credit claim. For example, 10 of the 34 returns indicate that the amount the taxpayer spent on fuel accounted for *****2***** of their Adjusted Gross Income.³⁰ This can be an indicator of an individual claiming a frivolous Fuel Tax Credit.

Of additional concern is the IRS's inability to identify patterns in amended return filings that indicate a promoter may have knowledge of the IRS dollar tolerance criteria. Our further review of the returns we selected found indications that there may be a promoter involved in an amended tax return Fuel Tax Credit scheme. For example, 10 of the 34 returns we reviewed *****1*****
****1*****. All 10 returns also used the *****1*****
****1*****. **1** of these returns had the *****1*****

²⁷ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population. We used a judgmental sample because the population of amended returns claiming a Fuel Tax Credit was not known. As a result, we could not determine a statistically valid sample size.

²⁸ A credit for certain nontaxable uses or sales of fuel during the income tax year.

²⁹ The dollar tolerance is the same regardless of whether the claim is filed on an original or amended return.

³⁰ Our analysis is based on an average cost per gallon of \$2.50.



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*****1*****. However, none of the
1 returns contained *****1*****. In addition, seven claims
were filed *****2*****.

IRS management stated that it evaluates all of the tax returns it confirms as being frivolous annually to ensure that the characteristics of these returns are reflected in the FRP filters. It should be noted that this annual evaluation does not include an assessment of potentially frivolous tax returns that are below the dollar tolerance at which returns are referred for additional frivolous filer review. Identifying and including original and amended tax returns below the dollar tolerance in its annual evaluation of the FRP filters is essential to ensuring filters accurately identify all potentially frivolous tax returns. In addition, review of these filings can also assist the IRS in ensuring that patterns do not exist that may indicate individuals attempting to commit fraud, including promoters, have knowledge of IRS dollar tolerances and are using this knowledge to successfully submit frivolous returns.

Programming errors prevented TIGTA from quantifying the impact of the IRS not using the same electronic frivolous return filters used when processing an original tax return for amended tax returns

We attempted to quantify the impact of the IRS's use of dollar tolerances to identify potentially frivolous amended returns. Specifically, we wanted to systemically identify individuals claiming the Fuel Tax Credit to detect those that are potentially frivolous. Internal guidelines require tax examiners when processing an amended tax return with a credit claim to input a Credit Reference Number in the tax return record. This reference number tells the IRS which credits were claimed on the amended return. For example, there is a specific Credit Reference Number that identifies an amended tax return filing with a Fuel Tax Credit claim. However, our analysis of tax accounts with amended tax return filings for Tax Years 2013 and 2014 found the Credit Reference Number for Fuel Tax Credit claims was not present on tax accounts.

We notified IRS management of our concerns with the missing Credit Reference Number in August 2015. Management indicated that a computer programming error caused the Credit Reference Number for some refundable credits to drop from the tax return record when the amended return adjustments posted to the IRS Individual Master File.³¹ Management indicated they would correct the programming error.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Ensure that the annual evaluation of the FRP filter criteria includes the identification and assessment of all original and amended tax returns, regardless of dollar tolerance, that meet the filter criteria. The annual assessment should include analysis to ensure

³¹ IRS database that maintains transactions or records of individual tax accounts.



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that individuals, including promoters, are not using knowledge of IRS dollar tolerances to successfully submit frivolous returns.

Management's Response: The IRS agreed with this recommendation. The IRS agreed that all returns, regardless of refund or credit amount, received in the FRP will be reviewed to identify new scheme filing patterns. The FRP filters will be adjusted at least annually, based on the analysis of the returns reviewed. However, amended returns will continue to be identified through existing referral procedures until such time as the IRS's plans for electronic submission of amended returns are realized.

Office of Audit Comment: Subsequent to its response, IRS management followed up to clarify that all returns that meet the FRP filter criteria, regardless of dollar tolerance, will be reviewed to identify schemes and opportunities to refine existing filters and determine if additional filters are needed.

Recommendation 2: Ensure that appropriate actions are taken on the 1,938 IRS-confirmed frivolous returns that TIGTA identified to secure a valid return from the taxpayer and assess the frivolous return penalty where applicable.

Management's Response: The IRS agreed with this recommendation. The IRS is currently reviewing the 1,938 returns to determine which accounts still need FRP actions, and will ensure that penalty assessments are applied when appropriate.

Recommendation 3: Correct the computer programming errors that resulted in the Credit Reference Number for some refundable tax credits dropping from the tax return record when adjustments resulting from an amended tax return post to the Individual Master File.

Management's Response: The IRS agreed with this recommendation. Programming changes were implemented in January 2016 to post the Fuel Tax Credit with a specific Credit Reference Number.

Employees Are Not Adequately Trained to Identify Tax Returns Claiming Frivolous Tax Return Arguments

As detailed in Figure 3, 40 of the 50 frivolous arguments are identified as a result of an IRS employee's manual review of paper-filed tax returns or correspondence. While the IRS has provided these employees with internal guidelines for identifying frivolous tax returns, which includes examples of some of the most common arguments, it has not ensured that its employees are adequately trained in applying those procedures. The IRS informed us that prior to Calendar Year 2013 annual FRP training was provided to its employees responsible for reviewing tax returns and correspondence. Management stated that the training was discontinued due to budget constraints.

