
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



*Actions Are Needed to Reduce the Risk of
Fraudulent Use of Employer Identification
Numbers and to Improve the Effectiveness of
the Application Process*

February 7, 2018

Reference Number: 2018-40-013

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Redaction Legend:

1 = Tax Return/Return Information

2 = Law Enforcement Techniques/ Procedures and Guidelines for Law Enforcement Investigations or Prosecutions.

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HIGHLIGHTS

ACTIONS ARE NEEDED TO REDUCE THE RISK OF FRAUDULENT USE OF EMPLOYER IDENTIFICATION NUMBERS AND TO IMPROVE THE EFFECTIVENESS OF THE APPLICATION PROCESS

Highlights

Final Report issued on February 7, 2018

Highlights of Reference Number: 2018-40-013 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

The IRS processed more than five million Employer Identification Number (EIN) applications in Fiscal Year 2016. Business identity theft is a growing threat to tax administration. As such, it is essential that the IRS develops processes to both authenticate individuals applying for an EIN and to ensure that there is a valid business reason to obtain an EIN.

WHY TIGTA DID THE AUDIT

This audit was initiated because many EINs are not used to file business tax returns and may be at risk for fraud or business identity theft. This audit evaluated the processing of EIN applications to ensure the accuracy and reliability of the data captured by the IRS.

WHAT TIGTA FOUND

Recognizing the risk associated with the misuse of EINs to commit filing fraud, the IRS developed filters and other processes in response to prior audit recommendations. As a result, the IRS reported that between January and June 1, 2017, it identified approximately 10,000 business returns with characteristics of identity theft with associated refunds totaling \$137 million. However, actions are needed to reduce the risk to tax administration associated with EINs issued for nontax-related purposes.

In addition, programming errors resulted in the incorrect assignment of more than 227,000 EINs to sole proprietors who either already had an EIN or were deceased according to IRS records.

TIGTA also found that additional application screening filters and processes to monitor the online application system could improve the accuracy of processed applications and reduce user burden. This includes strengthening processes to help identify applicants that may be abusing the system to obtain additional EINs.

We also identified that the processing of paper EIN applications results in a high number of errors and an inefficient use of resources. Based on a statistical sample of 206 EIN applications, 66 (32 percent) applications contained one or more processing errors. Based on the results of this sample, TIGTA projects that 20,867 applications were potentially inaccurately processed by the IRS.

Finally, the IRS has data which can be used to proactively identify EINs assigned to individuals who may pose a risk to tax administration. These data include a list of individuals or businesses used as responsible parties for businesses previously determined to be fictitious by the IRS.

WHAT TIGTA RECOMMENDED

TIGTA made 18 recommendations to improve EIN application processing. The IRS agreed with 15 recommendations and has taken or plans to take corrective actions. The IRS did not agree with three recommendations.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 7, 2018

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Actions Are Needed to Reduce the Risk of Fraudulent Use of Employer Identification Numbers and to Improve the Effectiveness of the Application Process
(Audit # 201640035)

This report presents the results of our review to evaluate the processing of Employer Identification Number applications to ensure the accuracy and reliability of entity data on the Internal Revenue Service's Master File. This audit was included in our Fiscal Year 2017 Annual Audit Plan and addresses the major management challenge of Improving Tax Compliance.

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

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



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Abbreviations

EIN	Employer Identification Number
FY	Fiscal Year
IRS	Internal Revenue Service
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number



Actions Are Needed to Reduce the Risk of Fraudulent Use of Employer Identification Numbers and to Improve the Effectiveness of the Application Process

Background

An Employer Identification Number (EIN) is a nine-digit number (in the format of XX-XXXXXXX) assigned by the Internal Revenue Service (IRS) and used to identify a business entity. Business entities that use an EIN include employers, sole proprietors, corporations, partnerships, nonprofit associations, trusts, estates, government agencies, certain individuals, and other types of businesses. To obtain an EIN, applicants can apply online through the IRS's public website (IRS.gov) or by telephone, fax, or mail using Form SS-4, *Application for Employer Identification Number*. Figure 1 provides a breakdown of the EIN applications processed in Fiscal Years (FY) 2014 through 2016 by method of request.

Figure 1: EIN Counts by Application Request Type (reported in thousands)

Request Method and Description	FY 2014	FY 2015	FY 2016
Online ¹ – applicants submit their application online to the IRS.	3,783.0	4,073.3	4,653.8
Fax – applicants fax an application to the IRS.	262.1	287.6	368.2
Bulk Bank List Program – certain businesses, such as banks or law firms that represent estates or trusts, may request batches of EINs at a time. Those businesses then assign the EINs to their customers as needed.	162.1	158.5	197.3
Phone – applicants call the IRS to submit their application.	83.6 ²	9.6	N/A
International – international applicants submit their applications via fax, mail, or telephone.	N/A ³	N/A	66.5
IRS-Created – when a business tax return is filed without an EIN, the IRS creates an EIN to allow processing of the tax return.	48.3	55.9	33.8
Mail – applicants mail an application to the IRS.	32.8	32.2	38.4
Total	4,371.9	4,617.1	5,358.0

Source: IRS Wage and Investment Division, Accounts Management Office. N/A = not available.

¹ The online category includes only applications for which an EIN was assigned to the applicant. The other categories represent the number of applications received by the IRS.

² As of January 6, 2014, the IRS discontinued accepting domestic EIN applications over the telephone.

³ FY 2016 is the first year that IRS management information reports included these as a separate category.



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When individuals or entities apply for an EIN, they are required to provide information such as the entity's legal name, mailing address, type of entity, date business was started or acquired, and reason they are applying for the EIN (*e.g.*, started a new business or hired an employee).

Applicants are also required to respond to additional questions based on the type of business associated with the EIN they are requesting. In addition, most EIN applicants must disclose the name and Taxpayer Identification Number (TIN) of the principal officer, general partner, grantor, owner, or trustor associated with the entity.⁴ The IRS defines these individuals or entities as the “responsible party,” and they are the ones who control, manage, or direct the applicant entity and the disposition of its funds and assets.⁵ If there is more than one responsible party, the entity may list whichever party the entity wants the IRS to recognize as the responsible party.

Processing of EIN applications

The IRS’s online Modernized Internet Employer Identification Number application system (hereafter referred to as the Modernized EIN), available at IRS.gov, is the method most used by applicants to apply for an EIN. Applications completed using the Modernized EIN follow a user-friendly, interview-style format, similar to the popular tax preparation products on the market. The online application is available Monday through Friday from 7 a.m. to 10 p.m. Eastern Standard Time.

Applicants begin by choosing the type of entity they are applying for and then only answer questions applicable to that type of entity. If a required field is not input, the program does not allow the applicant to proceed. For example, if the TIN field for the responsible party is not input, the system will provide the applicant with an onscreen error message and the applicant will need to provide this information before continuing with the application. When the applicant successfully completes the application, he or she has the option to either receive the EIN notification letter online at the time the application is completed or have it mailed.

Form SS-4 is used by applicants to file a paper EIN application with the IRS

Form SS-4 can be obtained on IRS.gov and submitted by taxpayers via fax or mail. The IRS’s Accounts Management function located in Covington, Kentucky, processes all EIN applications submitted via paper. Typically, there are eight full-time employees that process EIN applications, with an additional 35 to 40 employees rotated in on a daily basis if needed to assist with application processing.

Once a Form SS-4 is received by the IRS, an employee will review it for completeness based on established requirements, perform required validation checks, *e.g.*, name and TIN checks, and research IRS records to ensure that an EIN was not previously assigned to the applicant. If the

⁴ This is not required when a foreign individual or business requests the EIN. A trustor is the creator of a trust.

