



*Strengthened Validation Controls
Are Needed to Protect Against
Unauthorized Filing and Input of
Fraudulent Information Returns*

September 26, 2019

Reference Number: 2019-40-071

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

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HIGHLIGHTS

STRENGTHENED VALIDATION CONTROLS ARE NEEDED TO PROTECT AGAINST UNAUTHORIZED FILING AND INPUT OF FRAUDULENT INFORMATION RETURNS

Highlights

Final Report issued on September 26, 2019

Highlights of Reference Number: 2019-40-071 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

Administration of the U.S. tax system has become increasingly reliant on the use of information returns provided by third parties. As such, it is important that the IRS has strong authentication controls to ensure that it has a high confidence in the validity of each payer's identity prior to their submission of information returns that are then used for compliance matching and fraud detection purposes.

WHY TIGTA DID THE AUDIT

This audit was initiated to evaluate the IRS's verification process for authenticating transmitters of information returns to ensure the reliability of data transmitted.

WHAT TIGTA FOUND

Processes and procedures to authenticate users of the Filing Information Returns Electronically (FIRE) system do not comply with Federal Government information security standards. For example, our review identified that the IRS currently does not perform any type of identity proofing prior to providing users with access to the FIRE system.

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In addition, the systemic filters used to identify questionable information return submissions before they are processed and accepted need to be expanded. TIGTA found some information documents were filed by payers designated by the IRS as suspicious payers. For example,

524 information returns were filed in Tax Year 2016 by employers listed on the IRS's *Suspicious EIN Listing*. IRS management reviewed the 524 information returns that TIGTA identified and confirmed that 113 of the information returns were submitted by a bogus payer. These suspicious submissions reported income of more than \$1.4 million and withholding of \$12,600.

Finally, some paper information returns ****2**** *****2*****. TIGTA identified 24,826 paper Tax Year 2015 prior year Forms 1096, *Annual Summary and Transmittal of U.S. Information Returns*, with more than 85,000 information returns attached that **2** *****2*****. These Forms 1096 reported a total of \$13.8 billion in box 5 (*Total amount reported with this Form 1096*) and \$2 billion in Federal income tax withholding.

WHAT TIGTA RECOMMENDED

TIGTA made seven recommendations, including that the IRS ensure that the required Digital Identity Risk Assessment is completed for the FIRE system and that an implementation plan for identity proofing FIRE's users is developed; *****2*****
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*****2*****; evaluate potential business rules and filters that could be implemented to identify questionable information return submissions; develop processes to ensure that entities which received an account lock are not allowed access to the FIRE system and that paper returns are not posted to the Information Returns Master File; and *****2*****
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*****2*****.

The IRS agreed with five and partially agreed with one of the seven recommendations. Although ideal, IRS management disagreed that *****2*****
*****2***** IRS databases is feasible. The current IRS system that scans and transcribes paper inform returns can process *****2*****. The IRS cannot justify the cost to upgrade its system given the low volume of late-filed returns *****2***** and the new capability that will be included in the IRS Modernization Business Plan to improve document matching.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 26, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Strengthened Validation Controls Are Needed to Protect Against Unauthorized Filing and Input of Fraudulent Information Returns (Audit # 201840020)

This report presents the results of our review to evaluate the Internal Revenue Service's verification process for authenticating transmitters of information returns to ensure the reliability of data transmitted. This audit is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Improving Tax Reporting and Payment Compliance.

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

BSO	Business Services Online
E-File(d)	Electronically File(d)
EIN	Employer Identification Number
FIRE	Filing Information Returns Electronically
IRS	Internal Revenue Service
NIST	National Institute of Standards and Technology
OMB	Office of Management and Budget
SP	Special Publication
SSA	Social Security Administration
TCC	Transmitter Control Code
TY	Tax Year



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Background

An information return is used by any issuer or payer (e.g., corporations, partnerships, trusts, individuals, or government entities) to report certain transactions during a calendar year to the Internal Revenue Service (IRS). The Internal Revenue Code outlines the requirement to file information returns with the IRS. As of November 2016, the IRS identified 185 different types of information returns¹ reporting different types of transactions, including the following: income, withholding, currency transactions, and other transactions that may indicate a tax liability. Appendix IV provides a list of these information returns. For Fiscal Year² 2017, the IRS received nearly 3.6 billion information returns. Figure 1 provides examples of common information returns and the volumes received by the IRS for Tax Year (TY)³ 2016.

Figure 1: Common Information Returns and Volumes for TY 2016

Information Return	Volume
Form 1099-B, <i>Proceeds From Broker and Barter Exchange Transactions</i> – used to report gains or losses from the sales of securities.	2.4 billion
Form 1099-INT, <i>Interest Income</i> – used to report interest income, interest on U.S. Savings Bonds and Treasury obligations, and tax-exempt interest.	135.8 million
Form 1099-R, <i>Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.</i> – used to report payments related to distributions from pensions, annuities, profit-sharing and retirement plans, individual retirement arrangements, etc.	96.1 million
Form 1099-MISC, <i>Miscellaneous Income</i> – used to report payments made for royalties, rents, nonpayroll compensation for services, prizes and awards, and various other income payments.	96.6 million
Form 1099-DIV, <i>Dividends and Distributions</i> – used to report dividends and other distributions.	86.2 million
Form 1099-G, <i>Certain Government Payments</i> – used to report payments made for State or local income tax refunds, unemployment compensation, and other payments.	80.0 million

Source: IRS information return receipts for TY 2016, as of February 16, 2018.

¹ This does not include tax returns or schedules.

² 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.

³ The 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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Requirements for issuing and reporting information returns to the IRS

Payers send copies of information returns to the recipient (*i.e.*, the payee) and the IRS. When paper information returns are submitted to the IRS, the payer is required to file Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*. A payer submits a Form 1096 as a transmittal for each type of information return submitted. For example, if a payee issues both Forms 1099-INT and 1099-DIV, they complete one Form 1096 to transmit Forms 1099-INT and another to transmit Forms 1099-DIV. Information on Form 1096 summarizes the type of information return(s) being filed, number of information returns attached, total Federal income tax withheld, and total dollar amount reported. When information returns are electronically submitted to the IRS, the payer transmits an “A” Record, which is similar to Form 1096 and used to identify the payer information. Figure 2 provides an example of a Form 1096.