The IRS has developed two online frivolous return training courses. However, employees working in those units most likely to identify frivolous returns and correspondence are not



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required to take the training courses. According to the IRS, these two online training courses had been taken only 726 times between November 2011 and September 2015. By comparison, the IRS plans to bring on more than 19,000 returning or new seasonal employees for the 2016 Filing Season whose responsibilities will include opening mail, sorting tax returns, inputting paper tax returns into the IRS's computer systems, and working tax returns with IRS identified errors. All of these tasks provide an opportunity for employees to identify frivolous tax returns and/or correspondence.

Recommendation

Recommendation 4: The Commissioner, Wage and Investment Division, should ensure that all IRS employees who are responsible for identifying tax returns claiming potentially frivolous arguments complete frivolous return training annually.

Management's Response: The IRS agreed with this recommendation. The IRS already has a training course entitled, *Identifying IMF and BMF Frivolous Returns*, which is available to all operating divisions for training purposes. Return Integrity and Compliance Services staff also provide annual fraud briefings to all IRS processing sites,³² which includes awareness of frivolous return criteria identification and referral guidance. The IRS will also incorporate frivolous return training into the annual training curriculum of employees who are responsible for identifying tax returns claiming potentially frivolous arguments.

Frivolous Return Program Correspondence Unit Employees Incorrectly Identified for Destruction Correspondence Containing Potentially Frivolous Arguments

Our review found that the FRP Correspondence Unit is not always correctly identifying potentially frivolous correspondence for destruction. On June 4, 2015, we reviewed 155 pieces of taxpayer correspondence that the FRP Correspondence Unit had identified for destruction.³³ FRP internal guidelines require employees to research IRS records in an attempt to identify the taxpayer associated with the correspondence. Employees are directed to destroy any correspondence in which the Social Security Number (SSN) and taxpayer cannot be verified.

Our review of the 155 pieces of correspondence found that 11 (7 percent) pieces of correspondence should have been worked as frivolous correspondence but were incorrectly

³² Also referred to as IRS campuses. A campus is the data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

³³ Correspondence identified for destruction is retained in a locking garbage receptacle. The receptacle is removed for shredding when full. It is not dumped on a regular basis. Our review of correspondence identified for destruction included all applicable pieces of correspondence in the receptacle as of that date.



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identified for destruction. Each of these 11 pieces of correspondence included a written statement in which the taxpayer claimed a frivolous argument or had mailed a Notice of Deficiency back to the IRS. In addition, each of the 11 pieces of correspondence included the name of the taxpayer and at least a partial SSN that could be used to identify the taxpayer.

The IRS provides a partial SSN on many notices and letters for security purposes. The IRS provides employees with tools that enable them to identify the full SSN with a minimal amount of research thus enabling the IRS to verify the taxpayer's SSN and the taxpayer. However, IRS guidelines for working potentially frivolous correspondence do not clarify that a partial SSN should be considered a valid SSN for the purposes of verifying the taxpayer.

We notified the IRS of our concerns on June 23, 2015, and recommended that IRS management revise procedures to ensure that partial SSNs on IRS notices and letters are considered a valid SSN for the purposes of verifying the taxpayer. We also recommended that the IRS ensure that FRP Correspondence Unit employees are properly trained on frivolous correspondence procedures and that management conducts periodic reviews of correspondence identified for destruction. IRS management agreed with our recommendations. IRS management noted that they have established procedures to work correspondence with partial SSNs, and the FRP Correspondence Unit has received training as TIGTA recommended. Additionally, management stated that they will review the classified waste to ensure that employees are correctly identifying correspondence for destruction.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the IRS's efforts to identify and prevent the avoidance of individual income tax based on frivolous tax arguments. To accomplish this objective, we:

- A. Researched IRS information and the Internal Revenue Manual to determine the methods used to identify and process paper and e-filed frivolous tax claims.
- B. Evaluated the Electronic Fraud Detection System and Dependent Database filters used by the IRS to identify frivolous claims.
 1. Determined whether all returns are processed through the Electronic Fraud Detection System and Dependent Database filters. This included paper returns and all returns with balances due, zero balances, and refunds.
 2. Identified the individual and business tax return characteristics used by the current electronic filters and the frivolous arguments they are designed to identify.
- C. Using the Individual Return Transaction File,¹ we identified Tax Year² 2014 individual tax returns that contain the characteristics identified in Step B.2.
 1. Determined whether the IRS's individual frivolous return filters adequately identified the returns above the tolerance level. We quantified any exception cases.
 2. Identified returns that met the IRS's frivolous return filters but were below the IRS's dollar tolerances. We quantified the number of returns and the amount of refunds that were issued because the return was below the IRS tolerance.
- D. Using the Business Return Transaction File,³ we identified Tax Year 2014 business tax returns processed during Calendar Years 2014 and 2015 that contain the characteristics identified in Step B.2.
 1. Determined whether the IRS's business frivolous return filters adequately identified the returns above the tolerance level. We quantified any exception cases.

¹ Contains data transcribed from initial input of the original individual tax returns during return processing.

² 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.

³ A computer file of transcribed line items on all business returns and their accompanying forms and schedules.