⁵ The IRS does not capture information on the responsible party TIN for EINs issued by banks or law firms issued through the IRS’s Bulk Bank List Program.



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application is complete and accurate and was faxed, the applicant can expect to receive the EIN returned by fax within four business days. Applications submitted via mail will be processed within about four weeks, with the EIN mailed to the taxpayer. Incomplete or inaccurate applications are returned to the applicant with a letter requesting additional information. If the applicant was previously assigned an EIN, a letter is typically sent to the applicant providing the previously assigned EIN.

Prior reviews have raised concerns regarding the IRS's issuance of EINs and the use of EINs on tax returns for fraudulent purposes

In September 2013,⁶ the Treasury Inspector General for Tax Administration (TIGTA) reported that the IRS has developed processes to both authenticate individuals applying for an EIN and to ensure that there is a valid business reason to obtain an EIN. However, individuals can circumvent these processes and use someone else's identifying information or their own identifying information to obtain an EIN for an improper purpose, such as to report false income and withholding. They can also use an existing business's EIN for an improper purpose. We recommended that the IRS update fraud filters *****2*****
*****2*****s. We also recommended that the IRS develop processes to identify individuals who submit tax returns that report income and withholding using the *****2*****. IRS management agreed with our recommendations.

This review was performed with information obtained from the Wage and Investment Division office in Atlanta, Georgia; the Accounts Management function in Covington, Kentucky; and the Information Technology organization in Dallas, Texas, during the period July 2016 through August 2017. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁶ TIGTA, Ref. No. 2013-40-120, *Stolen and Falsely Obtained Employer Identification Numbers Are Used to Report False Income and Withholding* (Sept. 2013).



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Results of Review

Actions Are Needed to Reduce the Risk to Tax Administration Associated With Employer Identification Numbers Issued for Nontax-Related Purposes

Our review identified that the IRS issues EINs for nontax-related purposes, *i.e.*, uses other than to file a business tax return.⁷ In September 2015, we reported that almost *****2*****
*****2*****⁸ For the purposes of this report, we refer to these as *****2*****
2. Since first reporting on this issue, the number of *****2***** has grown to more than 40 million. *****2***** include those the IRS issues for nontax-related purposes. For example, sole proprietors who do not have employees may request an EIN even though they file their business income and expenses on their individual tax return using a Schedule C, *Profit or Loss From Business*. These individual businesses may acquire an EIN for banking purposes. Because these EINs are *****2*****⁸, the true owner of the EIN may never know or become aware if the EIN becomes stolen or is used to commit business identity theft.

To better identify the reason an individual or entity is applying for an EIN, beginning in July 2010, the IRS has required all applicants to specify one of nine reasons for requesting the EIN. Figure 2 provides a summary of that information and the number and percentage of applicants that have filed a business tax return using the requested EIN.

⁷ The term “tax-related purpose” refers to EINs that are issued and used by applicants to file business tax returns.

⁸ TIGTA, Ref. No. 2015-40-082, *Processes Are Being Established to Detect Business Identity Theft; However, Additional Actions Can Help Improve Detection* (Sept. 2015).



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Figure 2: Reason for Applying for an EIN

Reason for Applying	Number of EINs Issued	Number of Business Returns Filed	Percentage
Started a new business	19,425,949	5,551,208	29%
Other ⁹	3,477,406	1,083,830	31%
Created a trust	3,166,434	1,606,002	51%
Banking purpose	2,959,909	398,615	13%
Hired employees	721,635	343,552	48%
Changed type of organization	514,896	259,362	50%
Created a pension plan	346,257	107,023	31%
Purchased going business	230,366	126,957	55%
Compliance with IRS withholding regulations	86,421	15,921	18%
TOTAL	30,929,273	9,492,470	31%

Source: IRS's Compliance Data Warehouse¹⁰ and Business Master File¹¹ for records selected between July 2010 through February 2017.

In addition, when the IRS processes an EIN application, it assigns those businesses that will be required to file a business tax return what is called a “filing requirement.” Denoting a business with a filing requirement allows the IRS to identify businesses that do not file a tax return when required. Once a business is identified as not having filed a required return, the IRS sends a notice to the business requesting the return.

Processes have not been established to proactively reduce the risk of EINs being used to commit fraud by marking EINs that are issued with ***2*******

The IRS defines business identity theft as creating, using, or attempting to use a business’s identifying information without authority, in order to claim tax benefits. For example, in order to obtain a fraudulent refund, an identity thief files a business tax return (*e.g.*, Form 1120, *U.S. Corporation Income Tax Return*, Form 720, *Quarterly Federal Excise Tax Return*, or Form 941,

⁹ This reason is selected if the applicant is not requesting an EIN for any other reason listed on the application.

¹⁰ The Compliance Data Warehouse serves as a repository of data. The primary goal is to provide a single, integrated environment of data and computing services to support the research and analysis needs of IRS employees.

¹¹ The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.



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*Employer's QUARTERLY Federal Tax Return) using the EIN of an active or inactive business without the permission or knowledge of the EIN's owner. As another example, an identity thief applies for and obtains an EIN using the name and Social Security Number (SSN) of another individual as the responsible party (*i.e.*, fraudulently obtained EIN), without that individual's approval or knowledge, and uses it to create fictitious Forms W-2, *Wage and Tax Statement*, and bogus Forms 1040, *U.S. Individual Income Tax Return*, which the thief then files to claim a fraudulent refund.*

Recognizing the risk associated with the misuse of EINs to commit filing fraud, the IRS developed filters and other processes in response to prior TIGTA recommendations. For example, in September 2015, we reported that the IRS did *****2*****
*****2*****
*****2*****¹² For example, the IRS maintains a list of suspicious EINs¹³ determined to be associated with a fictitious business. However, no controls existed to ensure that *****2*****. In addition, we determined that processing filters could be developed to identify returns containing certain characteristics that could indicate potential identity theft cases. The IRS has data to proactively identify business tax returns filed using an *****2*****.

In response to our audit results, the IRS now deactivates the suspicious EINs¹⁴ so they cannot be used to file business tax returns. Also, the IRS now receives an alert if a suspicious EIN is used to file a Form W-2. When suspicious Forms W-2 are associated with a tax return, the IRS stops any refunds associated with these Forms W-2 from being issued. In addition, the IRS continues to develop filters to identify potential business identity theft for Forms 1120, 1120S, *U.S. Income Tax Return for an S Corporation*, and 1041, *U.S. Income Tax Return for Estates and Trusts*. The IRS reported between January and June 1, 2017, that it identified approximately 10,000 business returns with characteristics of identity theft with associated refunds totaling \$137 million. Figure 3 provides volumes and refund amounts associated with business identity theft returns the IRS identified in Calendar Years 2015 through 2017.

¹² TIGTA Ref. No. 2015-40-082, *Processes Are Being Established to Detect Business Identity Theft; However, Additional Actions Can Help Improve Detection* (Sept. 2015).

¹³ When tax examiners screen tax returns for fraud potential, they may identify a trend relating to a particular EIN used to report false income and withholding. Tax examiners perform extensive research in an attempt to locate the employers associated with these EINs. If the employer is ultimately determined to be a fictitious business, tax examiners designate the associated EIN as suspicious. The IRS maintains a list of the suspicious EINs used to identify additional tax returns that have income reported using those EINs.

¹⁴ Deactivating an EIN deletes the entity from the IRS's records when there are no accounts with a return or credit transaction present. EINs with a return or credit transaction present will have their filing requirements changed to indicate the entity is ***2***.



