



*Authorities Provided by the Internal Revenue
Code Are Not Effectively Used to Address
Erroneous Refundable Credit
and Withholding Credit Claims*

February 26, 2020

Reference Number: 2020-40-008

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:

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

7 = Information Reflecting the Bureau's Decisionmaking Process

Phone Number / 202-622-6500

E-mail Address / TIGTACommunications@tigta.treas.gov

Website / <http://www.treasury.gov/tigta>



To report fraud, waste, or abuse, call our toll-free hotline at:

1-800-366-4484

By Web:

www.treasury.gov/tigta/

Or Write:

Treasury Inspector General for Tax Administration
P.O. Box 589
Ben Franklin Station
Washington, D.C. 20044-0589

Information you provide is confidential and you may remain anonymous.



HIGHLIGHTS

AUTHORITIES PROVIDED BY THE INTERNAL REVENUE CODE ARE NOT EFFECTIVELY USED TO ADDRESS ERRONEOUS REFUNDABLE CREDIT AND WITHHOLDING CREDIT CLAIMS

Highlights

Final Report issued on February 26, 2020

Highlights of Reference Number: 2020-40-008 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

Congress provided the IRS with tools to address taxpayers identified as submitting fraudulent or reckless refundable credit claims. These tools include the authority to assess the erroneous refund penalty and require taxpayers to recertify that they meet refundable credit eligibility requirements for credits claimed on a return filed subsequent to disallowance of a credit, and the ability to apply two-year or 10-year bans on taxpayers who disregard credit eligibility rules.

WHY TIGTA DID THE AUDIT

A prior TIGTA review found that the IRS did not always recertify the eligibility of taxpayers who received Earned Income Tax Credit (EITC) before allowing the credit. This audit was initiated to evaluate the IRS's use of available tools to deter taxpayers from repeatedly claiming erroneous or fraudulent refundable tax credits.

WHAT TIGTA FOUND

The IRS does not use the tools provided by Congress to the extent possible to address erroneous credit payments. This is despite the IRS's estimate that 25 percent (\$18.4 billion) of the EITCs for Fiscal Year 2018 are likely improper, as well as nearly 33 percent (\$8.7 billion) of Additional Child Tax Credit payments in Tax Years 2009 through 2011, and more than 31 percent (\$5.3 billion) of American Opportunity Tax Credit payments during Tax Year 2012.

While the IRS assessed the erroneous refund penalty on 3,190 returns, TIGTA identified 494,555 taxpayers with more than \$2.6 billion in

withholding and refundable credits that were disallowed for Tax Years 2015, 2016, and 2017 for which almost \$534.7 million in potential penalties was not assessed.

TIGTA also identified 289,059 returns processed during Calendar Year 2018 for which the IRS did not verify the taxpayers' eligibility before recertifying them to receive a refundable credit. These taxpayers received more than \$532 million in refundable credits. In addition, recertification indicators were not placed on 6,259 Tax Year 2017 tax returns for which the IRS disallowed \$6.2 million in refundable credits as part of its Automated Questionable Credit program.

IRS criteria also allows taxpayers to claim erroneous refundable credits for multiple years before a two-year ban is placed on their tax account. TIGTA identified 3,934 taxpayers who claimed more than \$12.9 million in credits in Tax Year 2017 and had the same credit disallowed in multiple prior tax years. TIGTA estimates it costs the IRS nearly \$1.1 million to re-audit taxpayers who have previously been denied a refundable credit.

WHAT TIGTA RECOMMENDED

TIGTA made eight recommendations to the IRS Commissioner, Wage and Investment Division. The IRS agreed or partially agreed with five recommendations. The IRS did not agree to examine all tax returns with a recertification indicator, modify systemic processes to apply the two-year ban after two audits result in the disallowance of a refundable credit, or develop a plan to obtain and use information from the Social Security Administration of individuals who admit to falsely reporting self-employment income to receive refundable credits.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 26, 2020

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Authorities Provided by the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims (Audit # 201840037)

This report presents the results of our review to evaluate the Internal Revenue Service's use of available tools to deter taxpayers from repeatedly claiming erroneous or fraudulent refundable tax credits. This audit was included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Reducing Fraudulent Claims and Improper Payments.

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

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



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Table of Contents

<u>Background</u>	Page 1
<u>Results of Review</u>	Page 4
<u>The Majority of Taxpayers With Disallowed Refundable Credit Claims Are Still Not Assessed the Erroneous Refund Penalty</u>	Page 4
<u>Recommendation 1:</u>	Page 6
<u>Processes Do Not Ensure That the Majority of Taxpayers Who Are Recertified Meet Eligibility Requirements</u>	Page 7
<u>Recommendations 2 and 3:</u>	Page 9
<u>Recommendations 4 and 5:</u>	Page 10
<u>The Criteria Used to Apply the Bans Allows Taxpayers to Repeatedly File Erroneous Refundable Credit Claims</u>	Page 10
<u>Recommendation 6:</u>	Page 14
<u>Recommendations 7 and 8:</u>	Page 15
<u>Appendices</u>	
<u>Appendix I – Detailed Objective, Scope, and Methodology</u>	Page 16
<u>Appendix II – Major Contributors to This Report</u>	Page 21
<u>Appendix III – Report Distribution List</u>	Page 22
<u>Appendix IV – Outcome Measures</u>	Page 23
<u>Appendix V – Management’s Response to the Draft Report</u>	Page 29



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Abbreviations

ACTC	Additional Child Tax Credit
AOTC	American Opportunity Tax Credit
AQC	Automated Questionable Credit
DDb	Dependent Database
EITC	Earned Income Tax Credit
IMF	Individual Master File
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
PATH Act	Protecting Americans from Tax Hikes Act of 2015
SE	Self-Employment
SSA	Social Security Administration
TIGTA	Treasury Inspector General for Tax Administration



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Background

Refundable credits help low-income individuals reduce their tax burden. For example, the Earned Income Tax Credit (EITC), created in 1975, offsets the impact of Social Security taxes on low-income families and encourages them to seek employment.¹ Congress also created the Child Tax Credit² and the Additional Child Tax Credit (ACTC) to account for a growing family's reduced ability to pay taxes as family size increased. Refundable credits also provide incentives for other activities, such as obtaining a college education. The American Opportunity Tax Credit (AOTC) allows individuals to receive a credit for higher education expenses. Figure 1 shows the amount claimed for Tax Years³ 2015 through 2017 for the three largest refundable credits that the Internal Revenue Service (IRS) administers – the EITC, the ACTC, and the AOTC.⁴

Figure 1: EITC, ACTC, and AOTC Claimed for Tax Years 2015 Through 2017

Tax Year	EITC		ACTC		AOTC	
	Returns	Credit Amount	Returns	Credit Amount	Returns	Credit Amount
2015	28.0 million	\$68.8 billion	19.4 million	\$26.3 billion	9.6 million	\$8.8 billion
2016	27.3 million	\$66.6 billion	18.7 million	\$26.0 billion	8.7 million	\$8.3 billion
2017	26.2 million	\$64.5 billion	17.7 million	\$25.1 billion	7.9 million	\$7.0 billion

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the Individual Return Transactions File⁵ as of December 27, 2018.

The Internal Revenue Code (I.R.C.) provides the IRS with specific authorities to combat and deter false claims for refundable credits

Recognizing the extent of refundable credit improper payments and the IRS resources needed to identify and prevent the issuance of erroneous refunds, Congress enacted legislation to provide the IRS with specific authorities to address taxpayers who erroneously claim these refunds and credits. These authorities include:

¹ Tax Reduction Act of 1975, 1975, Pub. L. No. 90-12, 89 Stat. 32 §204.

² The Child Tax Credit is not refundable; however, the Additional Child Tax Credit is refundable.

³ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

⁴ These represent three of the most common refundable credits currently available to taxpayers.