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2. Identified returns that met the IRS's frivolous return filters but were below the IRS's dollar tolerances. We quantified the number of returns and the amount of refunds that were issued because the return was below the IRS tolerance.
- E. Manually pulled a judgmental sample⁴ of 3,964 individual returns stored in the Files Unit at the Austin, Fresno, and Kansas City Service Centers and reviewed them for frivolous arguments. We selected a judgmental sample because the population of potentially frivolous paper returns stored in the Files Unit is unknown.
- F. Determined the method and frequency of frivolous argument training that is designed to ensure that IRS return processing employees are aware of and are identifying returns filed with frivolous arguments.
- G. Evaluated incoming correspondence to determine if correspondence claiming frivolous arguments are properly identified and forwarded to the FRP.
- H. Determined whether the IRS is identifying frivolous amended returns.
1. Reviewed IRS processing of amended returns.
 2. Determined whether the IRS has processes in place to filter potential frivolous amended returns.
 3. Reviewed the IRS's identification and processing of amended Fuel Tax Credit returns.
 4. Reviewed a judgmental sample of 43 amended Fuel Tax Credit returns for Tax Years 2013 and 2014. We selected a judgmental sample because IRS computer programming errors prevented us from identifying all amended tax returns with a Fuel Tax Credit claim. As a result, we could not identify the population of amended tax returns on which to select a statistically valid sample.

Data Validation

During this review, we obtained extracts from the IRS's Individual and Business Return Transaction Files for Tax Year 2014 that were available on TIGTA's Data Center Warehouse.⁵ Before relying on our 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.⁶ We also performed analysis to ensure the validity and reasonableness of our data, such as ranges

⁴ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population. We used a judgmental sample because the population of amended returns requesting a Fuel Tax Credit was not known. As a result, we could not determine a statistically valid sample size.

⁵ A TIGTA repository of IRS data.

⁶ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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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: controls in place to electronically and manually detect potentially frivolous individual and business tax returns. We tested these controls by reviewing and analyzing relevant documents and data related to the detection of potentially frivolous tax returns. In addition, we manually reviewed amended tax returns and correspondence for indications of frivolous tax arguments.



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Appendix II

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Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Services and Enforcement
Director, Customer Account Services, Wage and Investment Division
Director, Return Integrity and Compliance Services, Wage and Investment Division
Director, Office of Audit Coordination
Chief Counsel
Director, Office of Legislative Affairs
Director, Office of Program Evaluation and Risk Analysis
National Taxpayer Advocate
Office of Internal Control



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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:

- Revenue Protection – Potential; \$136,137,170 in erroneous refunds or credit claims paid to 1,938 taxpayers over the next five years as a result of the undetected potentially frivolous tax returns (see page 9).

Methodology Used to Measure the Reported Benefit:

Using the IRS Individual Return Transaction File and the Business Return Transaction File, we identified Tax Year¹ 2014 individual and business tax returns that contain the characteristics of IRS-confirmed frivolous tax returns identified by the IRS FRP filters. We analyzed these tax returns to identify IRS activity that would indicate the tax returns were identified for additional review by the FRP filters. Our analysis identified 262,121 tax returns that were not detected by the FRP filters.

Based on our additional analysis, we determined that the IRS did not detect 222,844 Tax Year 2014 returns that contained the same characteristics as IRS-confirmed frivolous tax returns.

- \$260,594,983 paid on 221,771 potentially frivolous tax returns that were below the tolerance amount.
- \$23,178,705 paid on 1,073 potentially frivolous tax returns that were above the tolerance amount.

The IRS reviewed the 222,844 tax returns we identified and confirmed that 1,938 returns claiming \$27,227,434 were in fact frivolous. IRS management informed us that the applicable FRP filters have been modified to ensure that returns with the same characteristics as the 1,938 confirmed frivolous tax returns will be identified in the future. We forecast that the IRS

¹ 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.



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will prevent the issuance of \$136,137,170 in frivolous tax return claims to 1,938 taxpayers over the next five years as a result of modifications to its FRP filters.²

The actual amount of frivolous claims that the IRS protects is contingent upon the extent to which taxpayers are able to substantiate their tax return.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$42,625,000 in unassessed frivolous tax return penalties on 1,705 taxpayers over the next five years who filed potentially frivolous tax returns that were not identified by the IRS during processing (see page 9).

Methodology Used to Measure the Reported Benefit:

I.R.C. § 6702³ provides for the assessment of a \$5,000 penalty for filing frivolous tax returns or other specified frivolous submissions⁴ that are based on a position that the Secretary of the Treasury has identified as frivolous or reflects a desire to delay or impede the administration of the Federal tax law. This penalty can be applied to the filing of a frivolous original or amended tax return. Frivolous correspondence can also be subject to the frivolous return penalty if the correspondence claims to be “in lieu of” a tax return or informal refund claim. The FRP is responsible for determining if returns and correspondence meet frivolous return criteria, contacting the taxpayer to obtain a valid return, and assessing applicable penalties.

Once the FRP determines that a tax return contains a frivolous argument, it sends a Computer Paragraph 72, *Exam Frivolous Filer Notice*, or Letter 3176, *Response to Frivolous Documents>Returns Received from Taxpayers*, to the filer of the frivolous return. This correspondence defines a frivolous position and informs the taxpayer that he or she may have claimed a frivolous position on their tax return and also notifies the taxpayer that the IRS will assess a \$5,000 penalty if the return is not corrected within 30 days of receiving the notice. If the taxpayer timely responds to the IRS notice or letter, the FRP reviews the corrected return or other information provided by the taxpayer to determine the legitimacy of the taxpayer’s argument. If the IRS still considers the return to be frivolous or if the taxpayer fails to respond to the IRS notice or letter within 30 days, the IRS audits the tax return. According to the IRS, the taxpayer provided a valid tax return in 608 of the 4,912 cases in which the IRS requested a return during Calendar Year 2014.

We identified 1,938 tax returns that the IRS confirmed are in fact frivolous that were not identified through the FRP filters or detected through other IRS programs. As a result, these tax

² The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.