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Figure 3: Business Identity Theft Statistics (Calendar Years 2015 - 2017)

	2015	2016	2017 ¹⁵
Number of business identity theft filters	7	25 ¹⁶	25
Number of business identity theft returns identified	350	4,000	10,000
Total refunds	\$122 Million	\$268 Million	\$137 Million

Source: The IRS's Return Integrity and Compliance Services function.

The results of these new filters show that business identity theft is a growing threat to tax administration. While these new controls help the IRS identify potential business identity theft or tax fraud when a business return is filed, additional controls could be implemented at the time an EIN is issued or *****2***** to further reduce the risk of fraudulent use of EINs.

For example, prior to January 1, 2008, the IRS performed an annual extract of its Business Master File and deleted all EINs assigned *****2*****. The deletion of these *****2***** prevented individuals from using the EINs to file fraudulent Forms W-2. Specifically, if an individual electronically filed a tax return reporting income and withholding using a deleted *****2*****, then the IRS would reject the tax return because the EIN used to report income was not on its Business Master File.

However, the *****2***** in Calendar Year 2008 because the ****2***** *****2***** from the Business Master File prevented the IRS from subsequently obtaining information related to the EIN as the *****2***** all of the information related to the EIN from the Business Master File. We previously reported that the IRS has not *****2***** *****2***** that would continue to identify the *****2***** to report false income and withholding or prevent an *****2**** from being used to commit business identity theft or tax fraud.¹⁷

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Place an indicator on the tax account of those EINs *****2***** *****2***** that can be used to identify when these EINs are used to file business tax

¹⁵ The figures for 2017 are taken from January 1, 2017, through June 1, 2017.

¹⁶ The IRS used seven filters from January 1, 2016, through July 31, 2016. On August 1, 2016, the IRS added 18 more filters.

¹⁷ TIGTA, Ref. No. 2013-40-120, *Stolen and Falsely Obtained Employer Identification Numbers Are Used to Report False Income and Withholding* (Sept. 2013).



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returns or other tax documents, such as Forms W-2 or Forms 1099, *Miscellaneous Income*, to ensure the validity of these filings.

Management's Response: The IRS disagreed with this recommendation. IRS management responded that there are valid reasons why a filing requirement is not assigned during the EIN application process. For example, tax exempt entities do not have a filing requirement until their application of recognition has been formally accepted. Sole proprietors may have a need to issue Form 1099 which requires them to have an EIN. Additionally, some special trusts need an EIN for filing information returns. While there are no studies to indicate EINs not *****2***** are more likely to be used to commit fraud, the IRS has two existing programs that look to identify these types of entities when returns and/or information documents are filed. The Entity Fabrication Program identifies business entities and a program that has several filters that run against certain business forms claiming refunds. These filters look specifically for *****2***** that have a *****2***** and newly *****2**** that have never been ****2***.

Office of Audit Comment: As we reported above, when the IRS processes an EIN application, it already assigns those businesses that will be required to file a business tax return what is called a “filing requirement.” Adding an *****2***** to the tax accounts associated with those EINs issued without *****2***** would allow the IRS to identify subsequent tax returns filed using EINs originally issued for reasons that did not *****2*****. The IRS could then identify and assess the subsequent filing of a tax return and/or information return to ensure they are valid.

Recommendation 2: Expand fraud filters to identify potentially fraudulent tax return filings that use an *****2***** report income and withholding.

Management's Response: The IRS agreed with this recommendation. IRS management responded that it currently has a process in place. The entity fabrication project specifically identifies *****2***** used to report potentially fraudulent income and withholding.

Programming Errors Resulted in the Incorrect Assignment of Employer Identification Numbers to Some Sole Proprietors

Controls designed to ensure that EIN applications are processed correctly were not always working as intended. Our analysis of EIN application data associated with more than 96 million assigned EINs as of February 9, 2017, identified:

- 206,920 EINs issued to sole proprietors who had already been assigned an EIN. IRS procedures state that a sole proprietor should be issued only one EIN regardless of the number of businesses the sole proprietor owns. A sole proprietor is someone who owns an unincorporated business by himself or herself. The business owned by a sole



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proprietor is not treated as a separate entity and, therefore, has no legal distinction from the owner. As such, the owner is liable for all legal and financial matters. When we discussed this issue with the IRS, they indicated that additional EINs were issued to sole proprietors in error because computer programming used to determine if an EIN was already assigned was not working properly. In addition, the program that the IRS uses to determine whether the applicant already has an EIN takes time to update, which can cause additional EINs to be issued in error.

- 20,437 EINs issued to sole proprietors who, according to IRS records, were deceased at the time the application for the EIN was submitted. IRS procedures state that if a date of death for the sole proprietor is present on the IRS's system, the EIN application should be rejected. IRS management indicated that computer programming used to identify deceased sole proprietor applicants was not functioning properly. IRS management indicated that the programming problem would be corrected in October 2017.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 3: Correct programming to reject EIN applications when an EIN has previously been assigned to the same sole proprietor and to reject applications when IRS data indicate that the sole proprietor is deceased.

Management's Response: The IRS agreed with this recommendation. IRS management stated they have submitted a programming request to correctly reject applications when the sole proprietor is deceased. However, the implementation of required programming changes to accomplish this objective is subject to budgetary constraints, limited resources, and competing priorities.

Recommendation 4: Review the 206,920 EINs incorrectly assigned as duplicates to sole proprietors and the 20,437 assigned to sole proprietors who were deceased. Determine if the EINs should be merged or deactivated.

Management's Response: The IRS agreed with this recommendation. IRS management plans to research a statistical sample to determine if some EINs should be merged or deactivated and take appropriate actions based on its findings.

Expanding Modernized Employer Identification Number Screening Filters and Other Process Improvements Could Increase Application Accuracy and Reduce User Burden

Additional application screening filters can better ensure that applicants meet EIN issuance requirements. For example, our analysis of EIN application data associated with more than 96 million assigned EINs as of February 9, 2017, identified:



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- More than 4.4 million EINs were issued to estates and trusts¹⁸ for which the cross-reference TIN¹⁹ captured by the IRS was not that of a responsible party. Estate and trust applicants are required to provide two cross-reference TINs, *e.g.*, decedent of the trust or estate and a responsible party, when applying for an EIN online. For paper applications, there is space on the Form SS-4 to provide two cross-reference TINs, but the IRS does not reject the application if the second cross-reference TIN, *i.e.*, responsible party, is not provided.

In addition, whether the application is submitted via Modernized EIN or by paper, the IRS's Business Master File²⁰ only has one field to capture a cross-reference TIN associated with an estate or trust application. As a result, the IRS has chosen to capture the SSN of the decedent individual of the estate or trust rather than that of the responsible party. Capturing the TIN of the responsible party would require adding an additional field to the IRS's Business Master File. According to IRS management, the current system would not allow an additional field to be added without first eliminating other information currently being captured by the system. In our opinion, not capturing the responsible party TIN is significant enough to warrant the IRS to perform an assessment to determine how an additional field could be added to the current system. Not capturing the responsible party information hinders the IRS's ability to resolve tax concerns. For example, responsible party information is used by the IRS when a potential identity theft return is received. A notice is sent to the responsible party in order to help determine if the return is legitimate.

- 71,633 EINs were issued when the responsible party was a **2**. These **2** ranged from *****2*****. By definition, a ***2*** person would not be liable to legally carry out the duties of a responsible party. For example, the IRS defines a responsible party as someone who controls, manages, or directs the applicant entity and the disposition of its funds and assets. The Modernized EIN does not include a control to identify those applications for which the responsible party is a **2**.