Figure 2: Form 1096, Annual Summary and Transmittal of U.S. Information Returns

Form 1096 Department of the Treasury Internal Revenue Service	Annual Summary and Transmittal of U.S. Information Returns	OMB No. 1545-0108 2019
FILER'S name Street address (including room or suite number) City or town, state or province, country, and ZIP or foreign postal code		
Name of person to contact		Telephone number
Email address		Fax number
For Official Use Only 		
1 Employer identification number	2 Social security number	3 Total number of forms
4 Federal income tax withheld \$		5 Total amount reported with this Form 1096 \$
6 Enter an "X" in only one box below to indicate the type of form being filed.		
7 Form 1099-MISC with NEC in box 7, check <input type="checkbox"/>		
W-2G 32	1097-BTC 50	1098 51
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-LTC 93	1099-MISC 95	1099-OID 96
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-C 75	1099-E 84	1099-F 03
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-Q 74	1099-T 83	1099-A 80
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-B 79	1099-C 85	1099-CAP 73
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-DIV 91	1099-G 86	1099-INT 92
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-K 10	1099-LS 16	1099-PATR 97
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-QA 31	1099-QA 1A	1099-R 98
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-S 75	1099-SA 94	1099-SB 43
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3921 25	3922 26	5498 28
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5498-ESA 72	5498-QA 2A	5498-SA 27
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Source: TY 2019 Form 1096.

Processing of information returns

Information returns are generally required to be issued to the recipient by January 31 of the year following the tax year the income and withholding was reported. They are generally due to the IRS by February 28 of the year following the tax year. If the payer submits the information returns electronically, the due date becomes March 31. However, Forms 1099-MISC reporting nonemployee compensation are required to be filed on or before January 31 regardless of the filing method. Once information returns are screened and validated, they are posted to the IRS’s



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Information Returns Master File, where they are used to identify potentially erroneous and fraudulent returns, ensure compliance with Federal tax withholding requirements, and identify unreported income or overstated credits and deductions.

Processing of electronically filed (e-filed) information returns

Internal Revenue Code Section 6011(e)(2) requires that payers who file 250 or more of any information return in a calendar year file those returns electronically. Approximately 98 percent of all information returns are filed electronically. Currently, the 250-or-more requirement applies separately to each type of information return. For example, if a payer submits 200 Forms 1099-INT and 100 Forms 1099-DIV, the taxpayer is not required to e-file those information returns. However, in May 2018, proposed regulations⁴ were issued that would require that all information returns, in aggregate rather than separately, be taken into account to determine whether a payer meets the 250 return threshold. Additionally, the proposed regulations would require that, if an information return was e-filed, then any correction of that information return be e-filed. As of March 2019, the regulations had not been finalized.

The IRS developed the Filing Information Returns Electronically (FIRE) system to allow payers to submit various information returns electronically to the IRS. Information returns filed through the FIRE system are processed faster and with fewer errors than paper information returns. Before payers can e-file information returns, they must first obtain a Transmitter Control Code (TCC). To obtain a TCC, the payer must fill out and submit a Form 4419, *Application for Filing Information Returns Electronically*.⁵ This can either be done on paper or filled out electronically on IRS.gov. The application requires payers to enter their name, Employer Identification Number (EIN),⁶ contact individual, e-mail address, and types of information returns they will be filing electronically.

Applications submitted electronically are systemically reviewed for Taxpayer Identification Number/Name Control match⁷ and missing information. Applications submitted on paper are reviewed by the IRS's Electronic Products and Services Support Technical Services Operation for Taxpayer Identification Number/Name Control match and correspondence conditions (*i.e.*, missing contact information). Both paper and electronic applications are manually reviewed for questionable criteria. Some examples of questionable criteria include: ***2***
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*****2*****. The Technical Services Operation team contacts the applicant by mail and allows the applicant a 20-day response period to submit

⁴ 83 FR 24948 (May 2018).

⁵ See Appendix V.

⁶ A nine-digit number (in the format of XX-XXXXXXX) assigned by the IRS and used to identify a business entity.

⁷ A match of the Taxpayer Identification Number and first four characters of an individual's last name or business name on a document to IRS records.



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additional information. Once the applicant responds, the Technical Services Operation team makes the final determination to issue the TCC or deny the application. If the FIRE application is denied, the IRS contacts the applicant by mail to notify them of the denial. Further, if a payer fails to use a TCC for two years, the IRS automatically deletes the TCC and the payer must reapply. As of August 2, 2018, there were 132,405 active TCCs.

According to IRS management, there is an additional process in place to prevent fraud. ***2***
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*****2*****. Once the Technical Services Operation team approves the applicant, the payer receives the TCC by mail. The payer must have or purchase software or pay a service provider that will create the information return files in the correct IRS-mandated format. Once the information returns are in the correct format, they can be transmitted to the IRS 24 hours a day, seven days a week.

Processing of paper information returns

To submit a paper information return, a payer first needs to obtain IRS official printed information returns. In order to receive official forms, payers go to IRS.gov and request the form type and number of forms they wish to have mailed to them. The IRS then prints and mails the information returns to the payer. The payer fills out the information returns and sends a copy to the recipient and to the IRS to be processed. Forms accessed by and printed from IRS.gov are not usable, and the submitter may be assessed a penalty for not using the official printed version. IRS instructions state, “Because the IRS processes paper forms by machine (optical character recognition equipment), you cannot file Form 1096 or Copy A of Forms 1097, 1098, 1099, 3921, 3922, or 5498 that you print from the IRS website.” However, if a taxpayer does send in a printed form from IRS.gov, the IRS will process the information return. Paper information returns are processed at the Austin and Kansas City Tax Processing Centers. Figure 3 provides the volumes for selected TY 2016 e-filed and paper information returns.

Figure 3: Volumes of Selected TY 2016 E-Filed and Paper Information Returns

Information Return	TY 2016
E-filed information returns	2,955,054,421
Paper information returns	32,675,682

Source: Our analysis of Information Returns Master File report.

This review was performed at the Wage and Investment Division offices in Austin, Texas, and Martinsburg, West Virginia, with information obtained from the Small Business/Self-Employed Division Headquarters in Lanham, Maryland, and the Wage and Investment Division Headquarters in Atlanta, Georgia, during the period January 2018 through April 2019. We conducted this performance audit in accordance with generally accepted government auditing



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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

Administration of the U.S. tax system has become increasingly reliant on the use of information returns provided by third parties. For example, the IRS uses the data from information returns to ensure compliance with Federal tax withholding requirements, to identify unreported income or overstated credits and deductions, and to identify potentially erroneous and fraudulent returns. As such, it is important that the IRS has strong authentication controls to ensure that it has a high confidence in the validity of each payer’s identity prior to the submission of information returns that are then used for return validation, compliance matching, and fraud detection purposes.

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The Authentication Method for Accessing the Filing Information Returns Electronically System Does Not Comply With Federal Government Information Security Standards

Processes and procedures to identity proof and authenticate users of the FIRE system do not comply with the Level of Assurance Level 2 requirements per the National Institute of Standards and Technology (NIST) Special Publication (SP) 800-63-2 security standards⁸ and the IRS’s own FIRE system risk assessment completed in November 2016. For example, the IRS continues to use single-factor authentication⁹ to approve user access to the FIRE system and does not perform any type of identity proofing prior to approving user access to the FIRE system. Figure 4 provides an overview of the four NIST levels of e-authentication assurance.

⁸ The NIST is responsible for developing information security standards and guidelines, including minimum requirements for Federal information systems. NIST, NIST SP 800-63-2, *Electronic Authentication Guideline* (August 2013).