³ As amended by Pub. L. No. 109-432, 120 Stat. 2922, 2960-62 (2006).

⁴ These include frivolous requests for a collection due process hearing, application for installment agreement or offer in compromise, or taxpayer assistance order.



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returns were not evaluated for assessment of the frivolous return penalties. We then calculated the estimated number of individuals who would likely provide a valid tax return in response to the IRS notice or letter had the IRS sent one and the amount of frivolous return penalties the IRS would no longer be able to assess as a result of obtaining a valid tax return.

- Percent of frivolous return cases in which the taxpayer provided a valid tax return during Calendar Year 2014: 12 percent.
- Estimated number of potentially frivolous tax returns we identified in which the taxpayer would likely provide a valid tax return in response to the IRS notice or letter: 233 tax returns (1,938 x 12 percent).

As a result, we estimate the IRS could have potentially assessed \$8,525,000 in frivolous tax return penalties on returns that it were not forwarded to the FRP for review once identified. We computed the estimated penalties as follows:

- Number of frivolous returns where the taxpayers will not provide a valid return in response to IRS correspondence: $1,938 - 233 = 1,705$ potentially frivolous returns for which the IRS will not obtain a valid return.
- Potentially unassessed penalties associated with returns for which taxpayers will not provide a valid return in response to IRS correspondence: $1,705 \text{ returns} \times \$5,000 = \$8,525,000$.

We forecast that the IRS could potentially assess \$42,625,000 in frivolous tax return penalties on 1,705 taxpayers over the next five years.⁵

The actual amount of frivolous return penalties the IRS assesses is contingent upon the extent to which taxpayers substantiate their tax return and the actual number of valid tax returns the IRS secures in response to the frivolous return letter.

⁵ The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.



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Appendix V

*Internal Revenue Service Identified
Frivolous Tax Arguments*

The following is a description of the 50 frivolous tax arguments identified by the IRS and the number of returns identified by argument during Fiscal Years¹ 2012 through 2014.

#	Frivolous Argument	Explanation	Topic Area (The Truth About Frivolous Tax Arguments- January 2015)	Returns Identified Meeting Frivolous Arguments (FY 2012 – FY 2014)
1	Wages and Receipts Are Not Income	The filer argues that salaries and wages are not “income” within the meaning of the Sixteenth Amendment, which grants Congress the power to “Lay and collect taxes on income, from whatever source derived...”	The Meaning of Income: Taxable Income and Gross Income	354
2	Wages Are Nontaxable Receipts (Eisner v. McComber)	The filer reports wages but deducts them as “nontaxable receipts to reduce some or all income” referencing <i>Eisner v. McComber</i> 252 U.S. 189 (1920).	The Meaning of Income: Taxable Income and Gross Income	10
3	Zero Returns	The filer submits a return with zero money amounts on all or most of the line items on the form (e.g., an individual may enter zeros for income and deductions but enter an amount of tax withheld by an employer and request a refund of that amount).	The Voluntary Nature of the Federal Income Tax System	1,380
4	Zero Returns (U.S. v. Long)	The filer submits a return with zero money amounts and references <i>United States v. Long</i> (618F.2d 74 [9 th Cir 1980]).	The Voluntary Nature of the Federal Income Tax System	88

¹ 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.



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#	Frivolous Argument	Explanation	Topic Area (The Truth About Frivolous Tax Arguments- January 2015)	Returns Identified Meeting Frivolous Arguments (FY 2012 – FY 2014)
5	Not a U.S. Citizen	The filer argues that he or she is not a citizen of the United States and receives no income or benefits from sources within the United States. The individual may file a Form 1040NR, <i>U.S. Nonresident Alien Income Tax Return</i> , to receive a refund of withheld income tax or claim citizenship of a "State Republic."	The Meaning of Certain Terms Used in the Internal Revenue Code	161
6	Reparation Tax	The filer submits a return, an amended return, or correspondence referring to a reparation settlement based on the impact of slavery.	Fictional Legal Basis	2,960
7	Form 2555, Foreign Earned Income, Deduction	The filer submits a return showing income then deducts that same amount (or a large portion of that amount) by adding "Form 2555" to line 21 of Form 1040, <i>U.S. Individual Income Tax Return</i> .	The Meaning of Income: Taxable Income and Gross Income	7
8	Not a "Person" or "Individual"	The filer argues he or she is not a "Person" or "Individual" within the meaning of the Internal Revenue Code and is therefore not subject to income taxes.	The Meaning of Certain Terms Used in the Internal Revenue Code	90
9	Sixteenth Amendment	The filer argues the Sixteenth Amendment was not properly ratified and therefore the Federal Government does not have the legal authority to collect an income tax without apportionment.	Constitutional Amendment Claims	34
10	Fifth Amendment	The individual makes an improper blanket assertion of the Fifth Amendment right against self-incrimination as a basis for not providing any financial information.	Constitutional Amendment Claims	27
11	Altered Jurat	The filer submits a return that contains income and deductions but the jurat has been altered or stricken.	Not Included	327
12	Altered Form	The filer submits a return altering any or all line items with the intent of facilitating noncompliance with the tax laws.	Not Included	119
13	Unsigned Return	The filer completes a return but fails to sign and includes a statement explaining why the return is not signed indicating, among other arguments, disagreement with the tax system.	Not Included	52