When we brought this issue to the IRS's attention, management partially agreed but stated that there are instances in which a **2** would be considered the responsible party. These instances include those for which a **2** is a home care service recipient receiving care paid by the State or is the person being protected in a guardianship. We disagree. In these situations, it is likely the guardian or the home care service provider should be the responsible party as they control, manage, or direct the entity and dispose of funds and assets. Figure 4 provides a breakdown of the number and percentage of

¹⁸ The 4.4 million figure includes 3.3 million estates and 1.1 million trusts.

¹⁹ The type of cross-reference TIN obtained depends on the type of entity: 1) sole proprietor SSN for sole proprietors, 2) SSN of the decedent for estates, 3) TIN of grantor for trusts, and 4) responsible party TIN for most other entities.

²⁰ The IRS's Master File establishes the entity and stores information obtained from the EIN application.



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EINs that were issued in which the responsible party was someone *****2*****
*****2*****.

Figure 4: Responsible Party Counts by Age Range

Age Range (in years)	Number of Entities	Percentage
*****2*****	18,142	25.33%
*****2*****	29,443	41.10%
*****2*****	15,865	22.15%
*****2*****	8,183	11.42%
Total	71,633	100%

Source: TIGTA analysis of the Business Master File.

In addition, our analysis identified 26,889 EINs that were incorrectly issued to estates for which the decedent SSN provided on the application was the TIN of an individual who was not deceased. IRS procedures state that an estate is a legal entity created as a result of a person's death. An EIN should not be assigned if the named decedent on the application is not deceased. When we brought this issue to the IRS's attention, management agreed with our results but did not provide an explanation as to why the Modernized EIN does not ensure that the TIN of the decedent listed on the application is in fact that of a deceased individual and reject the application if not.

Processes did not timely identify and correct Modernized EIN errors

Our review identified that the IRS's manual processes to monitor and proactively identify Modernized EIN errors are not functioning as intended. Review of system error codes identified two codes that had abnormally high error counts. For example, in FY 2016, a total of 5,844 applicants were not able to complete their applications due to these system errors. Whereas, in the first half of FY 2017, these same system errors resulted in 97,917 applications not being processed, representing an increase of 1,576 percent. Figure 5 contains FYs 2016 and 2017 counts pertaining to these two system error codes.



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**Figure 5: Modernized EIN Significant Error Code Counts
for FYs 2016 and 2017**

Type of Error	FY 2016	FY 2017 (as of March 31)	Percentage Increase
Error Code 111 (Database Failure)	5,788	63,232	992%
Error Code 113 (Database Timeout)	56	34,685	61,838%
Total	5,844	97,917	1,576%

Source: TIGTA's analysis of Integrated Customer Communications Environment Web Applications reports.

Modernized EIN uses eight different computer servers to process applications. Error codes 111 and 113 were generated because some of these servers were not operational, resulting in applicants not being able to complete their applications. When an applicant accesses the system, the applicant is randomly directed to any one of the eight servers used to process the EIN application. When we questioned IRS management as to why there was a significant increase related to the two error conditions we identified, they stated that they manually review system logs twice a day to ensure that the Modernized EIN is properly functioning. If these reviews identify that error rates are abnormally high compared to the previous year or two, the Information Technology organization will be notified to research and identify a potential cause. If these reviews were performed as management stated, then these errors should have been promptly identified. However, Error Code 113 was not identified and addressed for approximately 63 calendar days and Error Code 111 was not identified and addressed for approximately 34 calendar days.

Processes need to be strengthened to identify applicants who may be abusing the Modernized EIN

Our review of Modernized EIN audit logs detailing applicant system accesses from January 10 through March 31, 2017, identified high numbers of application requests from the same Internet Protocol address.²¹ These applicants appeared to be bypassing a control implemented by the IRS to limit EIN requests to one per day per responsible party. For example, *****1*****
*****1*****. Upon further review, we found that *****1*****
*****1*****
*****1*****.

While the IRS did identify *****1*****
*****1*****
*****1*****

²¹ The numeric address of a computer on the Internet.



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*****2*****. After performing additional research, we determined that *****1*****. In response to our bringing this to management's attention, IRS management stated that they are changing procedures to require a responsible party to be a person, not another company or business entity.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 5: Perform an assessment to determine how an additional field could be added to the Business Master File so that both the decedent SSN and a responsible party TIN can be captured for estates and trusts.

Management's Response: The IRS agreed with this recommendation and plans to review the process to determine if an additional field can be added to capture the decedent's SSN and the responsible party TIN. However, the implementation of required programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities.

Recommendation 6: Revise internal procedures, application instructions, *etc.*, to require that estate and trust applicants applying on paper provide a responsible party.

Management's Response: The IRS agreed with this recommendation and plans to update the appropriate procedures and instructions once the required programming changes have been implemented. The implementation of requisite programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities.

Recommendation 7: Develop programming to reject applications for which the responsible party is a **2**.

Management's Response: The IRS disagreed with this recommendation. IRS management responded that there is no *****2***** for a taxpayer to be issued an EIN per its internal guidelines. There are also valid reasons a **2** would need an EIN. For example, EINs can be assigned to *****2***** who are engaged in business activities, estates in which the decedent was a **2** at the date of death, *****2***** investing funds, and numerous other scenarios.

Office of Audit Comment: The IRS did not provide any information to support that there was a valid reason to issue EINs for the 71,633 cases in which a **2** was the responsible party. With the prevalence of identity theft, these applications could



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represent instances of an unscrupulous individual using a ***2*** information for purposes of obtaining an EIN either for fraudulent purposes or to try and bypass some of the IRS's existing application controls. While there may be instances in which requests are made by **2** as legitimate responsible parties, there needs to be a process to identify and reject those that are not legitimate. The IRS agreed to review a statistically valid sample of the 71,633 EINs that we identified to ensure their validity. As such, they should use the results of their review to identify actions that can be taken to mitigate the risk associated with assigning EINs where a **2** is listed as the responsible party.

Recommendation 8: Ensure the validity of the 71,633 EINs we identified that were assigned to responsible parties who are ***2***.

Management's Response: The IRS agreed with this recommendation and plans to review a statistical sample of EINs to ensure their validity.

Recommendation 9: Develop programming to reject estate applications if the decedent TIN is not that of a deceased individual.

Management's Response: The IRS agreed with this recommendation and plans to implement required programming changes subject to budgetary constraints, limited resources, and competing priorities.

Recommendation 10: Ensure the validity of the 26,889 EINs we identified as being assigned to estates for which the decedent TIN was that of a living individual.

Management's Response: The IRS agreed with this recommendation and plans to review a statistical sample of EINs to determine their validity.

Recommendation 11: Establish systemic processes for the Modernized EIN to alert system administrators when error code counts reach certain thresholds based on historical trends.

Management's Response: The IRS agreed with this recommendation. IRS management plans to seek a feasible process for the Modernized EIN to alert system administrators when error code counts reach certain thresholds based on historical trends.

Recommendation 12: Revise procedures to not allow applicants to designate another business as the responsible party.

Management's Response: The IRS agreed with this recommendation. IRS management stated they are currently assessing a proposed policy change to determine the impact to other processes before moving forward with implementation activities.