⁵ The Individual Return Transactions File contains individual tax return data.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

- **Erroneous Refund Penalty** – The *Small Business and Work Opportunity Tax Act of 2007*⁶ provides the IRS with the ability to assess the erroneous claim for refund or credit penalty (referred to as the erroneous refund penalty). Congress provided the IRS with this penalty as a tool to deter aggressive claims for tax refunds and credits by increasing the cost to individuals who attempt to claim erroneous refunds. The erroneous refund penalty can be assessed on tax returns for which the IRS disallows an erroneous refund or refundable credit claim at the time the tax return is processed, *i.e.*, before the refund is issued. The Act amended the I.R.C. to allow for a monetary penalty for erroneous tax refund or tax credit claims for the ACTC and the AOTC. The Protecting Americans from Tax Hikes Act of 2015 (Path Act)⁷ expanded the use of the erroneous refund penalty to include disallowance of the EITC. Previously, the erroneous refund penalty could not be assessed if the denied claim was for the EITC. The IRS can assess the erroneous refund penalty for any underpayment defined in I.R.C. Section (§) 6664 for which the fraud penalty under I.R.C. § 6663 or accuracy-related penalties under I.R.C. § 6662 or 6662A do not apply. I.R.C. § 6676 states:

Civil penalty. If a claim for refund or credit with respect to income tax is made for an excessive amount, unless it is shown that the claim for such excessive amount is due to reasonable cause, the person making such claim shall be liable for a penalty in an amount equal to 20 percent of the excessive amount.

- **Two-Year and 10-Year Bans** – Prior to the PATH Act, the I.R.C. allowed for a two-year or 10-year ban on taxpayers from claiming the EITC.⁸ The PATH Act expanded the rules to apply to the Child Tax Credit/ACTC⁹ or the AOTC.¹⁰ When the IRS determines the taxpayer has abused the credit rules, it has the authority to impose a two-year ban on taxpayers who recklessly or intentionally disregarded the credit eligibility rules. The 10-year ban can be imposed on taxpayers who file fraudulent credit claims. The PATH Act granted the IRS math error authority to disallow credits without a formal audit if the taxpayer claims the credit during the period in which he or she is barred from doing so due to fraud or reckless or intentional disregard. I.R.C. § 32(k)(1), § 24(g)(1), and § 25A(b)(4) state:

Taxpayers making prior fraudulent or reckless claims

In general. No credit¹¹ shall be allowed under this section for any taxable year in the disallowance period.

⁶ Pub. L. No. 110-28, §§8201-8248.

⁷ Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015).

⁸ I.R.C. § 32(k)(1).

⁹ I.R.C. § 24(g)(1).

¹⁰ I.R.C. § 25A(b)(4).

¹¹ I.R.C. § 25A(b)(4) specifically references the AOTC.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Disallowance period

The disallowance period is –

- *The period of 10 taxable years after the most recent taxable year for which there was a final determination that the taxpayer’s claim of credit under this section was due to fraud, and*
- *The period of 2 taxable years after the most recent taxable year for which there was a final determination that the taxpayer’s claim of credit under this section was due to reckless or intentional disregard of rules and regulations (but not due to fraud).*

As of March 28, 2019, there were approximately 6,033 taxpayer accounts with a ban in effect.

- ***Recertification*** – The I.R.C. requires individuals whose EITC, ACTC, or AOTC claim has been reduced or disallowed to recertify their eligibility before they can receive the credit again. When the IRS reduces or denies these credits, it places a “recertification” indicator on the taxpayer’s account and sends letter CP 79, *Denied Credit Eligibility Requirement*, to the taxpayer. This letter informs the taxpayer that the IRS reduced or disallowed the credit and that the taxpayer will be required to file Form 8862, *Information To Claim Certain Credits After Disallowance*, to recertify their eligibility the next time they claim the credit. Taxpayers must recertify for each credit that was reduced or disallowed. In addition, when a taxpayer is banned from claiming a refundable credit for two years or 10 years, he or she must file Form 8862 to claim the credit after their banned period expires. I.R.C. § 32(k)(2), § 24(g)(2), and § 25A(b)(4) state:

TAXPAYERS MAKING IMPROPER PRIOR CLAIMS. — In the case of a taxpayer who is denied credit¹² under this section for any taxable year as a result of the deficiency procedures under subchapter B of chapter 63, no credit shall be allowed under this section for any subsequent taxable year unless the taxpayer provides such information as the Secretary may require to demonstrate eligibility for such credit.

This review was performed with information obtained from the IRS Wage and Investment Division’s Return Integrity and Compliance Services function in Atlanta, Georgia, during the period April 2018 through June 2019. 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.

¹² I.R.C. § 25A(b)(4) specifically references the AOTC.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Results of Review

Congress provided the IRS with tools to address taxpayers identified as submitting fraudulent or reckless refundable credit claims. These tools include the authority to assess the erroneous refund penalty and require taxpayers to recertify that they meet refundable credit eligibility requirements for credits claimed on a return filed subsequent to disallowance of a credit, and the ability to apply two-year or 10-year bans on taxpayers who disregard credit eligibility rules. However, the IRS does not use these tools to the extent possible to address erroneous credit payments. The ineffective use of the various authorities provided in the I.R.C. is a contributing factor in the high rate of improper payments. The IRS estimates that 25 percent (\$18.4 billion) of EITC payments made in Fiscal Year 2018 were improper payments. The IRS also estimates that nearly 33 percent (\$8.7 billion) of ACTC payments made during Tax Years 2009 through 2011, and more than 31 percent (\$5.3 billion) of AOTC payments made during Tax Year 2012, were potentially improper.

The Majority of Taxpayers With Disallowed Refundable Credit Claims Are Still Not Assessed the Erroneous Refund Penalty

In September 2013,¹³ TIGTA reported that the IRS incorrectly interpreted the erroneous refund penalty law and had significantly limited the types of erroneous tax refund or credit claims for which the penalty would apply. The IRS assessed 84 erroneous refund penalties totaling \$1.9 million between May 2007 and May 2012. We recommended that the IRS develop processes and procedures to enable Campus Operations¹⁴ to assess the erroneous refund penalty. Campus Operations are the IRS functional areas that are most frequently involved in the disallowance of refundable credit claims. The IRS agreed with the recommendation and stated that a cross-functional team of affected stakeholders will determine the operational and procedural changes needed to integrate the assessment of the erroneous refund penalty into the Campus Operations.

The IRS still does not assess the erroneous refund penalty on the majority of taxpayers with reduced or disallowed refundable credit claims

More than five years have passed since we made the previously referenced recommendation, yet the IRS still does not assess the erroneous refund penalty on the majority of taxpayers with disallowed refunds because of erroneous withholding and/or refundable credit claims. For Tax

¹³ TIGTA, Ref. No. 2013-40-123, *The Law Which Penalizes Erroneous Refund and Credit Claims Was Not Properly Implemented* (Sept. 2013).

¹⁴ Campus Operations functions include the Submission Processing function, Accounts Management function, Return Integrity and Compliance Services function, and Campus Examination function.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Years 2015, 2016, and 2017, the IRS assessed the erroneous refund penalty on 3,190 erroneous claims totaling \$2.7 million. However, our analysis identified 494,555 withholding and refundable credits disallowed for Tax Years 2015, 2016, and 2017 (as of December 27, 2018). These taxpayers filed 798,504 tax returns that claimed more than \$2.6 billion in improper withholding or refundable credits. Applying the 20 percent erroneous penalty rate to the disallowed credits computes to almost \$534.7 million in penalties that the IRS potentially could have assessed.¹⁵ Figure 2 provides a summary of the disallowed credits for which the IRS did not assess the erroneous refund penalty.

Figure 2: Summary of Tax Credits Disallowed – Tax Years 2015 Through 2017 With No Erroneous Refund Penalty Assessed

Type of Disallowed Refund	Disallowed Claims ¹⁶	Disallowed Amount	Potential I.R.C. § 6676 Penalty Amount
Withheld Taxes	147,594	\$966,327,458	\$193,265,492
Refundable Credits	650,910	\$1,707,046,939	\$341,409,388
EITC	320,664	\$1,243,772,906	\$248,754,581
ACTC	259,736	\$377,073,855	\$75,414,771
AOTC	70,510	\$86,200,178	\$17,240,036
Total	798,504	\$2,673,374,397	\$534,674,880

Source: TIGTA analysis of the IRS’s Individual Master File (IMF) as of December 27, 2018.

An IRS study concluded that the use of the erroneous refund penalty increases taxpayer credit compliance in subsequent filings

In response to the PATH Act’s expansion of the use of the erroneous refund penalty to combat improper EITC claims, the IRS initiated a study in February 2017. The purpose of the study was to determine how assessing the penalty affects taxpayers’ subsequent filing behavior. IRS management indicated that the study’s results would then be used to develop the appropriate future policy application. To perform the study, the IRS *****7*****
*****7*****
*****7*****. For each of these cases, the IRS assessed the erroneous refund penalty. The IRS analyzed these taxpayers’ subsequent filing behavior in Processing Year 2018. The study concluded that when the erroneous refund penalty was

¹⁵ The actual amount of penalties the IRS will assess depends on the circumstances of each taxpayer’s situation. We were unable to identify taxpayers who may have been considered for an erroneous refund penalty, accuracy-related penalty, or civil fraud penalty but the penalty was not assessed.