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#	Frivolous Argument	Explanation	Topic Area (The Truth About Frivolous Tax Arguments- January 2015)	Returns Identified Meeting Frivolous Arguments (FY 2012 – FY 2014)
14	Wages Deducted in Cost of Goods Sold	The individual submits a return with a Schedule C attached claiming a deduction which is equal, or nearly equal, to the amount reported as wage income. The deduction is usually included in the cost of goods sold but could appear under a different deduction category.	The Meaning of Income: Taxable Income and Gross Income	0
15	Valuation	The filer argues that income is not taxable because of the declining fair market value of the dollar, because the dollar is not backed by gold/silver, because the value of services is offset by the value of the labor (barter income), etc.	The Meaning of Income: Taxable Income and Gross Income	0
16	In Lieu of...	The individual submits a document captioned, <i>Statement in lieu of U.S. income tax Form 1040</i> . Various other arguments may be used in the document.	Not Included	27
17	Disclaimer of Liability	The individual submits documentation which contains a disclaimer. The disclaimer states the individual, "disclaims the liability for the tax due," making the liability on the return zero.	The Voluntary Nature of the Federal Income Tax System	12
18	Protest Against Government Action/Inaction	The filer argues that his or her refusal to file a return or pay tax is justified because he or she disagrees with Government policies or spending plans. For the return to be frivolous the individual must claim frivolous deductions or credits based on an objection to having his or her taxes used to support various Government activities.	Not Included	11
19	Taxes Are Voluntary	The filer argues on a return or specified submission that income taxes are voluntary.	The Voluntary Nature of the Federal Income Tax System	**1**
20	Challenges Title 26 or Other Laws	The filer may argue that Title 26 of the U.S. Code is not law because it was never enacted as named. Also, the individual may argue that other laws or documents prevent the IRS from assessing and collecting tax. This argument may reference the Bible, Bill of Rights, Declaration of Independence, etc.	Not Included	459



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#	Frivolous Argument	Explanation	Topic Area (The Truth About Frivolous Tax Arguments- January 2015)	Returns Identified Meeting Frivolous Arguments (FY 2012 – FY 2014)
21	Paper Work Reduction Act	An individual argues that he or she cannot be penalized for failing to file a Form 1040 series return because the instructions and regulations associated with the Form 1040 do not display an Office of Management and Budget control number.	Fictional Legal Basis	79
22	IRS Is a Private Entity That Collects Tribute, Not Taxes	The individual argues that the IRS is an entity named the Internal Revenue and Tax Service, Inc., which was incorporated in Delaware in 1933. The individual further argues that because the IRS deposits its revenues in the Federal Reserve Bank, it is a collection agency for the bank, which is in the business of making loans and conducting proprietary business, thereby removing the cloak of Governmental immunity. Additionally, he or she argues the Department of the Treasury is part of the United Nations and is clandestinely leading the tax-paying public into a “new world order.”	Fictional Legal Basis	**1**
23	Alleged Church and First Amendment Issues	The individual receives income from nonreligious sources and may claim a vow of poverty. The individual submits a return on which all, or substantially all, of the gross income is claimed as a deduction on Schedule A of the return.	Constitutional Amendment Claims	**1**
24	Amended Return or Form 843	The individual files an amended return or a Form 843, <i>Claim for Refund and Request for Abatement</i> , to obtain a total refund of all taxes paid in prior years, based on a tax avoidance argument not supported by law.	Not Included	8
25	Untaxed	The individual argues that he or she should be “untaxed” and attempts to drop out of the Social Security system. He or she will withdraw or rescind his or her SSN, claiming he or she is a sovereign citizen.	The Meaning of Certain Terms Used in the Internal Revenue Code	**1**
26	Federal Reserve Notes Are Not Legal Tender	The individual argues that his or her wages are not taxable because they were paid in Federal Reserve notes. He or she argues that notes are not valid currency or legal tender and, thus, those who possess them cannot be subject to a tax on them.	The Meaning of Income: Taxable Income and Gross Income	13



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#	Frivolous Argument	Explanation	Topic Area (The Truth About Frivolous Tax Arguments- January 2015)	Returns Identified Meeting Frivolous Arguments (FY 2012 – FY 2014)
27	Services Not Taxable, Thirteenth Amendment, or Form of Servitude	The individual argues that income results only from the sale of goods, and therefore, the value of services is not taxable. This includes indentured servitude arguments and barter offsets. The individual may also argue that the Thirteenth Amendment outlawed slavery. He or she may claim to be "natural unfranchised individuals and freemen" who are residents of States, and therefore nonresident aliens for the purpose of the I.R.C.	Constitutional Amendment Claims	3
28	Obscene, Vulgar, or Harassing Language or Images	The individual submits documents or other materials indicating that nonfiling is due to dissatisfaction with tax policies or taxation in general. Often, this argument is expressed with obscene, vulgar, or crude language and characters in an extremely demeaning manner.	Not Included	0
29	Miscellaneous	Any other position described as frivolous in any revenue ruling or other published guidance in existence when the return adopting the position is filed with or the specified submission adopting the position is submitted to the Service.	Not Included	1,568
30	Non-Negotiable Chargeback	The filer attempts to sell his or her birthright back to the Government for a large dollar amount and requests that a "Treasury Direct Account" be set up to hold the money.	Fictional Legal Basis	2,931
31	I.R.C. § 861 for Individual Employees	The individual files a return or claim stating that wages are not taxable based on 26 Code of Federal Regulations Section 1.861 and requesting a refund of all Federal withholding.	The Meaning of Income: Taxable Income and Gross Income	17
32	I.R.C. § 3121	The individual contends that I.R.C. § 3121 exempts the Federal Insurance Contribution Act ² portion of earnings from the definition of wages and therefore from gross income for Federal tax purposes. The individual attempts to reduce taxable income by his or her portion of withheld Social Security tax.	Not Included	5,675