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The Processing of Paper Applications Results in a High Number of Errors

Our review of a statistically valid sample²² of 206 paper Form SS-4 applications from a projected population²³ of 60,958 applications processed between September 19 and December 15, 2016, identified 66 (32 percent)²⁴ applications²⁵ that included one or more tax examiner processing errors. Based on the results of our sample, we project that 20,867 applications²⁶ were potentially inaccurately processed by the IRS during this time period. Specific tax examiner errors we identified include:

- 28 applications for which tax examiners did not provide all necessary information when corresponding with the applicant. This includes rejected EIN requests that did not identify and address all required fields that were not completed. When an EIN request is rejected, the IRS will correspond with an applicant to request additional information or to provide a previously assigned EIN. Internal guidelines state that all missing information should be requested when rejecting Form SS-4 applications.
- 14 applications for which tax examiners issued a letter to the applicant when procedures did not require a letter to be issued. Internal guidelines state that the IRS should not send a letter to notify the applicant of a previously assigned EIN if research shows that a letter was sent within the last 30 calendar days.
- 10 applications for which tax examiners erroneously issued an EIN even though the applicant either already had an EIN or was assigned an EIN when the application was incomplete. Internal guidelines state to always perform thorough research to verify that an EIN has not been previously assigned so as to avoid any possibility of duplication.
- 8 applications for which tax examiners entered information from the application incorrectly into the Integrated Data Retrieval System²⁷ when establishing the EIN. This

²² The sample of 206 included a sample of 103 accepted application requests and 103 rejected application requests. To select our sample, we used an expected error rate of 50 percent, a precision rate of ±10 percent, and a confidence interval of 95 percent.

²³ Because there was no record of the number of Forms SS-4 received by the IRS, we followed the guidance of our contracted statistician and sampled some of the boxes containing the Forms SS-4 to identify the projected population of 60,958.

²⁴ The point estimate error rate is 34.23 percent. We are 95 percent confident that the true population exception rate is between 26.06 percent and 42.41 percent.

²⁵ These 66 applications were associated with a total of 68 errors.

²⁶ The point estimate projection, based on a 95 percent confidence interval, is that between 15,884 and 25,850 EIN applications were not accurately processed.

²⁷ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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includes incorrectly entering the business name, the filing requirements, the fiscal year month, the business operational date, or the responsible party TIN.

- 6 applications for which tax examiners did not assign an EIN to the applicant although the applicant met all the requirements and the application was correctly prepared.
- *****1***** resulting in the inconsistent/inaccurate treatment of applicants. *****1*****1*****1*****1*****1*****1*****1*****. The IRS's internal guidelines do not provide specific instructions for processing applications for this type of trust. *****1*****1*****1*****. The IRS's internal procedures also do not provide instructions for processing (rejecting) applications in these circumstances.

When we discussed the results of our review of the processing of paper EIN applications, IRS management agreed with all but two of the errors we identified. Management did not agree with two errors for which we maintained that *****2***** should be required to provide a responsible party TIN (*e.g.*, an Individual Taxpayer Identification Number).²⁸ It should be noted that the IRS's internal guidelines require that a responsible party TIN be provided for most domestic applications. This requirement is in place so that the IRS can verify that the individual requesting an EIN is legitimate and to provide a point of contact. However, the IRS's internal guidelines for *****2***** do not require this same information. Therefore, the IRS is unable to verify the responsible party on *****2*****. During our discussions with IRS management, they agreed to consider additional information that could be used to verify **2** *****2*****.

Forms SS-4 were not properly maintained

Our review also identified that the IRS was destroying many Forms SS-4 subsequent to issuing an EIN. The IRS maintained only those applications related to estates, trusts, and entities with no filing requirements. IRS management noted that the remaining applications were destroyed because all contact information is transcribed from the Forms SS-4. We notified the IRS of our concerns on December 19, 2016, and pointed out the fact that not all of the information from the forms was in fact being transcribed. For example, if the information provided on the application is obtained from a third-party provider, the form asks for the third party's name and address. However, this information is not transcribed. The IRS agreed with our concerns and stated that it

²⁸ An Individual Taxpayer Identification Number is a nine-digit number issued by the IRS that always begins with the number 9. The IRS issues Individual Taxpayer Identification Numbers to individuals who are required to have a U.S. taxpayer identification number but who do not have, and are not eligible to obtain, an SSN from the Social Security Administration.



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immediately started to retain the forms in accordance with record retention guidelines. As such, we will not be making any additional recommendations.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 13: Update internal guidelines to require ****2***** to provide additional information on the application in order to receive an EIN.

Management's Response: The IRS disagreed with this recommendation. IRS management responded that this recommendation, whether foreign or U.S. formed entities, will place undue burden upon a ****2***** when applying for an EIN.

Office of Audit Comment: At no point during our discussions with IRS management did they indicate or substantiate that requiring additional information would place an undue burden on ****2*****. In fact, they indicated that they would consider requiring information that could be used to verify ****2*****.

Recommendation 14: Develop processes and procedures to ensure that tax examiners accurately process paper Forms SS-4. This should include additional employee training and performing additional management quality reviews.

Management's Response: The IRS agreed with this recommendation stating that its internal guidelines provide the appropriate processes and procedures for tax examiners. IRS management plans to review quality feedback to identify error trends and provide the necessary refresher training.

Recommendation 15: Update internal guidelines to include procedures for processing EIN applications associated with Form 1041 (special trusts) and requests for EINs from individuals who are minors.

Management's Response: The IRS agreed with this recommendation and plans to determine if procedural changes are necessary based on its review under Recommendation 8.

Additional Existing Data Could Further Improve Detection of Individuals Obtaining Employer Identification Numbers for Potential Misuse

The IRS has additional data that if used can further improve efforts to proactively identify EINs assigned to individuals who may pose a risk to tax administration. For example:



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- *****2***** data identified 27 entities *****2*****
*****2*****. This list contains the names of organizations, countries, and some individuals whose assets have been frozen because they have committed or pose a significant risk of committing acts of terrorism. The IRS currently uses this list to identify individuals or organizations potentially involved in terrorist activities that are applying for tax-exempt status.

When we discussed the results of our match with the IRS, management stated that **2**
*****2***** that would duplicate processes the IRS currently has in place to further scrutinize business returns and EINs for potential identity theft and fraud. It should be noted that management did not provide a business case analysis or support on how a computerized match would be *****2*****. In addition, *****2*****
*****2*****. Management referred these 27 cases to its Criminal Investigation Division for review.

However, we were recently advised *****2*****
*****2*****. A representative from the Criminal Investigation Division stated that the *****2*****
*****2*****
2. For example, banks are required to check the *Specially Designated Nationals List* and would not accept a transaction (*i.e.*, cash a check or make a deposit) from a business on this list. *****2*****
*****2*****
*****2*****
*****2*****.

- Our match of the responsible party associated with EINs on the IRS's *Suspicious EIN Listing* identified an additional 20,609 EINs that also had the same responsible party as the responsible party associated with an EIN on the list. Because EINs included on the list have been determined to be fictitious, it calls into question whether the responsible party associated with these EINs is legitimate. As such, other EINs using the same responsible parties should be reviewed to determine if the additional businesses these responsible parties are associated with are legitimate.

When we brought this issue to the IRS's attention, management stated that the Modernized EIN does not have the capability to review new EIN requests involving individuals associated with EINs on the *Suspicious EIN Listing*. However, the IRS agreed that EIN application processes should be strengthened to prevent known abused TINs from being used to obtain EINs.



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Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 16: Develop processes to *****2***** and refer any matches to the Criminal Investigation Division for further review.

Recommendation 17: Develop processes to match responsible parties associated with suspicious EINs, when added to the *Suspicious EIN Listing*, against the IRS's Business Master File to identify instances in which the same responsible parties are associated with additional EINs (not in the list) and determine if these additional EINs should be added to the list.

Management's Response: The IRS agreed with this recommendation and plans to add the cross-reference TIN associated with suspicious EINs to its current review process. IRS management stated they will complete any necessary treatment (e.g., adding any additional EINs to the *Suspicious EIN Listing*) identified during this review.

Recommendation 18: Refer the 20,609 entities that contain responsible party TINs associated with suspicious EINs to the IRS's Return Integrity and Compliance Services function to determine if any of these entities should be added to the *Suspicious EIN Listing*.