¹⁶ The number of disallowed claims exceeds the number of taxpayer accounts because some taxpayers had more than one claim disallowed in Tax Years 2015 through 2017.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

assessed, there was an impact on the taxpayer's subsequent filing. IRS analysis found that taxpayers who were assessed the penalty in Processing Year 2017 filed 2,876 (64 percent) tax returns in Processing Year 2018.

- 1,951 (67.8 percent) tax returns continued to include at least one refundable credit claim in Processing Year 2018. The IRS found 547 taxpayers who continued to claim a refundable credit made fewer errors on their tax returns. The remaining taxpayers who continued to claim a refundable credit had either the same number of errors as previously identified or more errors.
- 925 (32.2 percent) tax returns did not include a refundable credit claim in Processing Year 2018. The IRS found that these taxpayers reduced the number of dependents listed on their tax return by at least one for 728 (78.7 percent) of the 925 tax returns.

The IRS stated that although there were changes in the taxpayer's subsequent filing, the IRS could not determine if the change was in response to the penalty assessment as the study was not statistically valid and did not include a control group. IRS management noted that a balanced test and control group would allow researchers to determine if the reductions in the EITCs claimed are the result of the erroneous refund penalty assessment. As such, the IRS expanded its study in April 2019 to include the use of a control group. However, IRS management indicated that even if the recommendations are approved, the time frame to submit requirements for programming changes for the Calendar Year 2020 Filing Season would have passed. As a result, the earliest implementation date would be in Calendar Year 2021. Management further stated that in addition to assessing the erroneous refund penalty, there are several other applicable treatments for taxpayers who erroneously claim credits. These include audits, recertification, and assertion of the two-year or 10-year ban. However, before additional treatments are applied, the IRS wanted to determine the impact of the penalty on the taxpayer's behavior.

On October 25, 2019, IRS management stated that they have completed the expanded study of the erroneous refund penalty and are in the process of formulating recommendations for executive approval.

Recommendation

Recommendation 1: The Commissioner, Wage and Investment Division, should assess the erroneous refund penalty for reduced or disallowed withholding and refundable credit claims on all claims for which the IRS determines the claim is excessive and does not have a reasonable basis, and the taxpayer is not subject to the penalties under I.R.C. §§ 6662, 6662A, and 6663.

Management's Response: The IRS agreed with this recommendation and plans to recommend a population for treatment during an examination audit and will develop guidance to identify when the penalty is applicable.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Processes Do Not Ensure That the Majority of Taxpayers Who Are Recertified Meet Eligibility Requirements

Our review identified 311,883 tax returns, in which the taxpayers' tax accounts had a recertification indicator that either were processed during Calendar Year 2018¹⁷ or had an examination that was closed during Fiscal Year 2018. We identified 289,059 (93 percent) returns for which the IRS did not verify the taxpayers' eligibility before recertifying them to receive a refundable credit. These taxpayers received more than \$532 million in refundable credits.

The lack of verification is problematic because IRS recertification examination results show that most taxpayers who attempt to recertify do not meet the eligibility requirements. For example, the IRS selected 23,232 (7 percent) of the 311,883 returns for examination to verify their eligibility to claim the refundable credit(s) for Fiscal Year 2018.¹⁸ The IRS disallowed 20,015 (86 percent) claims totaling more than \$75 million.¹⁹ As a result, the recertification indicator will remain on the taxpayer's account, and the taxpayer will again be required to recertify the next time they claim a previously disallowed refundable credit. For each of these claims, the IRS's decision to disallow the credit was based on a tax examiner's review of the supporting documentation provided by the taxpayer.

When a tax return with a recertification indicator is selected for examination, the IRS corresponds with the taxpayer to request documentation to support his or her eligibility for the credit claimed. For example, documentation to support claims for the EITC or the ACTC can include school records, doctor records, evidence of childcare expenses, or evidence of the receipt of government assistance. For the AOTC, the documentation requested *must show* the dependent is at least a part-time student for at least one academic period at an accredited learning institution. This could be transcripts or prior year tax returns to verify the AOTC was not claimed for the dependent for more than four years. No such reviews were conducted for the 289,059 returns we identified that the IRS did not select for examination.

When we discussed with IRS management the fact that the majority of recertification cases are not reviewed, IRS management stated that for each of the 289,059 returns that were not examined, return processing filters ensure that *****2*****. These filters also identify whether the taxpayer was *****2*****. In addition, management stated that all returns filed, including returns

¹⁷ As of July 31, 2018.

¹⁸ A tax return could have more than one recertification indicator on the account. When the return is selected for examination, it is selected based on only one of the refundable credits and the remaining recertification indicators are released without review. We identified 408 tax returns that were included in the population for examined returns and the population of returns that were recertified without review.

¹⁹ The IRS provided the examination results for Fiscal Year 2018 showing the amount of change from EITC examinations, and we restricted our analysis to those for which the full amount of the EITC was disallowed.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

containing Forms 8862, are subject to audit if the return breaks Dependent Database (DDb)²⁰ rules and meets the Examination function's selection criteria. However, IRS management stated that failing one of the DDb rules does not ensure that the tax return will be examined, even if the credit claim meets the IRS's examination selection dollar threshold. Apart from DDb checks, the IRS took no additional steps to verify the eligibility for the more than \$532 million in refundable credits that these taxpayers received. IRS management stated that the IRS considers the taxpayers as meeting their legal requirement as it relates to recertification when they ****2**** *****2****. As such, if a recertification return is not selected for examination at the time the tax return is processed, the recertification indicator is removed from the taxpayer's account and the taxpayer receives the refundable credit(s) claimed.

Additional analysis of the 289,059 returns the IRS provided that were not examined found that 114,572 (40 percent) returns with claims that totaled more than \$432 million had a refundable credit amount that met the IRS's examination selection dollar threshold. Using the IRS's 86 percent recertification disallowance rate, we estimate the IRS potentially issued \$372 million to taxpayers who did not qualify for the credit being claimed. We also found DDb filters identified that the dependents claimed on 44,861 (39 percent) of the 114,572 returns were not eligible for the credit, *****2****. Refundable credit claims associated with these returns totaled approximately \$166 million.

Recertification indicators were not always placed on some taxpayer accounts

Our review also identified 6,259 Tax Year 2017 tax returns as of December 27, 2018, for which the IRS disallowed \$6.2 million in refundable credits but did not place the required recertification indicator on the associated taxpayer's tax account. These refundable credit claims were reduced or disallowed as part of the IRS's Automated Questionable Credit (AQC) program. The IRS AQC program is a prerefund treatment process to address questionable refundable credit claims that do not meet the IRS examination tolerance. For those returns selected, tax examiners review tax accounts and determine if appropriate documentation exists for the credit(s) claimed. If a recertification indicator is not put on a taxpayer's account, future attempts to claim the credit would not be identified for review to ensure that the taxpayer is eligible for the credit.

We notified IRS management of our concerns on November 19, 2018. IRS management agreed that the cases processed through the AQC program did not have the recertification indicator placed on the taxpayers' accounts when the credits were disallowed. IRS management stated that they have requested updated programming to systemically set the recertification indicator when claims are disallowed as a result of the AQC program. IRS management stated that they

²⁰ The DDb is a rules-based selection application that is designed to identify potentially ineligible tax returns claiming the EITC and other refundable credits, e.g., Premium Tax Credit, the ACTC, and the AOTC.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

expect a systemic process to be implemented in January 2020. However, implementation is dependent on available funding and information technology resources. IRS management further stated that there is currently no process to manually set a recertification indicator. As such, they are unable to set the indicator on cases worked in the AQC program, including the 6,259 cases we identified, until the systemic process is implemented.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 2: At a minimum, prioritize resources to ensure that all tax returns with a recertification indicator that meet the IRS's examination selection criteria and break a DDb rule are examined. As resources become available, the IRS should ensure that all tax returns with a recertification indicator that meet the examination selection criteria are examined.

Management's Response: The IRS disagreed with this recommendation. IRS management stated that they plan to ensure that all tax returns with a recertification indicator that meet the examination selection criteria and break a DDb rule are considered for examination. However, management will continue the current practices of auditing the most egregious returns, which may or may not be the returns with a recertification indicator, and provide effective coverage for all of its programs.