⁹ A characteristic of an authentication system or a token that uses one of the three authentication factors to achieve authentication – something you know, something you have, or something you are.



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Figure 4: Requirements for E-Authentication Levels of Assurance

Level of Assurance	Requirements	Level of Confidence
Level 1	No identity proofing is required.	Provides little or no confidence.
Level 2	Requires basic identity proofing data, ¹⁰ a valid current Government identification number, ¹¹ and a valid financial or utility account number. ¹² Access occurs only after identity proofing data and either the Government identification number or financial/utility account number are verified by the agency.	Provides some confidence in the validity of an individual's identity.
Level 3	Requires basic identity proofing data, a valid current Government identification number, and a valid financial or utility account number as well as the use of a second authentication factor such as a one-time supplemental code issued via text message or e-mail to the telephone number or e-mail address associated with the individual.	Provides high confidence in the validity of an individual's identity.
Level 4	Requires in-person identity proofing and verification.	Provides very high confidence in the validity of an individual's identity.

Source: NIST SP 800-63-2 and Office of Management and Budget (OMB) Memorandum M-04-04.¹³

In March 2018, the IRS completed a Risk Acceptance Form and Tool outlining its decision not to move the FIRE system behind its Level 2 e-Authentication. The document notes that the IRS rated the security impact of the FIRE system as “medium,” stating that there is an increased risk of security breaches given the high volume of data. The IRS further noted that the FIRE system business impact is “high” based on a projection that there would be a large percentage of users that would fail verification if required to comply with the IRS’s Level 2 e-Authentication. Furthermore, FIRE users also include non-U.S. citizens, and there is no industry solution available to identity proof non-U.S. citizens remotely. As a result, the IRS concluded that there is low overall security risk with the current process and has not moved its authentication of FIRE users to Level 2 to comply with NIST standards.

Instead, the IRS indicated it would use compensating controls to verify FIRE system applicants. These controls include *****2*****

¹⁰ Name, address, date of birth, etc.

¹¹ A driver’s license number, passport number, etc.

¹² A checking or savings account number, credit card account number, tax identification number, etc.

¹³ OMB, OMB Memorandum M-04-04, *E-Authentication Guidance for Federal Agencies* (Dec. 2003).



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*****2*****
 *****2*****. Once approved, the IRS sends the TCC information to the payer’s physical address. However, some of these compensating controls are manual processes and can be prone to human error. Further, the compensating controls do not include processes and procedures that comply with a Level 2 e-Authentication, which the IRS’s own risk assessment recommends. As such, sufficient and appropriate proactive actions have not been taken to reduce the risk associated with the fraudulent use of the FIRE system.

FIRE system authentication criteria are inconsistent with processes to validate employers submitting Forms W-2, Wage and Tax Statement

The authentication criteria used for the FIRE system are inconsistent when compared with the extensiveness of the authentication processes used to validate employers submitting Forms W-2 through the Social Security Administration’s (SSA) Business Services Online (BSO) system.¹⁴ Figure 5 provides a comparison of information that is required to be provided to obtain access to e-file with the BSO system versus the FIRE system.

Figure 5: Comparison of BSO and FIRE Access Requirements

Information	BSO	FIRE
Social Security Number of Applicant	X	
Applicant Name (as it appears on applicant's Social Security Card)	X	
Applicant Birthdate	X	
Applicants Home Address	X	
Business Name		X
E-Mail Address	X	X
Phone Number	X	X
Business Address		X

Source: Our analysis of the BSO and FIRE systems.

Once access has been granted to the BSO system, the individual then needs to request access to specific applications. For example, an individual can request access to the SSA Service Suite for Employers in order to report employee wages directly to the SSA, verify names and Social Security Numbers, or view the status of their submissions. The application information the BSO

¹⁴ The BSO system is the SSA’s suite of services that allows users to file Forms W-2 and Forms W-2C, *Statement of Corrected Income and Tax Amounts*, online and verify employees’ names and Social Security Numbers against the SSA’s records.



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system collects from the applicant allows the SSA to link a submission back to an individual. In comparison, the FIRE system does not collect similar information when verifying the individual application. Once individuals have gained access to the FIRE system and are given a TCC, *2*
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When we met with IRS management to discuss our concerns, they stated that they are currently in the process of completing a Digital Identity Risk Assessment for the FIRE system in response to new guidelines published by the NIST in June 2017.¹⁵ The IRS expects to have the assessment completed by the end of Fiscal Year 2019. These new NIST guidelines eliminate the single level of assurance model previously used by Federal agencies and provide multiple levels of assurance to allow Federal agencies more flexibility in selecting a tailored authentication solution. The new guidelines also allow Federal agencies to select identity proofing evidence that best fits their needs in contrast to selecting from a static list of evidence as previously allowed. The IRS's Digital Identity Risk Assessment is a new process in the IRS's ongoing effort to secure its various applications. The assessment is a data-driven process to determine identity assurance risks and how to implement the new NIST identity proofing and authentication recommendations.

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In addition to weak authentication requirements over payers submitting e-filed information returns using the FIRE system, *****2*****
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¹⁵ NIST, NIST SP 800-63-3, *Digital Identity Guidelines* (June 2017) (includes updates as of 12-01-2017), and NIST, NIST SP 800-63A, *Digital Identity Guidelines: Enrollment and Identity Proofing* (June 2017) (includes updates as of 12-01-2017).



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Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Ensure that the required Digital Identity Risk Assessment is completed for the FIRE system and an implementation plan for identity proofing the FIRE system’s users is developed.

Management’s Response: The IRS agreed with this recommendation and plans to conduct a Digital Identity Risk Assessment for the FIRE system. IRS management also plans to develop an implementation plan for identity proofing the FIRE system’s web-based users.

Recommendation 2: *****2*****
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Management’s Response: The IRS partially agreed with this recommendation. IRS management plans to study the feasibility of *****2*****
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Filters Need to Be Expanded to Identify Questionable Information Return Submissions

The IRS needs to expand its systemic filters used to identify questionable information return submissions before they are processed and accepted. When information returns are e-filed using the FIRE system, minimal validation checks are performed. For example, the system validates the TCC and the EIN of the payer and ensures that data on the information return are in the correct format.

Once these limited validations are completed, information returns are systemically reviewed to determine the rate of withholding. For e-filed information returns, the IRS Automatic Magnetic Media Processing System performs withholding checks to identify those records with a higher rate of withholding (e.g., withholding of more than *****2*****). The Automatic Magnetic Media Processing System also reviews all records submitted in one file to determine how many records had a higher rate of withholding. Files with a certain percentage of records with a higher rate of withholding are potentially fraudulent and will trigger an error code. The information return files are then sent back to the FIRE system and the IRS contacts the payer to correct the file for resubmission.