² Title 26, Subtitle C, Chapter 21



*Actions Are Needed to Better Identify and Address
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#	Frivolous Argument	Explanation	Topic Area (The Truth About Frivolous Tax Arguments- January 2015)	Returns Identified Meeting Frivolous Arguments (FY 2012 – FY 2014)
33	Form 1041, U.S. Income Tax Return for Estates and Trusts, Lifetime Social Security Claims	The individual claims a refund for all Social Security paid during his or her lifetime. Taxpayer requests a "lifetime earnings statement" from the Social Security Administration in order to list the amount of withheld Social Security taxes as Federal income tax or other payments.	Fictional Legal Basis	848
34	Form 1041 – In Lieu of Form 1040	The individual deducts personal income as fiduciary fees or other deductions on Form 1041 resulting in a zero tax liability.	Not Included	326
35	I.R.C. § 1341 – Claim of Right	The filer claims "compensation for personal labor" is not taxed by Title 26, I.R.C. § 1341, and takes a deduction on Schedule A, <i>Itemized Deductions</i> , or removes the amount from gross income.	The Meaning of Income: Taxable Income and Gross Income	21
36	Bosnian Refugees	The individual attempts to eliminate tax liability by filing Form 1040X, <i>Amended U.S. Individual Income Tax Return</i> , removing his or her tax on line 10 (Total Tax) and citing under Part II that he or she is entitled to refunds based upon his or her status as Bosnian refugees.	Not Included	0
37	Not Liable	The individual submits a return with "Not Liable" printed on it. The return also reflects zero money amounts despite indications the taxpayer has taxable income.	The Voluntary Nature of the Federal Income Tax System	25
38	I.R.C. § 861 – Business Employment Tax	This argument targets employers and advises them that wages are exempt from withholding. Based on 26 Code of Federal Regulations Section 1.861, promoters of this scheme advise employers to stop withholding and paying payroll taxes on their employee's wages. In addition, some employers file amended payroll tax returns and request refunds of previously paid payroll taxes.	Not Included	44
39	Earned Income Credit With Disability Income	The individual reports disability income as the sole source of income to claim the Earned Income Credit but does not attach a Form W-2, <i>Wage and Tax Statement</i> , or Form 1099, series of information returns.	Not Included	0



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#	Frivolous Argument	Explanation	Topic Area (The Truth About Frivolous Tax Arguments- January 2015)	Returns Identified Meeting Frivolous Arguments (FY 2012 – FY 2014)
40	Exempt Employees of World Bank Organization	The individual files a return with a statement attached which asserts, "World Bank Employee - Wages not Subject to Income and/or Non-Taxable Income - World Bank." The individual lists an adjustment equal to the amount of the wages and claims adjusted gross income is zero. May also cite I.R.C. § 893 which provides a tax exemption to some employees of international organizations.	Not Included	3
41	American Indian Treaty	The individual attempts to eliminate tax liability by filing Forms 1040 removing his or her income on line 21 (Other Income) and citing, "less Native American Indian Treaty" or "Native American Indian Treaty." The returns usually include Form 1099 MISC, <i>Miscellaneous Income</i> , or other income documents that include withholding which can result in a refund of withholding credit.	Fictional Legal Basis	19
42	Nunc Pro Tunc	The filer attempts to eliminate tax liability by filing returns citing "Nunc Pro Tunc" somewhere on the return. The return usually consists of all zeros except withholding and generally a refund is claimed. No further justification for the zero return is given. "Nunc Pro Tunc" is Latin for "Now for Then." These taxpayers appear to want the IRS to accept the frivolous return they have filed in place of what they filed previously.	The Voluntary Nature of the Federal Income Tax System	22
43	I.R.C. § 1001	The individual attempts to eliminate tax liability by filing Form 1040X removing all or part of income as an itemized deduction on Schedule A, "Other Miscellaneous Deductions" and citing, "I.R.C. 1001: even exchange of property Labor (property) - Employer's (property). NO GAIN REALIZED."	Not Included	161



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#	Frivolous Argument	Explanation	Topic Area (The Truth About Frivolous Tax Arguments- January 2015)	Returns Identified Meeting Frivolous Arguments (FY 2012 – FY 2014)
44	Zero Wages on a Substitute Form	Taxpayer generally attaches either a substitute Form W-2, Form 1099, or Form 4852, <i>Passive Activity Loss Limitations</i> , that shows "\$0" wages or no wage information. A statement may be included indicating the taxpayer is rebutting information submitted to the IRS by the payer. Entries are usually for Federal Income Tax Withheld, Social Security Tax Withheld, and/or Medicare Tax Withheld. An explanation on the Form 4852 may cite "statutory language behind I.R.C. 3401 and I.R.C. 3121," or may include some reference to the company refusing to issue a corrected Form W-2 for fear of IRS retaliation.	Not Included	2,810
45	Fuel Tax Credit	A filer files a return or claim requesting an amount of Fuel Tax Credit that is so disproportionately excessive to income (normally business income) reported on the individual's return as to be unallowable. In addition, the individual's occupation would generally not qualify for off-highway usage.	Fictional Legal Basis	8,792
46	Form 1099-OID	An individual or business files a return reporting false amounts of income (generally "Other" or "Miscellaneous" income) and claims a false amount of income tax withholding approximately equal to the amount of falsely reported income. Although the return reports income, the taxpayer does not calculate any tax due. Some of the returns have Form 1099-OID, <i>Original Issue Discount</i> , attached and some have Forms 1096, <i>Annual Summary and Transmittal of U.S. Information Returns</i> . Other false financial instruments may be filed in the place of or in addition to the Forms 1099-OID such as Form 2439, <i>Notice to Shareholder of Undistributed Long-Term Capital Gains</i> , promissory notes, bonds, sight drafts, etc.	Fictional Legal Basis	6,930