Office of Audit Comment: The IRS cites its practice of selecting the most egregious returns for audit yet disagreed with our recommendation to select returns with a recertification indicator that also break a DDb rule. The results from the IRS's examination of these types of returns show these are in fact egregious filings. For example, for Fiscal Year 2018, 86 percent of these types of returns that were examined did not meet recertification eligibility requirements and the IRS denied the claim.

Recommendation 3: Develop processes and procedures to manually set a recertification indicator on tax accounts associated with refundable credit claims that were disallowed through the AQC program until a systemic process is implemented.

Management's Response: The IRS agreed with this recommendation. However, IRS management does not have the ability to manually set the recertification indicators without updated programming. Management has requested updated programming for AQC disallowance treatment to include setting the recertification indicators as applicable. However, all programming requests are contingent upon budget and information technology resource availability. Until programming can be implemented, IRS management plans to identify another process to identify returns that should be referred for treatment.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Recommendation 4: Add recertification indicators to the tax accounts of the 6,259 cases we identified with a refundable credit claim disallowed through the AQC program. In addition, the IRS should identify additional taxpayers whose refundable credit claim was disallowed by the AQC program since December 2018 and add recertification indicators to these tax accounts.

Management’s Response: The IRS agreed with this recommendation. However, IRS management does not have the ability to manually set the recertification indicators without updated programming. Management has requested updated programming for AQC disallowance treatment to include setting the recertification indicators as applicable. Until programming can be implemented, IRS management plans to identify another process to identify returns that should be referred for treatment.

Recommendation 5: Ensure that a systemic process is implemented to set the recertification indicator on taxpayers’ accounts when refundable credit claims are disallowed as part of the IRS’s AQC program.

Management’s Response: The IRS agreed with this recommendation and has requested updated programming for the AQC disallowance treatment to include setting the recertification indicators as applicable. The request has been denied due to budget restraints and information technology resources. However, IRS management plans to resubmit it.

The Criteria Used to Apply the Bans Allows Taxpayers to Repeatedly File Erroneous Refundable Credit Claims

The IRS is not using bans to effectively address refundable credit noncompliance and ensure efficient use of limited examination resources. Our analysis of 1.9 million taxpayers who claimed the EITC, the ACTC, or the AOTC in Tax Year 2017²¹ and did not have a ban on their tax account identified 3,934 taxpayers who were allowed to claim more than \$12.9 million in credits despite having the same credit disallowed *****2***** (*2*).²² We estimate it costs the IRS nearly \$1.1 million to re-audit taxpayers who had already been denied the EITC, the ACTC, or the AOTC in two prior audits.

IRS management stated that the two-year ban can be asserted when the taxpayer demonstrates reckless or intentional disregard of the rules and regulations. According to IRS management, intentional disregard is demonstrated when the taxpayer has knowledge of the requirements and continues to claim a credit for which he or she is not entitled. IRS management stated that the examiner uses the facts and circumstances of the case such as the taxpayer’s response to

²¹ As of December 27, 2018.

²² The 3,934 taxpayers are limited to those taxpayers who the IRS audited *****2***** *****2*****, and *****2***** audits were closed *****2***** *****2*****.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

inquiries and prior audit history to determine whether the taxpayer has demonstrated a pattern of disregard for the rules.

Although the IRS has established processes to apply the two-year EITC ban systemically, no bans are asserted until the taxpayer has been disallowed a refundable credit ***2*******

The IRS has systemic processes to place a two-year EITC ban on a taxpayer’s account. However, these processes allow taxpayers to continue to file erroneous EITC claims *****2***** before they are banned from making additional claims. The IRS does not systemically apply a ban until it has conducted *****2***** audits of the taxpayer for which the EITC was disallowed. However, *****2***** , the IRS will not assert the two-year ban until after *****2***** audit for which the EITC is disallowed. For instances in which the IRS reviews more than one tax year in a single audit, the taxpayer may be allowed to claim the EITC ***2*** *****2***** before a ban is placed on the taxpayer’s account. For example,²³

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

In addition, the IRS’s systemic ban process does not adequately address taxpayers with erroneous claims that the IRS does not select for audit. Additional analysis of the 3,934 taxpayers we identified who had been denied the EITC, the ACTC, or the AOTC **2** *****2***** identified 873 taxpayers who the IRS identified as having an error ***2*** *****2***** , but the claim was not selected for audit. As a result, the IRS did not consider the two-year ban for these taxpayers despite their having been denied the credit in *2* *****2***** . In addition, *****2***** , the IRS would have systemically removed the recertification indicator from the 873 taxpayers’ accounts without verifying the taxpayers’ eligibility to claim *****2***** *****2***** . Finally, none of the 3,934 taxpayers we identified who were denied a credit in *****2***** were assessed an erroneous refund penalty.

When we discussed our concerns about the IRS’s systemic ban criteria with IRS management, they stated that the ban is not applied systemically until *****2***** because the taxpayer *****2*****

²³ The example illustrates the IRS’s general systemic ban processes and is not specific to any taxpayer account.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

*****2*****
*****2*****
2. IRS management also stated that the previous scenario, *****2*****
*****2*****, represents less than 10 percent of the EITC closures for Fiscal Years 2017 and 2018 and is applicable to cases in which *****2*****. In addition, IRS management stated that they do not assume the taxpayer has knowledge of the EITC rules and requirements until the credit is disallowed *****2*****.

However, management’s viewpoint appears to disregard that fact that the IRS sends taxpayers a CP 75 or a CP 75A, *Exam Initial Contact Letter*, at the beginning of every audit that informs the taxpayer why their EITC claim is being audited. For example, the letter states:

To qualify for Earned Income Tax Credit, you should:

- *Review the enclosed Form 886-H-EIC, Documents You Need to Send to Claim the Earned Income Credit on the Basis of a Qualifying Child or Children for Tax Year.*
- *Submit the documentation requested to show your child met the relationship, age and residency tests to qualify you for the Earned Income Credit.*

In addition, the letter provides the taxpayer with references where he or she can obtain additional information regarding EITC eligibility requirements and the audit process. As such, the only taxpayers who may not be informed of EITC requirements after the first audit are those taxpayers whose Exam Initial Contact Letter was returned to the IRS as undeliverable. IRS management did note that based on the facts and circumstances of the case, an examiner can manually assert the two-year ban in any year the taxpayer is audited.

The IRS has no systemic process to assert the two-year ban for disallowed ACTC and AOTC claims

Although the IRS has established systemic processes to assert the EITC ban, the IRS has no such processes for disallowed ACTC and AOTC claims. IRS management stated that the two-year ban for these credits was not implemented until Tax Year 2016. In addition, IRS management stated that the manual assertion of the two-year ban follows the same process as the EITC — the ban can be manually considered and proposed by an examiner for any audit based on the facts and circumstances of the case. According to IRS management, they plan to do an analysis to determine if a systemic ban assertion for the ACTC and the AOTC is warranted before they initiate a systemic process to apply the two-year ban. However, IRS management stated that if they determine the systemic assertion of the ban is warranted, the earliest that the ban could be implemented would be Fiscal Year 2021.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

The criteria used to apply the two-year ban results in the inefficient use of limited resources to continually examine taxpayers who repeatedly have their credit claim disallowed

As previously discussed, the IRS’s process for systemically applying the two-year ban results in the IRS auditing a taxpayer *****2***** before action is taken to prevent the taxpayer from filing additional claims. As such, the IRS is using limited resources to audit taxpayers who repeatedly claim the EITC, the ACTC, and the AOTC after having their claim denied rather than setting a ban that prevents these taxpayers from claiming the credit for two years. According to the IRS, it cost approximately \$395 to complete a prerefund audit in Fiscal Year 2018. Using the IRS’s figures, we estimate it cost the IRS nearly \$1.1 million²⁴ to audit the 1,028 taxpayers we identified in Tax Year 2017 who had the EITC, the ACTC, or the AOTC disallowed in a prior tax year. Further, the continued re-auditing of taxpayers who are disallowed a refundable credit rather than applying a ban, either systemically or manually, prevents the IRS from addressing additional taxpayers who improperly claim these credits.

Continued coordination is needed to obtain documentation from the Social Security Administration (SSA) identifying the individuals who ***2*******
*****2*****

Each year, the SSA provides the IRS with alerts called Self-Employment (SE) Determination Posting Records (hereafter referred to as SE transcripts) that identify individuals for whom it deletes SE income from the SSA earnings records. The transcripts notify the IRS of the tax year for which the individual stated the SE income was not earned and the amount of income that was deleted from his or her SSA earnings record. *****2*****
*****2*****
2. Our analysis of the SE transcripts the IRS received between January 1, 2015, and December 31, 2016, identified 4,024 (12 percent) transcripts in which the SSA *****2*****
*****2*****. Our analysis of tax returns filed by these individuals found that the IRS disallowed \$4.6 million in the EITC claimed on 1,114 tax returns for Tax Years 2013, 2014, and 2015.