For paper information returns, the IRS performs other validations intended to identify fraudulent submissions. *****2*****
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*****2*****. According to the IRS’s internal guidance, paper information returns identified as potentially fraudulent should be held



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from processing and sent to other IRS units for additional review. Further, programming was implemented in January 2018 to evaluate the amount of reported Federal income tax withheld on paper information returns.

Controls were not in place to identify questionable information returns with a high rate of withholding

Our review of TY 2016 information returns (reporting withholding of \$500 or more) identified 22,746 information returns that reported more Federal income tax withholding than income. A significant majority of these information returns, 97.2 percent, were e-filed returns (22,154 e-filed versus 628 paper). These returns contained more than \$615 million in Federal income tax withholding above the income reported on the information returns.¹⁶ These information returns are questionable because *****2*****
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When we shared the results of our analysis with the IRS, it stated that controls were not in place when the TY 2016 returns were filed and processed. For e-filed information returns, the IRS stated that the system only rejects information returns identified as questionable if *****2*****
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Further, the IRS reviewed the information returns we identified and found that 41 payers in the brokerage and mutual fund industry accounted for 81.2 percent of the information returns. IRS management indicated that these payers might be issuing withholding-only information returns as a workaround to some issue that is not yet known by the IRS. Therefore, IRS management believes it would be best to learn more about why this is occurring to determine how best to address the issue.

Some information documents were filed by payers designated by the IRS as a suspicious business

We identified 524 information returns filed in TY 2016 by payers listed on the IRS's *Suspicious EIN Listing*. A suspicious EIN is an EIN that was established for the sole purpose of defrauding

¹⁶ *****1*****
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*****1*****.



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the Government through the filing of individual and business false refund returns or income documents. We provided IRS management with the 524 information returns that we identified, and they confirmed that 113 of the information returns were submitted by a suspicious entity. These suspicious submissions reported income of more than \$1.4 million and withholding of \$12,600. In addition, the IRS agreed that eight information returns looked suspicious but were not confirmed as being submitted by a suspicious entity. The IRS found that the remaining 403 information returns were submitted by a valid payer. The IRS concluded that the payer was valid by *****2*****.

In August 2018,¹⁷ we recommended that the IRS review its *Suspicious EIN Listing* and lock the accounts of those entities that have clear indications of being suspicious (and the IRS agreed to do so). Locking the account prevents the entity from filing business tax returns. A similar process should be implemented to prevent entities listed on the *Suspicious EIN Listing* from using the FIRE system and to prevent their paper information returns from posting to the Information Returns Master File.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 3: Conduct outreach to affected industry groups to ensure that payers submit accurate information returns. Based on this outreach, determine if publications and materials need to be updated to provide better guidance on information return filing practices.

Management's Response: The IRS agreed with this recommendation. IRS management plans to partner with the IRS Advisory Council and/or Communications and Liaison to conduct outreach to the affected industry groups on the criteria for submitting accurate information returns. Based on feedback received from the industry groups, information will be shared with the appropriate functions to improve publications and materials as needed.

Recommendation 4: Evaluate potential business rules and filters that could be implemented to identify questionable information return submissions; for example, *****2*****.

Management's Response: The IRS agreed with the intent of this recommendation. IRS management believes that the recommendation to evaluate the business rules and filters to identify questionable information return submissions is premature and that additional analysis is needed. The IRS plans to complete an analysis on returns being

¹⁷ Treasury Inspector General for Tax Administration, Ref. No. 2018-40-061, *Additional Actions Can Be Taken to Further Reduce Refund Losses Associated With Business Identity Theft* (Aug. 2018).



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filed for which the associated non-Form W-2 information return is reporting Federal income tax withholding and the payer appears to be fabricated.

Recommendation 5: Develop processes to ensure that entities confirmed as suspicious, and that received the account lock, are not allowed access to the FIRE system and to prevent paper returns from posting to the Information Returns Master File.

Management's Response: The IRS agreed with this recommendation. IRS management stated that there are multiple reasons for locking accounts beyond the identification of an entity as being suspicious. However, management plans to complete an analysis of past filings to identify and evaluate appropriate protective measures that can be used to address filings by this subset of locked accounts. Management will share the findings and any recommendations with the owners of the information return intake processes.

Some Paper Information Returns ***2*******

We identified 24,826 paper TY 2015 prior year Forms 1096 with more than 85,000 information returns attached that *****2*****. These Forms 1096 reported a total of \$13.8 billion in box 5 (*Total amount reported with this Form 1096*) amounts and \$2 billion in Federal income tax withholding. According to the IRS's internal guidelines, *****2*****
*****2*****
*****2*****
*****2*****.

When we brought our concerns about prior year information returns to IRS management's attention, they stated that their internal guidance *****2*****
*****2***** and should be reconsidered. As a result, IRS management agreed to *****2***** until they could determine if they needed to change their procedures. When we further discussed our concerns with IRS management, management advised us that they *****2*****
*****2*****
*****2*****. We disagree with this assertion. The IRS's Automated Underreporter program, which matches information returns to individual tax returns, performs three matches each year. The last match that is performed identifies tax returns filed between January and March of the calendar year subsequent to that in which the tax return was due. To ensure that this third match produces consistent results with earlier matches, the IRS should ensure that *****2*****.

Our review also identified 90,485 TY 2016 Forms 1096 that the IRS processed for which no corresponding information returns were attached. These Forms 1096 reported \$409.7 billion in box 5 and \$362.7 billion in Federal income tax withholding, signifying that there should be



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information documents attached corresponding to these figures. *****2*****
*****2*****
*****2*****
*****2*****
*****2*****
*****2***** . As such, the questionable
Forms 1096 warrant further investigation by the IRS.

Although we were unable to determine if the information documents were missing because they were never attached to the Forms 1096 by the taxpayers or were attached but later lost by the IRS before they could be processed, we were able to establish that IRS employees were not following their internal guidelines to correspond with taxpayers regarding the missing information returns. Specifically, these guidelines state that, if a Form 1096 has a money amount entered in box 5 and it did not come with detailed information returns, the IRS is to correspond with or call the taxpayer and request the information documents. If the IRS had followed its own procedures, it might have identified the entity mentioned above as questionable much sooner in the process and before information from the Form 1096 was entered into the IRS’s systems. When we brought our concerns to management’s attention, management acknowledged that employees were failing to follow this procedure and stated that they will place additional emphasis on employee training to ensure that correspondence procedures are followed.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 6: *****2*****
*****2*****.

Management’s Response: The IRS disagreed with this recommendation. IRS management agrees that digitizing all data submitted to the IRS is ideal; however, they disagree with the corrective action specific to this recommendation. The count of affected information returns that were filed late *****2*****
*****2***** is negligible in comparison to the total number of information returns filed and processed each year. The 85,000 information returns that were filed late **2**
*****2***** represents only 0.003 percent of the nearly 3 billion information returns filed for Tax Year 2015. The IRS’s legacy systems that scan and transcribe paper information returns *****2***** programming of those legacy systems would be needed to *****2*****
*****2***** that the optical character recognition process used to transcribe the returns would recognize where each field of data is placed on the paper document and accurately convert it to an electronic record. The IRS Modernization Business Plan provides for capability that will provide a consistent solution for the acceptance, perfection, management, and use of information return data. Given the low volume of



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late-filed returns *****2***** and the new capability in the plan to improve document matching, the IRS cannot justify a cost to upgrade a legacy system.