Management's Response: The IRS agreed with this recommendation and plans to review the identified entities for possible inclusion in the *Compromised/Suspicious EIN Listing*.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the processing of EIN applications to ensure the accuracy and reliability of entity data on the IRS's Master File. To accomplish this objective, we:

- I. Determined if IRS policies and procedures ensured that EINs were not issued for invalid or potentially fraudulent purposes.
 - A. Reviewed the Internal Revenue Code, Internal Revenue Manuals, and any other IRS forms, instructions, and publications that describe the intent and purpose of an EIN.
 - B. Interviewed IRS personnel to obtain an understanding of the policies, procedures, and practices used to determine the purposes for assigning an EIN.
 - C. Reviewed prior TIGTA report findings dealing with EINs and determined if proper corrective actions were taken regarding these findings.
 - D. Using the Entity Module Table¹ and SS-4 file² stored on TIGTA's Data Center Warehouse,³ identified EINs that may have been issued without a valid tax purpose.
 1. Identified entities having the same cross-reference TIN and determined if these entities had a valid reason to have more than one EIN (including sole proprietors).
 2. *****2*****.
 3. Identified the reason that entities applied for an EIN between July 2010 and February 2017 and determined how many of these entities have filed a business tax return.
- II. Determined whether systemic controls used to process EIN applications were functioning properly.
 - A. Reviewed IRS processes and procedures to determine what validity checks were required when processing an EIN application, *e.g.*, responsible party TIN should match the name control given for that TIN, for both paper and electronic processing.
 - B. Entered test applications into the Modernized EIN with 1) data that should be rejected

¹ The Entity Module Table contains data that originates from the IRS's Business Master File. The Entity Module Table contains information such as the business name of the taxpayer, the business address, the businesses filing requirements, *etc.*

² TIGTA's SS-4 file contains information from the IRS's Compliance Data Warehouse files.

³ A collection of IRS databases containing various types of taxpayer account information that is maintained by TIGTA for the purpose of analyzing data for ongoing audits.



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- or 2) missing required information to determine if the system properly rejects invalid or missing information.
- C. From the Business Master File Entity Module Table and TIGTA's SS-4 file, determined the following:
1. The number of estate entity records for which the decedent SSN was that of a living individual.
 2. The number of records for which the responsible party TIN or sole proprietor TIN belonged to a deceased or **2** person.
 3. The number of entity records that should, but do not, contain a responsible party TIN.
- D. Obtained Modernized EIN audit logs for the first quarter of Calendar Year 2017 and determined if any questionable trends or anomalies existed.
- E. Interviewed appropriate IRS personnel to gain an understanding of the various Modernized EIN reports used for monitoring and how these reports are generated.
- F. Reviewed Modernized EIN information reports, *e.g.*, error code reports, to determine if the reports showed any potential issues with the application process and determined if the IRS proactively monitored these reports for potential issues.
- III. Determined if effective processes were in place to report fraudulently obtained EINs.
- A. Identified what actions the IRS takes to ensure that a fraudulently obtained EIN is not misused.
 - B. Obtained the list of EINs that have been identified by the IRS as suspicious entities.
 - C. Identified the responsible parties listed on the *Suspicious EIN Listing* and determined if these responsible parties are listed on other EIN accounts.
- IV. Determined if EIN applications were processed accurately and efficiently by the IRS.
- A. Reviewed IRS policies and procedures and interviewed IRS personnel to obtain an understanding of these policies and procedures related to the processing of both paper and electronically filed EIN applications.
 - B. Reviewed a statistical sample⁴ of 206 paper Forms SS-4, *Application for Employer Identification Number*, from a projected population⁵ of 60,958 and determined

⁴ A statistical sample was selected so that the result of the sample review could be projected to the population. The sample of 206 included a sample of 103 accepted application requests and 103 rejected application requests.

⁵ Because there was no record of the number of Forms SS-4 received by the IRS, we followed the guidance of our contracted statistician and sampled some of the boxes containing the Forms SS-4 to identify the projected population of 60,958.



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whether applications were properly processed, including if the information from these forms was properly input and appropriate steps were taken to assign an EIN and establish an entity account on the Master File. To select our sample, we used an expected error rate of 50 percent, a precision rate of ± 10 percent, and a confidence interval of 95 percent. A contract statistician assisted with developing the sampling plan and projections.

- C. Based on the accuracy rates and costs to process paper applications, determined if the IRS should consider requiring all EIN applications to be electronically filed.
- V. Determined if Forms SS-4 were being properly retained or disposed.
 - A. Reviewed relevant Internal Revenue Manuals, the General Records Schedule,⁶ and Records Control Schedules⁷ to determine proper retention or disposal of Forms SS-4.
 - B. Interviewed IRS personnel to understand current retention practices related to Forms SS-4 and determined if the IRS was following proper Government retention policies.

Data validation methodology

During this review, we relied on data stored at TIGTA's Data Center Warehouse, the Department of the Treasury's Office of Foreign Assets Control *Specially Designated Nationals List*, the IRS's Electronic Fraud Detection System,⁸ and the IRS's Modernized EIN audit logs. To assess the reliability of computer-processed data, programmers within TIGTA's Data Center Warehouse validated the data files stored on that database. We ensured that each data extract contained the specific data elements we requested and that the data elements were accurate. For example, we reviewed judgmental samples⁹ of the data extracts and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System¹⁰ or other systems, if possible. As a result of our testing, we determined the data used in our review were reliable.

⁶ The General Records Schedule provides disposal authorization for the following records related to electronic systems or collections of electronic records: input or source records, system output records, and non-recordkeeping copies of electronic records. In other words, it covers records that contain information duplicated in the recordkeeping copies of electronic records (also known as the master records or master files).

⁷ The Records Control Schedules contain retention and disposal of various IRS records. Records Control Schedule 29, item 70(1) relates to the retention and disposal of EIN applications.

⁸ An automated system used to maximize fraud detection at the time tax returns are filed to eliminate the issuance of questionable refunds.

⁹ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

¹⁰ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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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: the Internal Revenue Manual, General Records Schedule, Records Control Schedules, Modernized EIN visual guides, and Modernized EIN reports. We tested these controls by reviewing policies and procedures for processing EIN applications, then examining EIN applications, and analyzing stored application data to see if the controls were working as intended. We also reviewed the policies and procedures to determine if any necessary controls were missing.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner

Office of the Commissioner – Attn: Chief of Staff

Deputy Commissioner for Services and Enforcement

Deputy Commissioner, Wage and Investment Division

Director, Accounts Management, Wage and Investment Division

Director, Customer Account Services, Wage and Investment Division

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

Director, Submission Processing, Wage and Investment Division

Director, Office of Audit Coordination



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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:

- Reliability of Information – Potential; 206,920 entity accounts (see page 8).

Methodology Used to Measure the Reported Benefit:

Our review of EIN application data associated with more than 96 million assigned EINs as of February 9, 2017, identified 206,920 EINs issued to sole proprietors who already had an EIN. IRS procedures state that a sole proprietor should be issued only one EIN, regardless of the number of businesses the sole proprietor owns. A sole proprietor is someone who owns an unincorporated business by himself or herself. The business owned by a sole proprietor is not treated as a separate entity and, therefore, has no legal distinction from the owner. As such, the owner is liable for all legal and financial matters. IRS management indicated that additional EINs were issued in error because computer programming used to determine if an EIN was already assigned was not working properly.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 20,437 entity accounts (see page 8).