In March 2016, we reported that the IRS was not using information the SSA provided that identifies individuals *****2*****
2. ²⁵ We recommended that the IRS establish processes to ensure that all SE transcript cases for which the SSA *****2*****
*****2***** are evaluated to determine whether *****2*****
*****2****. To assist with this screening, we recommended that the IRS obtain copies of

²⁴ See Appendix IV for details on how this cost was calculated.
²⁵ TIGTA, Ref. No. 2016-40-027, *Social Security Administration Information on Misreported Self-Employment Income Is Not Effectively Used to Recover Fraudulent or Erroneously Claimed Refundable Credits* (Mar. 2018).



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

information from the SSA for cases in which *****2*****. The IRS agreed with this recommendation.

In April 2018, we reported that IRS management stated that the SSA determined that it could not provide *****2***** to the IRS under its existing information-sharing agreement.²⁶ At that time, IRS management indicated that the IRS was continuing to work with the SSA to modify this agreement to include such documentation. On October 5, 2018, the IRS stated that it had stopped coordinating with the SSA and reiterated that the SSA determined that it could not provide *****2***** *****2***** to the IRS under its existing information-sharing agreement.

In discussions we had with the SSA on January 17, 2019, SSA management confirmed that they cannot provide *****2***** to the IRS under the Privacy Act Statement in Section 205a of the Social Security Act (42 U.S.C. § 405a). However, SSA management agreed to continue to work with the IRS to modify Form *****2***** *****2***** to include the information the IRS needs *****2***** *****2*****. We notified the IRS on February 13, 2019, of our discussions with the SSA and the SSA’s agreement to continue working with the IRS to provide the needed information. IRS management met with the SSA on April 8, 2019. SSA management indicated that it will likely take some time to revise *****2***** to capture the information the IRS needs. IRS management informed the SSA that they were eager to support the SSA in its efforts to revise the **2** and associated procedures that would allow the IRS to use the **2** in its EITC compliance efforts. Specifically, the IRS can use this information to *****2***** *****2*****.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 6: Update the systemic process to include applying the two-year ban for disallowed ACTC and AOTC claims.

Management’s Response: The IRS partially agreed with this recommendation. IRS management plans to research the effectiveness of the recertification process for the ACTC and the AOTC to determine whether the extension of the systemic process for applying the two-year ban to these credits is warranted. IRS management stated that they are conducting an analysis to determine if a systemic ban assertion for the ACTC and the AOTC is warranted. If it is determined that the systemic assertion of the two-year ban is warranted, the earliest the ban could be implemented would be Fiscal Year 2021.

²⁶ TIGTA, Ref. No. 2018-40-032, *The Internal Revenue Service Is Not in Compliance With Improper Payment Requirements* (Apr. 2018).



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Recommendation 7: Modify the systemic process for applying the two-year ban to apply the ban at the time the IRS concludes the second audit for which the IRS disallows the taxpayer’s EITC, ACTC, and AOTC claims.

Management’s Response: The IRS disagreed with this recommendation. IRS management does not agree that the systemic assertion of the ban should occur in the second year of audit. However, management plans to continue to reinforce that examiners consider the assertion of the ban during the audit, when warranted.

Office of Audit Comment: Management’s response misrepresents our recommendation. Our recommendation is to apply the ban *at the conclusion* of the second audit if the IRS again disallows the taxpayer’s refundable credit claim. As noted in our report, the continued re-auditing of taxpayers who are disallowed a refundable credit rather than applying a ban wastes limited resources and prevents the IRS from addressing additional taxpayers who improperly claim these credits.

Recommendation 8: Develop an implementation plan in coordination with the SSA that identifies key actions such as working with the SSA to *****2***** and the estimated time frame to begin receiving *****2*****. The implementation plan should also include the processes and procedures that will be put in place to *****2*****
*****2*****
*****2*****.

Management’s Response: The IRS disagreed with this recommendation. IRS management stated that the development of proposed internal procedures for *****2***** **2** is contingent on the SSA providing *****2***** and procedures. However, management plans to continue to support the SSA’s efforts in this area and ultimately intends to complete internal procedures *****2***** when the IRS begins to receive it from the SSA.

Office of Audit Comment: Management’s disagreement is contrary to their earlier position. As noted above in the text of our report, IRS management previously stated that they were eager to support the SSA in its efforts to *****2***** and associated procedures that would allow the IRS to *****2***** in its EITC compliance efforts.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the IRS's use of available tools to deter taxpayers from repeatedly claiming erroneous or fraudulent refundable tax credits. To accomplish our objective, we:

- I. Determined if the IRS implemented an effective process to assess the erroneous refund penalty or to ban individuals erroneously claiming refundable credits.
 - A. Identified IRS procedures for Campus Operations employees to assess the applicable penalty: erroneous refund penalty, accuracy-related penalty, or civil fraud penalty.
 - B. Evaluated procedures for assessing the erroneous refund penalty to determine if they provide adequate guidance for correctly assessing the penalty.
 - C. Evaluated actions taken in response to recommendations taken to enable Campus Operations to assess the erroneous refund penalty for disallowed credit claims that are excessive and do not have a reasonable basis.
 1. Evaluated the IRS study on erroneous refund penalties.
 - a. Determined if the recommendations identified as the result of the studies achieved the goal for the IRS to properly assess the penalty and if it was implemented effectively.
 - b. Evaluated IRS management decisions to assert the erroneous refund penalty based on the results of the study.
 - D. Evaluated actions taken to impose the two-year ban to ensure that IRS employees are effectively using bans to deter individuals from claiming erroneous or fraudulent refundable tax credits.
 - E. Quantified the number of taxpayers who were assessed the erroneous refund penalty in Tax Years 2015, 2016, and 2017.
 - F. Quantified the number of taxpayers who were assessed a two-year and 10-year ban during Tax Years 2015, 2016, and 2017.
 - G. Identified tax returns claiming the EITC, the ACTC, or the AOTC for Tax Years 2015, 2016, and 2017 and quantified the amount of credits claimed. We determined if the EITC, the ACTC, or the AOTC was fully allowed, partially disallowed, or fully disallowed for Tax Years 2015, 2016, and 2017.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

1. For taxpayers whose credit was disallowed, evaluated the potential effect of a progressive treatment for taxpayers who are repeatedly disallowed the credit.
 - a. Identified taxpayers who claimed the EITC, the ACTC, or the AOTC in Tax Year 2017 but were disallowed the credit in Tax Year 2015.
 - b. Identified taxpayers who claimed the EITC, the ACTC, or the AOTC in Tax Year 2017 but were disallowed the credit in Tax Year 2016.
 - c. Identified taxpayers who claimed the EITC, the ACTC, or the AOTC in Tax Year 2017 but were disallowed the credit in both Tax Years 2015 and 2016.
 - d. Identified taxpayers who claimed the EITC, the ACTC, or the AOTC in Tax Year 2017 but were disallowed the credit in Tax Years 2015, 2016, and 2017.
 - e. Quantified the potential impact if the IRS assessed the penalty on individuals who failed to comply with eligibility requirements in the first year and imposed the two-year ban on repeat taxpayers.
- II. Determined if IRS processes ensure that individuals who must recertify for the EITC, the ACTC, or the AOTC effectively prevented individuals who were previously disallowed the credit from continuing to receive erroneous credits.
 - A. Identified requirements and procedures for placing recertification indicators on taxpayer accounts.
 1. Obtained and reviewed all policies and procedures for placing recertification indicators on taxpayer accounts.
 2. Interviewed appropriate Wage and Investment Division Accounts Management function and Submission Processing function personnel to determine actions taken to place recertification indicators on taxpayer accounts.
 - B. Determined if taxpayers are correctly having recertification indicators placed on their accounts.
 1. Identified Tax Year 2017 tax returns for which the EITC, the ACTC, or the AOTC was fully disallowed.
 2. Determined if the appropriate recertification indicators were correctly placed on the taxpayer accounts.
 - C. Identified procedures for processing tax returns filed on accounts with recertification indicators when Form 8862, *Information To Claim Certain Refundable Credits After Disallowance*, was attached to the tax return.
 1. Obtained and reviewed all policies and procedures for removing recertification indicators from taxpayer accounts.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