Office of Audit Comment: While the number of prior year information returns we identified is a small percentage of the overall population of information returns, these returns reported significant dollars—\$13.8 billion in box 5 and \$2 billion in Federal income tax withholding, respectively. Further, the IRS’s Modernization Business Plan estimates that the IRS will start planning a solution for information returns processing in FY 2022, dependent upon the availability of funding, and that the project will continue in development up through FY 2024, thus leaving a considerable gap in the IRS’s ability to substantiate potentially billions of dollars in Federal income tax withholding claims through its document matching processes.

Recommendation 7: Ensure that employees correspond with payers when paper Forms 1096 are received without any corresponding information returns.

Management’s Response: The IRS agreed with this recommendation and plans to issue an alert to remind employees to follow its internal guidelines to correspond or call the payer to request the information returns that should have been attached to Form 1096.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the IRS's verification process for authenticating transmitters of information returns to ensure the reliability of data transmitted. To accomplish this objective, we:

- I. Determined if the IRS is following proper requirements for processing information returns.
 - A. Determined if the IRS processes unofficial information returns by reviewing IRS forms, instructions, and internal guidance as well as interviewing IRS management. Additionally, we determined how official information returns are obtained.
 - B. Determined that the IRS processes Forms 1096, *Annual Summary and Transmittal of U.S. Information Returns*, without the corresponding information returns attached.
 1. Reviewed internal guidance and interviewed management related to the processing of Forms 1096. We also determined the correspondence procedures used when a Form 1096 is received without its related information returns.
 2. Determined the number of Forms 1096 that are received and processed without the related information returns.
 - C. Evaluated the processes and procedures relating to prior year information returns by reviewing relevant internal guidance and interviewing management. We determined the number of prior year information returns filed for TY¹ 2015 and quantified the amounts on those forms.
- II. Determined if the IRS's FIRE system complies with NIST² and OMB security standards.³
 - A. Reviewed the NIST and OMB security standards.
 - B. Obtained and reviewed the risk assessment document that the IRS prepared for the FIRE system.

¹ The 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.

² NIST, NIST SP 800-63-2, *Electronic Authentication Guideline* (August 2013), NIST, NIST SP 800-63-3, *Digital Identity Guidelines* (June 2017) (includes updates as of 12-01-2017), and NIST, NIST SP 800-63A, *Digital Identity Guidelines: Enrollment and Identity Proofing* (June 2017) (includes updates as of 12-01-2017).

³ OMB, OMB Memorandum M-04-04, *E-Authentication Guidance for Federal Agencies* (Dec. 2003).



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- C. Determined if the IRS's authentication level of assurance for the FIRE system is adequate for the risks involved.
- III. Evaluated the IRS's processes to authenticate information return transmitters and issue TCCs.
 - A. Reviewed FIRE system processes and procedures to determine authentication checks that are required to be able to submit information returns.
 - B. Determined the authentication and validation checks that the SSA performs when accepting Forms W-2, *Wage and Tax Statement*, and compared them to the authentication done by the FIRE system.
- IV. Evaluated the effectiveness of the IRS's processes and procedures to identify questionable information returns at the time of processing.
 - A. Reviewed internal guidance and documentation to determine current processes to identify questionable paper and e-filed information returns.
 - B. Interviewed management to obtain an understanding of policies, procedures, and practices to identify questionable information returns.
 - C. Analyzed TY 2016 data to ensure that processes and procedures are properly identifying questionable information returns.
 - D. Determined if the IRS is processing and accepting suspicious information returns used to support claims on individual tax returns by comparing information returns to the IRS's *Suspicious EIN Listing*.

Data validation methodology

For this review, we relied on TY 2016 information returns extracted from the Information Returns Master File⁴ and TYs 2015 and 2016 information from the Payer Master File.⁵ Additionally, we relied on data in the IRS's *Suspicious EIN Listing*. To assess the reliability of computer-processed data, we selected random samples and verified that the data in the extracts were the same as the data contained in the IRS's Integrated Data Retrieval System.⁶ We determined the data were sufficiently reliable for our intended purposes.

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

⁴ The Information Returns Master File creates and maintains a master file of current and prior year information returns.

⁵ A database used to maintain information documents for Forms 1096.

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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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 IRS's policies and procedures for accepting and processing information returns, including prior year returns and returns with correspondence conditions. This also includes reviewing the IRS process for authenticating FIRE system users and the verification and authentication of information returns submitted electronically. We also evaluated the IRS's risk assessment of the FIRE system to determine the adequacy of the security level assigned by the IRS. We accomplished this by interviewing IRS management and reviewing internal guidance and other key documentation related to the acceptance and processing of information returns.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Commissioner, Small Business/Self-Employed Division
Commissioner, Wage and Investment Division
Director, Submission Processing
Director, Accounts Management
Director, Office of Audit Coordination



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Appendix IV

*List of Information Returns Identified
by the Internal Revenue Service*

Form Number	Form Name
SS-4	<i>Application for Employer Identification Number</i>
SS-8	<i>Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding</i>
SS-16	<i>Certificate of Election Coverage Under the Federal Insurance Contributions Act</i>
T	<i>Forest Activities Schedule</i>
W-2	<i>Wage and Tax Statement</i>
W-2AS	<i>American Samoa Wage and Tax Statement</i>
W-2C	<i>Corrected Wage and Tax Statement</i>
W-2G	<i>Certain Gambling Winnings</i>
W-2GU	<i>Guam Wage and Tax Statement</i>
W-2VI	<i>U.S. Virgin Islands Wage and Tax Statement</i>
W-3	<i>Transmittal of Income and Tax Statements</i>
W-3C	<i>Transmittal of Corrected Wage and Tax Statements</i>
W-3C(PR)	<i>Transmision de Comprobantes de Retencion Corregidos</i>
W-3PR	<i>Informe de Comprobantes de Retencion</i>
W-3SS	<i>Transmittal of Wage and Tax Statements</i>
W-4	<i>Employee's Withholding Allowance Certificate</i>
W-4P	<i>Withholding Certificate for Pension or Annuity Payments</i>
W-4S	<i>Request for Federal Income Tax Withholding From Sick Pay</i>
W-4V	<i>Voluntary Withholding Request</i>
W-7	<i>Application for IRS Individual Taxpayer Identification Number</i>
W-7A	<i>Application for Taxpayer Identification Number for Pending U.S. Adoptions</i>