Methodology Used to Measure the Reported Benefit:

Our review of EIN application data associated with more than 96 million assigned EINs as of February 9, 2017, identified 20,437 EINs issued to sole proprietors who, according to IRS records, were deceased at the time of the application. IRS procedures state that if a date of death for the sole proprietor is present on the IRS's system, the EIN application should be rejected. IRS management indicated that computer programming used to identify deceased sole proprietor applicants was not functioning properly. IRS management indicated that the programming problem would be corrected in October 2017.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 26,889 entity accounts (see page 9).



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Methodology Used to Measure the Reported Benefit:

Our review of the IRS's EIN application data identified that 26,889 EINs were incorrectly issued to estates for which the decedent SSN provided on the application was the TIN of an individual who was not deceased. The IRS's procedures state that an estate is a legal entity created as a result of a person's death. An EIN should not be assigned if the named decedent on the application is not deceased. When we brought this issue to the IRS's attention, management agreed with our results but did not provide an explanation as to why the Modernized EIN does not ensure that the decedent whose TIN is listed on the application is in fact deceased and reject EIN applications for which the TIN is not that of a deceased individual.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 2,493 taxpayer accounts (see page 15).

Methodology Used to Measure the Reported Benefit:

Our review of a statistically valid sample¹ of 206 paper Form SS-4 application requests, from a population² of 60,958 applications, identified 28 (14 percent)³ applications for which the IRS did not provide all necessary information in its correspondence with the applicant. This includes rejected EIN requests that did not address all missing, required fields. Based on the results of our sample, we project that 2,493 applications⁴ were not accurately processed due to the IRS not providing all necessary information in its correspondence with the applicant.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 1,330 taxpayer accounts (see page 15).

¹ The sample of 206 included a sample of 103 accepted application requests and 103 rejected application requests. To select our sample, we used an expected error rate of 50 percent, a precision rate of ± 10 percent, and a confidence interval of 95 percent.

² We identified the population of 60,958 processed between September 19 and December 15, 2016.

³ The point estimate error rate is 4.09 percent. We are 95 percent confident that the true population exception rate is between 2.12 percent and 6.06 percent.

⁴ The point estimate projection, based on a 95 percent confidence interval, is that between 1,293 and 3,692 EIN applications were not accurately processed.



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Methodology Used to Measure the Reported Benefit:

Our review of a statistically valid sample⁵ of 206 paper Form SS-4 application requests, from a population⁶ of 60,958 applications, identified six (3 percent)⁷ applications for which the IRS did not assign an EIN to the applicant although the application met all the requirements. Based on the results of our sample, we project that 1,330⁸ applications were not accurately processed due to the IRS not assigning an EIN to the applicant although the application met all the requirements.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 4,150 entity accounts (see page 15).

Methodology Used to Measure the Reported Benefit:

Our review of a statistically valid sample⁹ of 206 paper Form SS-4 application requests, from a population¹⁰ of 60,958 applications, identified eight (4 percent)¹¹ applications for which the IRS entered information from the application incorrectly into the system when establishing the EIN. This includes incorrectly entering the business name, the filing requirements, the fiscal year month, the business operational date, or the responsible party TIN. Based on the results of our sample, we project that 4,150¹² applications were not accurately processed due to the IRS entering information from the application incorrectly into the system when assigning the EIN.

⁵ The sample of 206 included a sample of 103 accepted application requests and 103 rejected application requests. To select our sample, we used an expected error rate of 50 percent, a precision rate of ± 10 percent, and a confidence interval of 95 percent.

⁶ We identified the population of 60,958 processed between September 19 and December 15, 2016.

⁷ The point estimate error rate is 2.18 percent. We are 95 percent confident that the true population exception rate is between 0.01 percent and 4.57 percent.

⁸ The point estimate projection, based on a 95 percent confidence interval, is that between six and 2,786 EIN applications were not accurately processed.

⁹ The sample of 206 included a sample of 103 accepted application requests and 103 rejected application requests. To select our sample, we used an expected error rate of 50 percent, a precision rate of ± 10 percent, and a confidence interval of 95 percent.

¹⁰ We identified the population of 60,958 processed between September 19 and December 15, 2016.

¹¹ The point estimate error rate is 6.81 percent. We are 95 percent confident that the true population exception rate is between 2.26 percent and 11.36 percent.

¹² The point estimate projection, based on a 95 percent confidence interval, is that between 1,377 and 6,922 EIN applications were not accurately processed.



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Type and Value of Outcome Measure:

- Reliability of Information – Potential; 1,556 entity accounts (see page 15).

Methodology Used to Measure the Reported Benefit:

Our review of a statistically valid sample¹³ of 206 paper Form SS-4 application requests, from a population¹⁴ of 60,958 applications, identified three (1 percent)¹⁵ applications for which the IRS assigned an EIN and established the entity even though the application was incomplete. Based on the results of our sample, we project that 1,556¹⁶ applications were not accurately processed due to the IRS assigning an EIN and establishing the entity even though the application was incomplete.

¹³ The sample of 206 included a sample of 103 accepted application requests and 103 rejected application requests. To select our sample, we used an expected error rate of 50 percent, a precision rate of ± 10 percent, and a confidence interval of 95 percent.

¹⁴ We identified the population of 60,958 processed between September 19 and December 15, 2016.

¹⁵ The point estimate error rate is 2.55 percent. We are 95 percent confident that the true population exception rate is between 0.00 percent and 5.41 percent.

¹⁶ The point estimate projection, based on a 95 percent confidence interval, is that between three and 3,298 EIN applications were not accurately processed.



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Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

December 29, 2017

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report - Actions Are Needed to Reduce the Risk of
Fraudulent Use of Employer Identification Numbers and to
Improve the Efficiency and Effectiveness of the Application
Process (Audit# 201640035)

Thank you for the opportunity to review and comment on the subject draft report. Every business entity required to file a federal tax return must have, or be assigned, an Employer Identification Number (EIN). Business entities consist of sole proprietors, corporations, partnerships, nonprofit associations, trusts and estates, government agencies, and other types of businesses.

Taxpayers can apply for an EIN by mailing/faxing a Form SS-4, *Application for Employer Identification Number*, or online using the online assistant, Modernized Internet Employer Identification Number (Mod-EIN). The Mod IEIN is a user-friendly application in a question and answer format similar to the popular tax preparation products on the market. To obtain an EIN, the users follow the prompts and choose the type of entity they are applying for and answer questions applicable to that entity. At the end of the session, the taxpayer receives an EIN.

The report identified that the IRS issues many EINs that are not used to *****2*****
*****2***** and may be at risk for fraud or business identity theft. We agree EINs are issued without a business tax return filing requirement, i.e., to open a bank account or apply for credit in the name of a business; apply for business permits; or to furnish independent contractors a Form 1099-MISC, *Miscellaneous Income*.

We believe that we have effective mitigations in place to detect and prevent use of EINs to commit fraud. While there are no studies to indicate *****2*****
*****2***** are more likely to be used to commit fraud, the Service has two existing programs that look to identify these types of entities when returns and/or information documents are filed. The Entity Fabrication Program identifies business entities where



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individual returns are submitted using withholding information documents and the associated EIN has no activity within our systems. This includes no activity as sole proprietors, corporate filers, or employment tax filers. The Business Taxpayer Protection Program has several filters that run against Form(s) 1120, *U.S. Corporation Income Tax Return*, 1120-S, *U.S. Income Tax Return for an S Corporation*, and 1041, *U.S. Income Tax Return for Estates and Trusts* claiming refunds. These filters look specifically for dormant entities that have a period of inactivity and newly active entities that have never been active.

The report indicates that the processing of paper filed EIN applications resulted in a high number of errors and inefficient use of resources. While we agree that processing paper filed applications could result in processing errors, processing that requires manual input will always have a level of risk; however, this service continues to meet or exceed our quality goals.