2. Interviewed appropriate Wage and Investment Division Accounts Management function and Submission Processing function personnel to determine actions taken to remove recertification indicators from taxpayer accounts.
- D. Determined if the Form 8862 requires taxpayers to provide the information necessary for the IRS to determine eligibility for the EITC, the ACTC, or the AOTC.
- E. Obtained Examination Selection Criteria for selecting recertification cases for audit.
1. Reviewed the criteria to determine the IRS's criteria for selecting recertification cases for audit.
 2. Determined the number of tax returns with Forms 8862 attached selected for audit during Processing Year 2018.
 3. Obtained the change/no change rate for those selected for audit.
 - a. Obtained the amount of credit disallowed for those cases that were changed.
 - b. Obtained the amount of credit allowed for those cases that were not changed.
- F. Evaluated the 325,522 tax accounts for which the recertification indicator was removed in Calendar Year 2018 to determine the amount of credits claimed on the tax returns. We compared the credit amounts to the examination tolerance set for each credit to determine whether the Form 8862 was not reviewed because the credit was below tolerance.
- G. Identified tax returns filed in Processing Year 2018 that submitted Form 8862 and quantified the amount of the EITC, the ACTC, or the AOTC claimed on the tax returns.
1. Verified whether the proper audit code is used to identify the tax returns during processing.
 2. Determined the number of the tax returns with an audit code selected for examination.
 3. Identified tax returns not selected for audit.
 - a. Matched the tax return to the DDb¹ data to determine if any DDb rules were broken and the rules that were broken.

¹ The DDb is a rules-based selection application that is designed to identify potentially ineligible tax returns claiming the EITC and other refundable credits, e.g., Premium Tax Credit, the ACTC, and the AOTC.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

- b. Matched primary taxpayer, secondary taxpayer, and dependent(s) listed on Form 8862 to the National Account Profile² and determined if the Taxpayer Identification Number³ used to claim the credit is a valid Taxpayer Identification Number issued by the due date of the tax return.
 - 1. Determined if the Name Control⁴ matched National Account Profile data.
 - 2. Determined if the child was deceased or did not meet the age criteria to qualify for a credit.
- c. Matched the dependent Taxpayer Identification Number to the Social Security Number Lookup Table on the Data Center Warehouse to determine if there are multiple uses of the Taxpayer Identification Number.
- d. Evaluated whether the taxpayer's request for recertification was accurately processed.
 - 1. Quantified the number of taxpayers whose recertification indicator was not released incorrectly.
 - 2. Quantified the number of taxpayers whose recertification indicator was released incorrectly and the amount of credit that was allowed incorrectly.
 - 3. For those that were released incorrectly, determined if the credit was below the tolerance of \$2,000 for the EITC and the ACTC, and \$1,000 for the AOTC.
- e. Based on Steps II.G.3.d.1., 2., and 3., determined if the taxpayer is eligible to claim the EITC, the ACTC, or the AOTC.

III. Determined the IRS's status for obtaining SSA *****2*****
*****2*****, for individuals who *****2*****
*****2***** to claim the EITC.

Data validation methodology

During this review, we relied on IMF Data Center Warehouse data that contain all the tax returns that posted on the Master File and all the information needed to identify any adjustments done in those accounts. We relied on the Individual Return Transactions File on the Data Center Warehouse to identify the tax returns that were filed claiming the EITC, the ACTC, or the

² The National Account Profile database is a compilation of selected entity data from various IRS Master Files that also includes data from the SSA.

³ A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the Taxpayer Identification Number is an Employer Identification Number, a Social Security Number, or an Individual Taxpayer Identification Number.

⁴ The first four letters of the taxpayer's last name. The name control is used to check the Master File to ensure that the Taxpayer Identification Number corresponds to the correct taxpayer.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

AOTC. We also relied on IMF entity data to verify the recertification indicators, DDb database DDB_SCORED to verify the rules that were broken, and the Form 8862 in the Compliance Data Warehouse⁵ Modernized Tax Return Data Base⁶ MTRDB_F8862_DETAIL to verify the information provided by the taxpayer to recertify. Before relying on the data, we ensured that each file contained the specific data elements, requested and selected random samples of each dataset, and verified that the data were the same as reflected in the IRS's Integrated Data Retrieval System.⁷ Based on the results of our testing, we believe that the data used in our review were reliable.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the processes and procedures the IRS has in place to assess the erroneous refund penalty as stated in the I.R.C. Section (§) 6676; to assess the two-year ban as required by I.R.C. § 32(k)(1)(B)(ii), § 24(g)(1)(B)(ii), and § 25A(b)(4)(A)(ii)(II) for EITC, ACTC, and AOTC claims; and to assign a recertification indicator to individuals whose EITC, ACTC, or AOTC claims have been reduced or disallowed, which requires these taxpayers to recertify their eligibility before they can receive the credit again according to I.R.C. § 32(k)(2), § 24(g)(2), and § 25A(b)(4)(B). We evaluated these controls by reviewing IRS procedures, information included on the taxpayers' account, and the results of examinations.

⁵ An IRS repository of compliance, filing, and related databases that are used to support projects, analyses, and studies related to tax administration.

⁶ The legal repository for original electronically filed returns received by the IRS through the Modernized e-File system.

⁷ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Appendix II

Major Contributors to This Report

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)

Deann L. Baiza, Director

Sharla J. Robinson, Acting Director

Kathleen A. Hughes, Audit Manager

Ismael M. Hernandez, Lead Auditor

Cally M. Sessions, Auditor



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Commissioner, Wage and Investment Division
Deputy Commissioner, Wage and Investment Division
Director, Return Integrity and Compliance Services, Wage and Investment Division
Director, Submission Processing, Wage and Investment Division
Director, Enterprise Audit Management



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

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:

- Increased Revenue – Potential; \$534.7 million in unassessed penalties on 494,555 tax accounts with disallowed withholding or EITC, ACTC, and AOTC refundable credit claims (see page 4).

Methodology Used to Measure the Reported Benefit:

Using the IMF¹ as of December 27, 2018, we identified 163,549,307 tax returns that claimed the EITC, the ACTC, or the AOTC for Tax Years 2015, 2016, or 2017. We reduced this population to 109,093,321 tax returns that posted on the IMF. We identified 3,155,603 tax returns that included full and partially disallowed claims for which the reversal was part of the original tax return. We reduced our results to 3,046,137 tax returns that were disallowed before any overpayment posted, of which 680,471 returns were disallowed as the result of an examination. From the 680,471 returns, we removed 10,518 tax returns for which the refundable credit was disallowed due to identity theft or another penalty already being assessed. As a result, we identified 669,953 tax returns for which examination disallowed the EITC, the ACTC, or the AOTC. These tax returns potentially have \$357,690,051 in unassessed penalties.

We also identified 6,662,630 tax returns that claimed withholding or Excess Social Security or Railroad Retirement taxes for Tax Years 2015, 2016, or 2017. These included 716,068 tax returns for which examination had disallowed Federal withholding or Excess Social Security or Railroad Retirement taxes (of which, 631,033 returns claimed a refund on the original tax return). We reduced our results to 434,218 tax returns with disallowances that were a part of the original tax return. We then removed 240,007 tax returns for which the withholding was disallowed because the tax return was identified as identity theft, was previously filed, had more than one reversal, posted in the incorrect tax module, or did not have a preredund disallowance. We also removed 865 tax returns with an erroneous refund penalty, an accuracy-related penalty, or a civil fraud penalty. As a result, we identified 193,346 tax returns with disallowed withholding and potentially \$407,831,120 in unassessed penalties.

In total, 669,953 tax returns for which examination disallowed the EITC, the ACTC, or the AOTC + 193,346 tax returns with disallowed withholding equals 863,299 tax returns with

¹ A file containing information about taxpayers who file individual income tax returns (Form 1040 series) and related documents.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

potentially \$765,521,171 (\$357,690,051 + \$407,831,120) in unassessed penalties. The 863,299 tax returns were filed by 546,059 taxpayers (tax accounts).

To ensure that we are only including disallowed claims in which the denied credit did not result in an underpayment of tax which would be subject to an accuracy-related penalty, we limited our outcome to only those tax accounts in which the disallowed credit amount was less than or equal to the refund claimed by the taxpayer. We determined that 494,555 of the 546,059 taxpayers had a disallowed credit that was less than or equal to the refund claimed. These taxpayers had \$2,673,374,398 in disallowed credit claims with \$534,674,880 in potential unassessed penalties.