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Form Number	Form Name
W-8BEN	<i>Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)</i>
W-8BEN-E	<i>Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)</i>
W-8CE	<i>Notice of Expatriation and Waiver of Treaty Benefits</i>
W-8ECI	<i>Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States</i>
W-8EXP	<i>Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding and Reporting</i>
W-8IMY	<i>Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding and Reporting</i>
W-9	<i>Request for Taxpayer Identification Number and Certification</i>
W-10	<i>Dependent Care Provider's Identification and Certification</i>
11-C	<i>Occupational Tax and Registration Return for Wagering</i>
56	<i>Notice Concerning Fiduciary Relationship</i>
56-F	<i>Notice Concerning Fiduciary Relationship of Financial Institution</i>
637	<i>Application for Registration (For Certain Excise Tax Activities)</i>
706	<i>United States Estate (and Generation-Skipping Transfer) Tax Return</i>
706-A	<i>United States Additional Estate Tax Return</i>
706-CE	<i>Certificate of Payment of Foreign Death Tax</i>
706-GS(D)	<i>Generation-Skipping Transfer Tax Return for Distributions</i>
706-GS(D-1)	<i>Notification of Distribution From a Generation-Skipping Trust</i>
706-GS(T)	<i>Generation-Skipping Transfer Tax Return for Terminations</i>
706-NA	<i>United States Estate (and Generation-Skipping Transfer) Tax Return Estate of nonresident not a citizen of the United States</i>
706-QDT	<i>U.S. Estate Tax Return for Qualified Domestic Trusts</i>
709	<i>United States Gift (and Generation-Skipping Transfer) Tax Return</i>
712	<i>Life Insurance Statement</i>
720-CS	<i>Carrier Summary Report</i>
720-TO	<i>Terminal Operator Report</i>



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Form Number	Form Name
851	<i>Affiliations Schedule</i>
926	<i>Return by a U.S. Transferor of Property to a Foreign Corporation</i>
966	<i>Corporate Dissolution or Liquidation</i>
972	<i>Consent of Shareholder To Include Specific Amount in Gross Income</i>
973	<i>Corporation Claim for Deduction for Consent Dividends</i>
976	<i>Claim for Deficiency Dividends Deductions by a Personal Holding Company, Regulated Investment Company, or Real Estate Investment Trust</i>
982	<i>Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)</i>
990-BL	<i>Information and Initial Excise Tax Return for Black Lung Benefit Trusts and Certain Related Persons</i>
1000	<i>Ownership Certificate</i>
1041	<i>U.S. Income Tax Return for Estates and Trusts</i>
1041-A	<i>U.S. Information Return Trust Accumulation of Charitable Amounts</i>
1041 (Schedule K-1)	<i>Beneficiary's Share of Income, Deductions, Credits, etc.</i>
1041-T	<i>Allocation of Estimated Tax Payments to Beneficiaries</i>
1042-S	<i>Foreign Person's U.S. Source Income Subject to Withholding</i>
1042-T	<i>Annual Summary and Transmittal of Forms 1042-S</i>
1065-B (Schedule K-1)	<i>Partner's Share of Income (Loss) From an Electing Large Partnership</i>
1065 (Schedule K-1)	<i>Partner's Share of Income, Deductions, Credits, etc.</i>
1094-B	<i>Transmittal of Health Coverage Information Returns</i>
1094-C	<i>Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns</i>
1095-A	<i>Health Insurance Marketplace Statement</i>
1095-B	<i>Health Coverage</i>
1095-C	<i>Employer-Provided Health Insurance Offer and Coverage</i>
1096	<i>Annual Summary and Transmittal of U.S. Information Returns</i>
1097-BTC	<i>Bond Tax Credit</i>



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Form Number	Form Name
1098	<i>Mortgage Interest Statement</i>
1098-C	<i>Contributions of Motor Vehicles, Boats, and Airplanes</i>
1098-E	<i>Student Loan Interest Statement</i>
1098-MA	<i>Mortgage Assistance Payments</i>
1098-Q	<i>Qualifying Longevity Annuity Contract Information</i>
1098-T	<i>Tuition Statement</i>
1099-A	<i>Acquisition or Abandonment of Secured Property</i>
1099-B	<i>Proceeds From Broker and Barter Exchange Transactions</i>
1099-C	<i>Cancellation of Debt</i>
1099-CAP	<i>Changes in Corporate Control and Capital Structure</i>
1099-DIV	<i>Dividends and Distributions</i>
1099-G	<i>Certain Government Payments</i>
1099-H	<i>Health Coverage Tax Credit (HCTC) Advance Payments</i>
1099-INT	<i>Interest Income</i>
1099-K	<i>Payment Card and Third Party Network Transactions</i>
1099-LTC	<i>Long term Care and Accelerated Death Benefits</i>
1099-MISC	<i>Miscellaneous Income</i>
1099-OID	<i>Original Issue Discount</i>
1099-PATR	<i>Taxable Distributions Received From Cooperatives</i>
1099-Q	<i>Payments from Qualified Education Programs (Under Sections 529 and 530)</i>
1099-QA	<i>Distributions From ABLE Accounts</i>
1099-R	<i>Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.</i>
1099-S	<i>Proceeds from Real Estate Transactions</i>
1099-SA	<i>Distributions From an HSA, Archer MSA, or Medicare Advantage MSA</i>
1116	<i>Foreign Tax Credit</i>
1120-S (Schedule K-1)	<i>Shareholder's Share of Income, Deductions, Credits, etc.</i>



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Form Number	Form Name
1122	<i>Authorization and Consent of Subsidiary Corporation to be Included in a Consolidated Income Tax Return</i>
1125-E	<i>Compensation of Officers</i>
1363	<i>Export Exemption Certificate</i>
2032	<i>Contract Coverage Under Title II of the Social Security Act</i>
2439	<i>Notice to Shareholder of Undistributed Long-Term Capital Gains</i>
2555	<i>Foreign Earned Income</i>
2555-EZ	<i>Foreign Earned Income Exclusion</i>
2678	<i>Employer/Payer Appointment of Agent</i>
3520	<i>Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts</i>
3520-A	<i>Annual Information Return of Foreign Trust With a U.S. Owner</i>
3921	<i>Exercise of an Incentive Stock Option Under Section 422(b)</i>
3922	<i>Transfer of Stock Acquired Through An Employee Stock Purchase Plan Under Section 423(c)</i>
4563	<i>Exclusion of Income for Bona Fide Residents of American Samoa</i>
5227	<i>Split-Interest Trust Information Return</i>
5305	<i>Traditional Individual Retirement Trust Account</i>
5471	<i>Information Return of U.S. Persons With Respect to Certain Foreign Corporations</i>
5472	<i>Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business</i>
5498	<i>IRA Contribution Information</i>
5498-ESA	<i>Coverdell ESA Contribution Information</i>
5498-QA	<i>ABLE Account Contribution Information</i>
5498-SA	<i>HSA, Archer MSA, or Medicare Advantage MSA Information</i>
5500	<i>Annual Return/Report of Employee Benefit Plan</i>
5500-EZ	<i>Annual Return of A One Participant (Owners/Partners and Their Spouses) Retirement Plan or A Foreign Plan</i>
5500-SF	<i>Short Form Annual Return/Report of Small Employee Benefit Plan</i>
5713	<i>International Boycott Report</i>