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#	Frivolous Argument	Explanation	Topic Area (The Truth About Frivolous Tax Arguments- January 2015)	Returns Identified Meeting Frivolous Arguments (FY 2012 – FY 2014)
47	C-Filings	This frivolous position includes four categories of filings as follows: 1) An individual files a return claiming various types of deductions, credits, or overpayments/refunds that are clearly unrealistic and because of their outrageous character, qualify as frivolous returns; 2) an individual files a return containing the filer's identifying information but does not request a refund, often lacking sufficient information to determine a tax liability; 3) an individual files a return with various types of rambling dialogue and/or confusing arguments that no one could reasonably view as a good faith attempt to comply with the law; and 4) an individual files a return that attempts to send some type of message or protest to the IRS, but fails to include sufficient identifying information for the Service to determine the identity of the taxpayer or the taxpayer's return address.	Not Included	532
48	Prisoner Filings	An individual who is incarcerated files a return with which he or she includes a Substitute Form W-2 (Form 4852). In the explanation portion of the Form 4852 he or she explains the income is based on a computation of minimum wage for hours worked within the prisons and lists an amount of withholding which allegedly represents the withholding an employer would withhold from an employee working at minimum wage. The inmate claims a refund based on the data for income and withholding the prisoner alleges the prison should have reported. The claims also may include a list that includes a work log or a computer printout showing his or her cost of incarceration.	Not Included	1,216



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#	Frivolous Argument	Explanation	Topic Area (The Truth About Frivolous Tax Arguments- January 2015)	Returns Identified Meeting Frivolous Arguments (FY 2012 – FY 2014)
49	Collection Issues	An individual submits documents contending, on frivolous grounds, that certain collection actions are invalid, such as: 1) the statutory notice of deficiency, Notice of Federal Tax Lien, collection due process notice, or notice and demand is invalid because it is not signed by the Secretary of the Treasury or some particular official; 2) the assessment is invalid because the taxpayer did not receive a copy of a Form 23C, <i>Assessment Certificate</i> , because a Form 23C must be signed personally by the Secretary of the Treasury, or because the assessment was made on the basis of a 6020(b) return, which is not a valid return; 3) the form or content of a Notice of Federal Tax Lien is controlled by or subject to a State or local law, and a Notice of Federal Tax Lien that does not comply in form or content with State law is invalid; 4) verification under section 6330 that the requirements of any applicable law or administrative procedure have been met may be based only on one or more particular forms or documents (which must be in a certain format), such as a summary record of assessment, or that the particular forms or documents or the ones on which verification was actually determined must be provided to a taxpayer at a collection due process hearing.; 5) revenue officers are not authorized to seize property in satisfaction of unpaid taxes; 6) IRS employees lack authority to carry out their duties because they lack certain required credentials, such as a pocket commission or badge; or 7) a civil action to collect unpaid taxes or penalties must be personally authorized by the Secretary of the Treasury and Attorney General.	Frivolous Arguments in Collection Due Process Cases	3
50	Non Taxable Social Security Benefits	An individual files a return reflecting nontaxable Social Security, or Railroad Retirement benefits and claims false or excessive withholding credit resulting in a zero return.	Fictional Legal Basis	190

Source: Internal Revenue Bulletin 2010-33 issued April 26, 2010, IRS's Truth About Frivolous Tax Arguments issued January 2015, and Internal Revenue Manual 25.25.10-1.



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Appendix VI

Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

AUG 03 2016

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Debra Holland *Debra Holland*
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Actions Are Needed to Better Identify and
Address Individuals Who File Tax Returns Using Frivolous
Arguments (Audit # 201540022)

Thank you for the opportunity to review and comment on the subject draft audit report. We appreciate the Treasury Inspector General for Tax Administration's (TIGTA) observations and recognition that, although not treated by the Frivolous Return Program (FRP), our other processes detected more than 78,000 returns with frivolous characteristics and prevented the payment of more than \$3.6 billion in fraudulent refund claims. In addition to using the FRP as a tool for identifying abusive schemes and improper promoter activities, it also serves the purpose of encouraging taxpayers to become compliant with the tax laws by advising them of the potential consequences for asserting frivolous arguments. We also use the FRP to take appropriate actions when taxpayers continue to pursue frivolous arguments or activities. A frivolous argument is one that has no basis in law or in fact, attempting to illegally avoid/reduce tax liabilities or to increase refunds by fraudulent or frivolous means. The IRS has identified 50 frivolous tax arguments used by taxpayers. From Fiscal Year (FY) 2012 through FY 2014, we identified over 36,000 tax returns using at least one of the frivolous arguments, and assessed almost 47,000 penalties for over \$233 million.