The actual amount of penalties the IRS will assess depends on the circumstances of each taxpayer's situation. For example, we were unable to identify taxpayers who may have been considered for an erroneous refund penalty, accuracy-related penalty, or civil fraud penalty but for whom the penalty was not assessed.

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; \$372 million in unverified refundable credit claims paid on 114,549 tax accounts that may not qualify for the credit being claimed (see page 7).

Methodology Used to Measure the Reported Benefit:

The IRS provided us with a list of records that were recertified without examination for Calendar Year 2018 as well as a list of all records that had a completed recertification examination in Fiscal Year 2018. From these:

- We identified 309,191 refundable credits claimed on 289,059 returns that were recertified without being selected for an examination. The taxpayers associated with these returns received more than \$532 million in refundable credits for Calendar Year 2018.
 - 117,942 refundable credits filed on 114,572 unique tax returns claiming more than \$432 million for which at least one refundable credit claim met the IRS tolerance to be selected for audit, but the IRS did not review the returns. The 114,572 tax returns were filed by 114,549 taxpayers (tax accounts).
 - 191,249 refundable credits filed on 174,487 unique tax returns claiming more than \$99 million which had at least one refundable credit claim below the tolerance set by the IRS. We did not include these records in our projection based on the examination criteria provided by the IRS.
- We identified 23,232 unique tax returns that had an audit completed in Fiscal Year 2018. The IRS provided us the amount of the EITC claimed and disallowed only for tax returns that received a recertification audit. However, the IRS indicated that a recertification audit is a full-scope audit that includes a review of all three refundable credits (the EITC, the ACTC, and the AOTC).



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

- 20,015 unique tax returns had an audit that was completed with a full reversal of the EITC (with more than \$75 million in the EITC disallowed).
- 956 unique tax returns had an audit completed with a partial change to the EITC (with more than \$2 million in the EITC disallowed).
- 2,261 unique tax returns had an audit completed with no change to the EITC (with an amount claimed and allowed of more than \$8 million).

We calculated the percentage of taxpayers for which the IRS fully denied the refundable credit claim as a result of a completed recertification audit. Because the IRS provided only the EITC claimed and disallowed, we considered all ACTC and AOTC recertification examinations as no change. We divided the 20,015 returns with credit claims that were fully disallowed in Fiscal Year 2018 by the 23,232 returns that were audited for Fiscal Year 2018. This gives the percentage of recertification audits that result in a full disallowance of the EITC, which is calculated as 86 percent ($20,015/23,232 = 0.86$).

We multiplied the 114,572 tax returns that met IRS tolerance but were not audited by the percentage of returns for which the recertification audit resulted in the full disallowance of the refundable credit. Based on our calculation, we estimate that 98,532 tax returns would have had a full reversal of refundable credits ($114,572 \times 0.86 = 98,532$ tax returns).

To estimate the potential refundable credits that the IRS would disallow, we calculated the average of the refundable credits on the 114,572 tax returns that met the tolerance for review but were not selected for audit. This is calculated as \$3,775.13, rounded to \$3,775 per tax return ($\$432,525,035/114,572$). We then multiplied the 98,532 tax returns that we estimate the IRS would have fully disallowed the refundable credit for by the average credit amount per return, which results in \$371,958,300 in refundable credits that would have potentially been denied.

As previously noted, the IRS did not provide us the amount of the ACTC and the AOTC it disallowed as the result of recertification audits during Fiscal Year 2018. As a result, our estimate of the amount of erroneous refundable credits the IRS could potentially prevent is likely understated because we were able to quantify only the amount of the EITC that the IRS potentially would have disallowed.

Finally, as detailed in our report, we identified 408 tax returns that were included in the population for examined returns *and* the population of returns that were recertified without review. Of these 408 tax returns, 85 tax returns have multiple credit claims for which the IRS potentially recertified one credit with an examination but another credit on the return was not examined despite meeting the examination selection tolerance.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Type and Value of Outcome Measure:

- Revenue Protection – Potential; \$6.2 million in disallowed refundable credits claimed on 6,259 Tax Year 2017 tax accounts for which the IRS did not place a recertification indicator on the tax account as required (see page 7).

Methodology Used to Measure the Reported Benefit:

The IRS has established processes to systemically set the recertification indicator for EITC, ACTC, and AOTC claims when the credit is disallowed as a result of an examination. Our analysis of the IMF as of December 27, 2018, identified 221,097 tax returns that had a refundable credit that was either fully or partially reversed for Tax Year 2017.

- 29,740 of the 221,097 returns had a recertification indicator on the taxpayer’s account and the refundable credit adjustment resulted from an examination.
- 191,357 returns had the refundable credit denied as a result of a regular (not refundable credit) adjustment and there was no recertification indicator placed on the taxpayer’s account.

We further determined that 6,259 of the 191,357 records had the credit disallowed by the IRS’s AQC program. The AQC program is part of the IRS’s Integrity and Verification Operation, which completes reviews of cases that do not meet traditional examination criteria. The records disallowed by the AQC program complete the deficiency process and, based on the Protecting Americans from Tax Hikes Act of 2015,² would qualify for a recertification indicator. ***2***
*****2*****
*****2*****

The 7,105 refundable credits filed on these 6,259 unique tax accounts for which the refundable credits claimed for Tax Year 2017 were fully or partially reversed by the AQC program in Calendar Year 2018 totaled \$6,227,299.

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Potential; \$1.1 million to audit taxpayers who had the EITC, the ACTC, or the AOTC disallowed for two or three consecutive years, but a two-year ban was not placed on the taxpayer’s account (see page 10).

Methodology Used to Measure the Reported Benefit:

Using the IMF as of December 27, 2018, we identified 51,537,231 Tax Year 2017 tax returns that claimed the EITC, the ACTC, or the AOTC. Additional analysis identified that 15,647 of

² Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015).



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

these credits were also claimed ***2*** previous years, and the credit was fully or partially disallowed in more than one consecutive tax year as a result of an examination.

- The same refundable credit was disallowed 14,215 times *****2*****.
- The same refundable credit was disallowed 1,432 times *****2***** **2**.

We excluded tax returns from our analysis when the refundable credit was reversed because the tax return was identified as identity theft, when the taxpayer filed an amended tax return, or when the tax return was posted to the incorrect tax module. We also eliminated taxpayers with an erroneous refund penalty, an accuracy-related penalty, or a civil fraud penalty assessed on Tax Years 2015, 2016, or 2017. After applying our exclusions, we identified 3,934 taxpayers who had the same refundable credit disallowed *****2*****. We determined that 1,028 of the 3,934 taxpayers we identified did not have a two-year ban on the taxpayers' tax accounts. IRS processes require the IRS to examine these taxpayers *****2***** before a ban is systemically applied to prevent future erroneous claims.

According to the IRS, it cost \$395.10 to complete a preresult audit during Fiscal Year 2018. Using the IRS's figures, we estimate it cost the IRS \$1,096,007 to audit the 1,028 taxpayers we identified for Tax Year 2017 who had the EITC, the ACTC, or the AOTC disallowed in a prior tax year. We computed our cost estimate as follows:

- 873 taxpayers were audited *****2*****. This is despite these tax returns breaking one or more of the IRS's DDb rules that indicate a potential error in the taxpayer's credit claim. Because the IRS did not examine these taxpayers *****2*****, it must now *****2***** before the two-year ban will be applied systemically.
 - 873 taxpayers x **2** examinations = **2** examinations.
 - **2** examinations x \$395.10 = *****2*****
- 155 taxpayers were audited *****2*****. Based on the IRS's processes, the systemic ban will not set *****2*****. As a result, the IRS must *****2***** these 155 taxpayers before the two-year ban will set.
 - 155 taxpayers x **2** examination = **2** examinations
 - **2** examinations x \$395.10 = *****2*****
- The total potential cost to conduct additional audits of taxpayers who repeatedly file erroneous EITC, ACTC, and AOTC claims is \$1,096,007.40, rounded to \$1,096,007.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Type and Value of Outcome Measure:

- Revenue Protection – Potential; \$3.8 million in claimed EITCs, ACTCs, and AOTCs in Tax Year 2017 because a two-year ban was not in place on 873 taxpayer accounts (see page 10).