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Form Number	Form Name
5754	<i>Statement by Person(s) Receiving Gambling Winnings</i>
6088	<i>Distributable Benefits From Employee Pension Benefit Plans</i>
6497	<i>Information Return of Nontaxable Energy Grants or Subsidized Energy Financing</i>
7004	<i>Application for Automatic Extension of Time To File Certain Business Income Tax, Information and Other Returns</i>
8027	<i>Employer's Annual Information Return of Tip Income and Allocated Tips</i>
8027-T	<i>Transmittal of Employer's Annual Information Return of Tip Income and Allocated Tips</i>
8038	<i>Information Return for Tax-Exempt Private Activity Bond Issues</i>
8233	<i>Exemption From Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual</i>
8274	<i>Certification by Churches and Qualified Church-Controlled Organizations Electing Exemption from Employer Social Security and Medicare Taxes</i>
8281	<i>Information Return for Publicly Offered Original Issue Discount Instruments</i>
8282	<i>Donee Information Return (Sale, Exchange or Other Disposition of Donated Property)</i>
8288-A	<i>Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests</i>
8288-B	<i>Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests</i>
8300	<i>Report of Cash Payments over \$10,000 Received in a Trade or Business</i>
8308	<i>Report of a Sale or Exchange of Certain Partnership Interests</i>
8329	<i>Lender's Information Return for Mortgage Credit Certificates (MCCs)</i>
8594	<i>Asset Acquisition Statement Under Section 1060</i>
8596	<i>Information Return for Federal Contracts</i>
8609	<i>Low-Income Housing Credit Allocation and Certification</i>
8610	<i>Annual Low-Income Housing Credit Agencies Report</i>



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Form Number	Form Name
8621	<i>Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund</i>
8703	<i>Annual Certification of a Residential Rental Project</i>
8804	<i>Annual Return for Partnership Withholding Tax (Section 1446)</i>
8804-C	<i>Certificate of Partner-Level Items to Reduce Section 1446 Withholding</i>
8805	<i>Foreign Partner's Information Statement of Section 1446 Withholding Tax</i>
8806	<i>Information Return for Acquisition of Control or Substantial Change in Capital Structure</i>
8809	<i>Application for Extension of Time to File Information Returns</i>
8809-EX	<i>Request for Extension of Time To File an ExSTARS Information Return (For Form 720TO or Form 720CS)</i>
8809-I	<i>Application for Extension of Time to File FATCA Form 8966</i>
8811	<i>Information Return for Real Estate Mortgage Investment Conduits (REMICs) and Issuers of Collateralized Debt Obligations</i>
8813	<i>Partnership Withholding Tax Payment Voucher (Section 1446)</i>
8823	<i>Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition</i>
8840	<i>Closer Connection Exception Statement for Aliens</i>
8843	<i>Statement for Exempt Individuals and Individuals with a Medical Condition</i>
8851	<i>Summary of Archer MSAs</i>
8854	<i>Initial and Annual Expatriation Statement</i>
8858	<i>Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)</i>
8865 (Schedule K-1)	<i>Partner's Share of Income, Deductions, Credits, etc.</i>
8870	<i>Information Return for Transfers Associated With Certain Personal Benefit Contracts</i>
8872	<i>Political Organization Report of Contributions and Expenditures</i>
8883	<i>Asset Allocation Statement Under Section 338</i>
8886	<i>Reportable Transaction Disclosure Statement</i>



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Form Number	Form Name
8886-T	<i>Disclosure by Tax-Exempt Entity Regarding Prohibited Tax Shelter Transaction</i>
8891	<i>U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans</i>
8898	<i>Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession</i>
8922	<i>Third-Party Sick Pay Recap</i>
8925	<i>Report of Employer-Owned Life Insurance Contracts</i>
8938	<i>Statement of Foreign Financial Assets</i>
8947	<i>Report of Branded Prescription Drug Information</i>
8955-SSA	<i>Annual Registration Statement Identifying Separated Participants With Deferred Vested Benefits</i>
8957	<i>Foreign Account Tax Compliance Act (FATCA) Registration</i>
8966	<i>FATCA Report</i>
8971	<i>Information Regarding Beneficiaries Acquiring Property from a Decedent</i>

Source: www.IRS.gov



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Appendix V

Form 4419, Application for
Filing Information Returns Electronically

Form 4419 (June 2018)	Department of the Treasury - Internal Revenue Service Application for Filing Information Returns Electronically (FIRE)	OMB Number 1545-0387 IRS Use Only
<input type="checkbox"/> Revised Form 4419		
Current Transmitter Control Code (TCC) (revised only) (refer to instructions page 2) _____		
1. Transmitter and/or Payer information		
Legal name (associated with EIN in Block 2) _____		
Mailing address _____	City _____	State _____ ZIP code _____
2. Employer Identification Number (EIN) (SSN not permitted) _____		
3. Is the request for a foreign transmitter without a TIN <input type="checkbox"/> Yes <input type="checkbox"/> No	4. What Tax Year will electronic filing begin _____	
5. Check the box(es) next to the returns you will file electronically		
Note: IRS encourages transmitters who file for multiple payers to submit one application and use the assigned TCC for all payers.		
<input type="checkbox"/> Forms 1097, 1098, 1099, 3921, 3922, 5498 and W-2G (See Publication 1220)		
<input type="checkbox"/> Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding (See Publication 1187)		
<input type="checkbox"/> Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips (See Publication 1239)		
<input type="checkbox"/> Form 8955-SSA, Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits (See Publication 4810)		
<input type="checkbox"/> I have read the following FIRE System requirement: In order to file electronically through the FIRE System, you must have software or a service provider that will create the file in the standard ASCII format. The FIRE System does not provide an on-line fill-in option. You must transmit your data in the specific format required by IRS.		
6. Person to contact about this request		
Name _____		
Position title _____		
Email address _____	Telephone number _____	
7. <input type="checkbox"/> I have read the Affidavit in the Instructions on page 2 and I am authorized to sign the document on behalf of the transmitter and/or payer.		
Under penalties of perjury, I declare that I have examined this document including any accompanying statements, and to the best of my knowledge and belief, it is true, correct, and complete.		
8. Official of the company or organization		
Name _____	Position title _____	
Signature (a computer generated signature is not acceptable) _____	Date _____	
For Privacy Act and Paperwork Reduction Act Notice, see Instructions.		
Catalog Number 41639J	www.irs.gov	Form 4419 (Rev. 6-2018)



*Strengthened Validation Controls Are Needed
to Protect Against Unauthorized Filing
and Input of Fraudulent Information Returns*

Appendix VI

Management's Response to the Draft Report

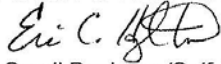


COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

September 9, 2019

MEMORANDUM FOR MICHAEL E. McKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Eric C. Hylton 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Strengthened Validation Controls Are
Needed to Protect Against Unauthorized Filing and Input of
Fraudulent Information Returns (Audit # 201840020)

Thank you for the opportunity to review and comment on the subject draft audit report. Any person, including a corporation, partnership, individual, estate, and trust, who engages in certain transactions during a calendar year, must file information returns to report those transactions to the IRS and to the recipient. There are 185 different types of information returns reporting a variety of transactions. For Tax Year 2016, we received and processed over 2.7 billion.