We appreciate the Treasury Inspector General for Tax Administration's thorough review and recommendations, which will help to further strengthen this program. Attached are our comments and proposed actions to your recommendations. If you have any questions, please contact me, or a member of your staff may contact James P. Clifford, Director, Customer Account Services, Wage and Investment Division, at (470) 639-3504.

Attachment



Actions Are Needed to Reduce the Risk of Fraudulent Use of Employer Identification Numbers and to Improve the Effectiveness of the Application Process

Attachment

Recommendations

The Commissioner, Wage and Investment, should:

RECOMMENDATION 1

Place an indicator on the tax account of those EINs *****2***** that can be used to identify when these EINs are used to file business tax returns.

CORRECTIVE ACTION

We disagree with this recommendation. There are valid reasons why a filing requirement isn't assigned during the Employer Identification Number (EIN) application process. For example, tax exempt entities do not have a filing requirement until their application of recognition has been formally accepted. Sole Proprietors may have a need to issue Form 1099-MISC, *Miscellaneous Income*, which requires them to have an EIN. Additionally, as noted in recommendation 15 (page 15), some special trusts need an EIN for filing information returns. While there are no studies to indicate EINs not *****2***** are more likely to be used to commit fraud, the Service has two existing programs that look to identify these types of entities when returns and/or information documents are filed. The Entity Fabrication Program identifies business entities and a program that has several filters that run against certain business forms claiming refunds. These filters look specifically for *****2***** that have a ****2***** and newly ****2**** that have never been ***2*** as mentioned in the memo.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

Expand fraud filters to identify potentially fraudulent tax return filings that use an ****2*** **2** to report income and withholding.

CORRECTIVE ACTION

We agree with this recommendation, and currently have a process in place. The entity fabrication project specifically identifies *****2***** used to report potentially fraudulent income and withholding.

IMPLEMENTATION DATE

Implemented



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RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 3

Correct programming to reject EIN applications when an EIN has previously been assigned to the same sole proprietor and to reject applications when IRS data indicates that the sole proprietor is deceased.

CORRECTIVE ACTION

We agree with this recommendation. A programming request has been submitted to correctly reject applications when the sole proprietor is deceased. However, the implementation of required programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS cannot provide an implementation date at this time.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 4

Review the 206,920 EINs incorrectly assigned as duplicates to sole proprietors and the 20,437 assigned to sole proprietors that were deceased. Determine if the EINs should be merged or deactivated.

CORRECTIVE ACTION

We agree with the recommendation. The IRS will research a statistical sample to determine if some EINs should be merged or deactivated and take the appropriate action based on our findings.

IMPLEMENTATION DATE

October 15, 2018



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RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 5

Perform an assessment to determine how an additional field could be added to the Business Master File so that both the decedent SSN and a responsible party TIN can be captured for estates and trusts.

CORRECTIVE ACTION

We agree with this recommendation and will review the process to determine if an additional field can be added to capture the decedent's Social Security Number and the responsible party Taxpayer Identification Number. However, the implementation of required programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS cannot provide an implementation date at this time.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 6

Revise internal procedures, application instructions, etc., to require that estate and trust applicants applying on paper provide a responsible party.

CORRECTIVE ACTION

We agree with this recommendation. When Recommendation 5 is implemented, the appropriate procedures and instructions will be updated. The implementation of requisite programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS cannot provide an implementation date at this time.

IMPLEMENTATION DATE

N/A



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RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 7

Develop programming to reject applications for which the responsible party is a **2**.

CORRECTIVE ACTION

We disagree with this recommendation. Per Internal Revenue Manual 21.7.13.2.2, *When to Assign EINs*, there is no *****2***** for a taxpayer to be issued an EIN, and there are valid reasons a **2** would need an EIN. For example, EINs can be assigned to *****2***** who are engaged in business activities, estates where the decedent was a ***2*** at the date of death, *****2***** investing funds, and numerous other scenarios.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 8

Ensure the validity of the 71,633 EINs we identified that were assigned to responsible parties who are ***2***.

CORRECTIVE ACTION

We agree with this recommendation. The IRS will review a statistical sample of EINs to ensure their validity. The EINs can be assigned to *****2***** who are engaged in business activities, estates where the decedent was a ***2*** at the date of death, *****2***** investing funds, and numerous other scenarios.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Accounts Management, Customer Account 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 9

Develop programming to reject estate applications if the decedent TIN is not that of a deceased individual.

CORRECTIVE ACTION

We agree with this recommendation; however, the implementation of required programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS cannot provide an implementation date at this time.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 10

Ensure the validity of the 26,889 EINs we identified as being assigned to estates for which the decedent TIN was that of a living individual.

CORRECTIVE ACTION

We agree with this recommendation. The IRS will review a statistical sample of EINs to determine validity.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.



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RECOMMENDATION 11

Establish systemic processes for the Modernized EIN to alert system administrators when error code counts reach certain thresholds based on historical trends.

CORRECTIVE ACTION

We agree with the recommendation. The IRS will seek a feasible process for the Modernized EIN to alert system administrators when error code counts reach certain thresholds based on historical trends.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 12

Revise procedures to not allow applicants to designate another business as the responsible party.

CORRECTIVE ACTION

We agree with this recommendation and are currently assessing a proposed policy change to determine the impact to other processes before moving forward with implementation activities.

IMPLEMENTATION DATE

December 15, 2018

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 13

Update internal guidelines to require *****2***** to provide additional variable information on the application in order to receive an EIN.



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CORRECTIVE ACTION

We disagree with this recommendation. This recommendation, whether for foreign or U.S. formed entities, will place undue burden upon a *****2***** when applying for an EIN.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 14

Develop processes and procedures to ensure that tax examiners accurately process paper Forms SS-4. This should include additional employee training and performing additional management quality reviews.

CORRECTIVE ACTION

We agree with this recommendation. The IRM 21.7.13, *Assigning Employer Identification Numbers* provides the process and procedures. We will review quality feedback to identify error trends and provide the necessary refresher training.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 15

Update internal guidelines to include procedures for processing EIN applications associated with Form 1041 (special trusts) and requests for EINs from individuals who are minors.

CORRECTIVE ACTION

We agree with this recommendation. However, we will determine if procedural changes are necessary based on our review under Recommendation 8.

IMPLEMENTATION DATE

October 15, 2018



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RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 16

Develop processes to *****2***** and refer any matches to the Criminal Investigation Division for further review.

CORRECTIVE ACTION

We agree that individuals on the Specially Designated Nationals List (SDN) should not be assigned an EIN. *****2*****. We will explore the possibility of establishing *****2*****. However, the implementation of any necessary programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. For that reason, the IRS cannot provide an implementation date.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 17

Develop processes to match responsible parties associated with suspicious EINs, when added to the *Suspicious EIN Listing*, against the IRS's Business Master File to identify instances in which the same responsible parties are associated with additional EINs (not in the list) and determine if these additional EINs should be added to the list.

CORRECTIVE ACTION

We agree with this recommendation and will add this to our review process of potentially suspicious EINs. Any necessary treatment identified through the review will be completed.



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IMPLEMENTATION DATE

July 15, 2018

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 18

Refer the 20,609 entities that contain responsible party TINs associated with suspicious EINs to the IRS's Return Integrity and Compliance Services function to determine if any of these entities should be added to the *Suspicious EIN Listing*.

CORRECTIVE ACTION

We agree with this recommendation and will review the identified entities for possible inclusion in the Compromised/Suspicious EIN listing.

IMPLEMENTATION DATE

July 15, 2018

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.