The IRS uses complex electronic filters to help identify tax returns claiming frivolous arguments for further review. The FRP scored and screened over 221,000 returns in Processing Year (PY) 2014. During this audit, TIGTA identified 1,938 additional returns that filed one or more frivolous arguments, accounting for less than one percent of the total screened. All 1,938 returns identified by TIGTA were business returns. We appreciate the TIGTA's insight into the refinement of the FRP for business returns. We are currently reviewing these frivolous returns to ensure appropriate treatment, and have subsequently modified our business filters to identify returns with the same characteristics to ensure appropriate treatment of the frivolous claims in the future. Although IRS agrees that business returns require additional filters to assist in identifying frivolous conditions, these business filters were in the early stages of



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development. We disagree with TIGTA that filing patterns are always indicative of frivolous positions taken by known taxpayers, as many filing patterns have similar characteristics also used by identity thieves posing as other taxpayers to file fraudulent returns.

We must also clarify comments in the draft report regarding individual tax returns identified as having a potentially frivolous Original Issue Discount (OID) argument not being forwarded to the FRP unit for action, and the IRS decision to discontinue using the more than 800 separate individual OID return criteria at the end of Calendar Year 2015. Per the draft report:

- "38,351 returns with refunds totaling **2** had a risk score of zero indicating these returns were not a frivolous OID claim.
- 10,849 returns with refunds totaling more than **2** were identified as having characteristics of a potentially frivolous OID claim. However these returns were not sent to the FRP for further review because the score was below the risk cutoff score. As a result, these returns were not reviewed to confirm frivolous activity."

A risk score being equal to or close to zero does not confirm a return is not frivolous, but that the likelihood of being frivolous is low. There could still be frivolous returns that have a risk score of zero. Additionally, not all returns scored by the OID models should be considered as a frivolous risk. The criteria used to score returns by the frivolous models are necessary in order to produce reliable results.

Also, per the draft report, "subsequent to the completion of our review, IRS management informed us that the IRS discontinued using the more than 800 separate individual OID return criteria at the end of Calendar Year 2015. According to IRS management, the volume of confirmed frivolous returns identified by the filters no longer justified the resources needed to maintain the existing OID filters. "There are not 800 individual OID models, but only two individual OID models, each with hundreds of rules/criteria. The IRS discontinued building the OID models because the significant decrease in qualifying returns meant the adaptive models could no longer effectively self-adjust to detect and correctly score the returns meeting OID criteria. The report notes that during PY 2014, the IRS identified 10,775 returns with a risk score indicating OID frivolous potential, and confirmed 514 claiming \$5.1 billion in refunds were, in fact, frivolous and the refunds were stopped; however, it should also be noted that our decision to discontinue using the OID models in the EFDS was based on PY 2015 results, where only 4,058 returns met the OID scoring criteria and only 77 were found to be frivolous. During PY 2016, while programming is being completed to transfer OID detective capabilities to the Return Review Program for PY 2017, we are using manual analytics to identify potential OID returns.

The IRS has already established training material that is available to all operating divisions, and conducts annual fraud awareness briefings for all processing sites,



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including appropriate referral criteria for returns identified with possible frivolous arguments. The IRS is committed to refund fraud prevention, including tax returns claiming frivolous arguments and will continue to evaluate and modify our filters and training material based on current fraud trends.

Attached are our comments to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Ken Corbin, Director, Return Integrity and Compliance Services, Wage and Investment Division, at (470) 639-3450.

Attachment



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Attachment

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1

Ensure the annual evaluation of the FRP filter criteria includes the identification and assessment of all original and amended tax returns regardless of dollar tolerance that meet the filter criteria. The annual assessment should include analysis to ensure individuals, including promoters, are not using knowledge of IRS dollar tolerances to successfully submit frivolous returns.

CORRECTIVE ACTION

We agree that all returns, regardless of refund or credit amount received in the Frivolous Return Program (FRP) program, will be reviewed to identify new scheme filing patterns. The FRP filters will be adjusted at least annually, based on the analysis of the returns reviewed; however, amended returns will continue to be identified through existing referral procedures until such time as our plans for electronic submission of amended returns are realized.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

Ensure appropriate actions are taken on the 1,938 IRS confirmed frivolous returns that TIGTA identified to secure a valid return from the taxpayer and assess the frivolous return penalty where applicable.

CORRECTIVE ACTION

We agree with this recommendation and are currently reviewing the 1,938 returns to determine which accounts still need FRP actions, and will ensure penalty assessments are applied when appropriate.

IMPLEMENTATION DATE

October 15, 2016

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 3

Correct the computer programming errors that resulted in the Credit Reference Number for some refundable tax credits dropping from the tax return record when adjustments resulting from an amended tax return post to the Individual Master File.

CORRECTIVE ACTION

We agree with this recommendation. Programming changes were implemented in January 2016 to post the fuel credit with a specific credit reference number.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

Manager, Office of Servicewide Penalties, Servicewide Operations, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

N/A

Recommendation

RECOMMENDATION 4

The Commissioner, Wage and Investment Division, should ensure that all IRS employees who are responsible for identifying tax returns claiming potentially frivolous arguments complete frivolous return training annually.

CORRECTIVE ACTION

We agree with this recommendation. There is already a training course entitled, *Identifying IMF and BMF Frivolous Returns*, which is available to all operating divisions for training purposes. Return Integrity and Compliance Services staff also provide annual fraud briefings to all processing sites, which includes awareness of frivolous return criteria identification and referral guidance. We will also incorporate frivolous return training into the annual training curriculum of employees who are responsible for identifying tax returns claiming potentially frivolous arguments.

IMPLEMENTATION DATE

April 15, 2017



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RESPONSIBLE OFFICIALS

Director, Return Integrity and Compliance Services, Wage and Investment Division
Director, Accounts Management, Customer Account Services, Wage and Investment
Division
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.