Information returns are critical to promoting voluntary compliance and to tax administration. Taxpayer compliance rates are significantly higher for amounts subject to information reporting as opposed to those amounts where there is no information reporting. Additionally, we use information returns to identify potentially erroneous and fraudulent returns, ensure compliance with Federal tax withholding requirements and identify unreported income or overstated credits and deductions.

Your review was initiated to evaluate our verification process for authenticating transmitters of information returns to ensure the reliability of the data transmitted. The IRS developed the Filing Information Returns Electronically (FIRE) system to allow payers to submit certain returns electronically. Approximately 98% of all information returns are filed electronically. The FIRE system allows us to process returns faster and with fewer errors than paper returns. We take steps to authenticate FIRE users and have processes for applying added scrutiny and level of review to information returns that are filed using information documents linked to suspicious entities. We are in the process of completing a Digital Identity Risk Assessment for the FIRE system including an implementation plan for further identity proofing the system users. We also plan to conduct outreach with certain industry groups on the criteria for submitting accurate information returns.



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Attached are our detailed comments and, where applicable, proposed actions to your recommendations. If you have any questions, please contact me, or Denice Vaughan, Director, Operations Support, Small Business/Self-Employed Division.

Attachment



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Attachment

The Commissioner, Wage and Investment Division, should:

Recommendation 1:

Ensure that the required Digital Identity Risk Assessment is completed for the FIRE system and an implementation plan for identity proofing the FIRE system's users is developed.

Corrective Actions:

1. We agree with this recommendation and will conduct a Digital Identity Risk Assessment for the FIRE system.
2. We agree with this recommendation and will develop an implementation plan for identity proofing the FIRS system's web-based users.

Implementation Date:

1. January 15, 2020
2. October 15, 2021

Responsible Officials:

1. Associate Chief Information Officer, Cybersecurity
2. Associate Chief Information Officer, Applications Development

Corrective Monitoring Plan:

IRS will monitor this corrective action as part of our internal management system of controls.

Recommendation 2:

*****2*****
*****2*****

Corrective Action:

We agree in part. We will study the feasibility of *****2*****
*****2*****

Implementation Date:

October 15, 2020

Responsible Officials:

Chief Privacy Officer
Director, Identity Assurance, Office of Privacy, Governmental Liaison and Disclosure

Corrective Monitoring Plan:

IRS will monitor this corrective action as part of our internal management system of controls.



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Recommendation 3:

Conduct outreach to affected industry groups to ensure that payers submit accurate information returns. Based on this outreach, determine if publications and materials need to be updated to provide better guidance on information return filing practices.

Corrective Action:

We agree with this recommendation. The Small Business/Self-Employed Division will partner with the IRS Advisory Council and/or Communications and Liaison to conduct outreach to the affected industry groups on the criteria for submitting accurate information returns. Based on feedback received from the industry groups, information will be shared with the appropriate functions to improve publications and materials as needed.

Implementation Date:

June 15, 2020

Responsible Official:

Director, Exam Case Selection, Small Business/Self-Employed Division (SB/SE)

Corrective Monitoring Plan:

IRS will monitor this corrective action as part of our internal management system of controls.

Recommendation 4:

Evaluate potential business rules and filters that could be implemented to identify questionable *****2*****
*****2*****.

Corrective Action:

We agree with the intent of this recommendation; however, we believe the recommendation to evaluate the business rules and filters to identify questionable information return submissions is premature. Additional analysis is needed. We will complete an analysis on returns being filed where the associated non-Form W-2, Wage and Tax Statement, information return is reporting Federal income tax withholding and the payor appears to be fabricated.

Implementation Date:

February 15, 2021

Responsible Official:

Director, Return Integrity Verification and Program Management, Return Integrity and Compliance Services, Wage and Investment Division



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Corrective Monitoring Plan:

IRS will monitor this corrective action as part of our internal management system of controls.

Recommendation 5:

Develop processes to ensure that entities confirmed as suspicious, and that received the account lock, are not allowed access to the FIRE system and to prevent paper returns from posting to the Information Returns Master File.

Corrective Action:

We agree with the recommendation. There are multiple reasons for locking accounts beyond the identification of an entity as being suspicious. To determine the most appropriate treatment for information returns, filed either on paper or electronically, by suspicious entities whose accounts have been locked, we will complete an analysis of past filings to identify and evaluate appropriate protective measures that can be used to address filings by this subset of locked accounts. Our findings and any recommendations will be shared with the owners of the information returns intake processes.

Implementation Date:

April 15, 2021

Responsible Official:

Director, Return Integrity Verification and Program Management, Return Integrity and Compliance Services, Wage and Investment Division

Corrective Monitoring Plan:

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

Recommendation 6:

*****2*****.

Corrective Action:

We agree that digitizing all data submitted to the IRS is ideal; however, we disagree with the corrective action specific to this recommendation. The count of affected information returns that were filed late *****2***** is negligible in comparison to the total number of information returns filed and processed each year. The 85,000 information returns that were filed late *****2***** represent only 0.003 percent of the nearly 3 billion information returns filed for the 2015 tax year¹. Our legacy systems that scan and transcribe paper information returns *****2*****

¹ Publication 55-B, Internal Revenue Service Data Book, 2016, Table 14 (<https://www.irs.gov/pub/irs-soi/16datbk.pdf>).



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*****2*****. Additional programming of those legacy systems would be needed to
*****2***** so that the optical
character recognition process used to transcribe the returns would recognize where
each field of data is placed on the paper document and accurately convert it to an
electronic record. The IRS Modernization Business Plan provides for capability that will
provide a consistent solution for the acceptance, perfection, management and use of
information return data. Given the low volume of late-filed returns *****2***** and
the new capability in the Plan to improve document matching, we cannot justify a cost to
upgrade a legacy system.

Implementation Date:

N/A

Responsible Official:

N/A

Corrective Monitoring Plan:

N/A

Recommendation 7:

Ensure that employees correspond with payers when paper Forms 1096 are received
without any corresponding information returns.

Corrective Action:

We agree with this recommendation and will issue an alert to remind employees to
follow the instructions in Internal Revenue Manual (IRM) 3.10.8.3(4) to correspond or
call the payer to request the information returns that should have been attached to Form
1096, Annual Summary and Transmittal of U.S. Information Returns.

Implementation Date:

October 15, 2019

Responsible Official:

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

Corrective Monitoring Plan:

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