Methodology Used to Measure the Reported Benefit:

As discussed previously, our analysis of the IMF as of December 27, 2018, identified 1,028 taxpayers who had the EITC, the ACTC, or the AOTC disallowed *****2*****
*****2*****
*****2*****, but a two-year ban was not placed on the taxpayers' accounts. Further analysis of the 1,028 taxpayers identified 873 taxpayers who were denied the same credit *****2*****
*****2*****. Using the IMF, we determined that these 873 taxpayers received \$3,818,690 in refundable credits because a two-year ban was not in place when they filed their Tax Year 2017 tax return.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Appendix V

Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

DEC 30 2019

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Authorities Provided by the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims (Audit # 201840037)

Thank you for the opportunity to review and comment on the subject draft report. We appreciate the Treasury Inspector General for Tax Administration (TIGTA) acknowledging the IRS's concern regarding its limited resources in combating erroneous claims for refundable credits. The IRS maximizes its resources to identify and prevent the issuance of improper payments. However, the IRS must work within the constraints of these resources to address tax issues related to both refundable credits and erroneous withholdings.

The IRS continues in its efforts to combat erroneous claims for refundable credits. Some of the most recent efforts we have taken include the following:

- Established procedures to ensure the recertification indicator is appropriately placed on taxpayer accounts when the Child Tax Credit (CTC)/Additional Child Tax Credit (ACTC) or American Opportunity Tax Credit (AOTC) is disallowed or adjusted during an audit, in accordance with the Protecting Americans from Tax Hikes Act of 2015¹ (PATH Act).
- Conducted a study for the Internal Revenue Code (IRC) §6676 Erroneous Refund Penalty (expanded to include excessive Earned Income Tax Credit (EITC) claims by the PATH Act) to determine the appropriate policy for assertion of the penalty.
- Provided training for employees to ensure the proper consideration of the two-year and 10-year bans. Training has been provided in Continuing Professional Education for this issue in fiscal years 2015, 2017 and 2019.

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



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

2

- Continued to leverage the earlier Forms W-2, *Wage and Tax Statement*, to determine returns overstating or reporting false withholding credits in a pre-refund environment. At-risk cases are treated in the Withholding Only claim disallowance program.

Our challenges include policy decisions, system programming, and tax law changes. In April 2014, a cross functional team was established to determine the operational and procedural changes needed to integrate the assessment of the penalty into Campus Exam, based on the TIGTA's recommendation². The PATH Act was passed prior to a decision being made by the IRS regarding the application of the penalty. The PATH Act made significant changes to IRC § 6676, including making the penalty applicable to claims for refund involving the EITC where the refund was held and not paid out. The new legislation was effective for returns filed after December 18, 2015. The PATH Act enactment date made the implementation for tax year 2015 infeasible. Changes to IRC § 6676 made by the PATH Act required the IRS to establish a new implementation strategy. The majority of refundable credit audits are worked in a pre-refund environment. Consequently, this legislation had the potential to impact a significant number of those audits. The new strategy required establishing a policy on how and when the penalty should be asserted. The strategy also involved securing programming to apply the penalty on the IRS's systems, such as Report Generation Software (RGS). The RGS programming was revised to allow the manual assertion of the penalty in June 2016. The systemic assertion of the penalty could not be implemented until February 2017, allowing IRS to implement the IRC § 6676 study. We implemented actions as timely as possible, considering the policy decisions and programming requirements surrounding this penalty.

A recertification indicator may potentially deter erroneous claims for refundable credits, since taxpayers are required to file Form 8862, *Information To Claim Certain Credits After Disallowance*, to demonstrate eligibility. However, the presence of the indicator is not determinative of the compliance or non-compliance of the return. Ensuring that the information on the Form 8862 is correct and consistent with information on the tax return before recertifying taxpayers, as the TIGTA requested, requires the tax return to be audited. To maximize our limited resources effectively, the IRS relies on its filters to identify the potential non-compliant taxpayers with the highest potential for non-compliance to select for audit. Auditing every return with a recertification indicator may not be the best use of the IRS's limited resources.

The PATH Act redefined the refundable credits subject to the recertification indicator. Under the PATH Act, tax year 2016 was the first year a taxpayer could be subject to recertification or a ban if their CTC/ACTC and/or AOTC was disallowed or adjusted. Tax year 2017 was the first year taxpayers could be considered for a ban due to reckless or

² TIGTA Audit - *Late Legislation Delayed the Filing of Tax Returns and Issuance of Refunds for the 2013 Filing Season* (Audit 2013-40-124)



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

3

intentional disregard of rules and regulations. We developed guidelines to ensure the manual assertion of the ban was considered in cases where contact with the taxpayer indicated the taxpayer recklessly or intentionally disregarded the rules and regulations when claiming the credits.

Prior to initiating a systemic process to apply the two-year ban on the AOTC and CTC/ACTC, the IRS will evaluate the potential population of taxpayers subject to the penalty. The IRS will use the analysis to determine the appropriate population for the systemic assertion of the two-year ban, considering the AOTC qualifications, which are unlike EITC and ACTC. For AOTC, the credit can be claimed for the qualifying child and primary and secondary taxpayers. The IRS will consider the impact of applying the two-year ban on a credit that is only available for four years.

As the TIGTA highlighted, the IRS promotes taxpayers' knowledge of the law regarding the refundable credits by including enclosures explaining the reason for examination and describing the necessary documents to support receipt of the credit. The IRS agrees that providing taxpayers information on the rules and regulations, and the taxpayer's failure to respond, may be considered when establishing the applicability of the two-year ban. However, individually, these factors do not constitute the required condition of recklessness or intentional disregard. While the taxpayer bears the burden of proving their eligibility for refundable credits, the IRS bears the burden of determining whether a ban applies, based on the facts and circumstances of each case.

Sections 24(g)(1), 25A(b)(4), and 32(k)(1) of the IRC do not define reckless or intentional disregard, nor do any regulations issued pursuant to any of these sections. In the context of the accuracy-related penalty, Treasury Regulation §1.6662-3(2) defines a disregard as "reckless" if the taxpayer makes little or no effort to determine whether a rule or regulation exists, under circumstances which demonstrate a substantial deviation from the standard of conduct that a reasonable person would observe. A disregard is "intentional" if the taxpayer knows of the rule or regulation that is disregarded. Reckless or intentional disregard is a higher standard than "negligence," which, in the context of the accuracy-related penalty, includes any failure to make a reasonable attempt to comply with the provisions of the internal revenue laws or to exercise ordinary and reasonable care. As such, the determination of reckless or intentional disregard of the rules requires greater due diligence on the part of the IRS. Contact with the taxpayer or evidence of efforts to contact the taxpayer is paramount in making a determination that the taxpayer acted with reckless or intentional disregard in claiming the EITC, CTC/ACTC or AOTC, a determination that is necessary in order to assert the ban.

We do not agree to assert the ban systemically *****2***** because there are other factors to consider. The IRS cannot determine whether the taxpayer has knowledge of a rule or regulation by the mere fact that information was mailed and presumably received by the taxpayer. Therefore, the IRS relies on the audit history to determine if a taxpayer has established a pattern of disregard of the rules and



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

4

regulations. Also, as previously noted by the IRS, *****2*****
*****2***** , thus taxpayer knowledge
is not clearly established. Tax examiners are instructed to consider a manual assertion
of the ban in cases where contact with the taxpayer indicates that the taxpayer
“recklessly or intentionally disregarded” the rules and regulations when claiming the
credits. Due to the severe consequences of asserting a ban, any systemic assertion of
the ban must ensure enforcement efforts are fair to all taxpayers.

Attached is our response to your recommendations. If you have any questions, please
contact me, or a member of your staff may contact Michael Beebe, Director, Return
Integrity and Compliance Services, Wage and Investment Division, at 470-639-3250.

Attachment



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

Attachment

Recommendation

RECOMMENDATION 1

The Commissioner, Wage and Investment Division, should assess the erroneous refund penalty for reduced or disallowed withholding and refundable credit claims on all claims for which the IRS determines the claim is excessive and does not have a reasonable basis, and the taxpayer is not subject to the penalties under I.R.C. §§ 6662, 6662A, and 6663.

CORRECTIVE ACTION

We agree that the erroneous refund penalty for reduced or disallowed withholding credit claims should be asserted when warranted. Return Integrity and Compliance Services will recommend a population for treatment during an Exam audit and will develop guidance for identifying when the penalty is applicable.

IMPLEMENTATION DATE

April 15, 2021

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

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

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 2

At a minimum, prioritize resources to ensure that all tax returns with a recertification indicator that meet the IRS's examination selection criteria and break a DDb rule are examined. As resources become available, the IRS should ensure all tax returns with a recertification indicator that meet the examination selection criteria are examined.

CORRECTIVE ACTION

We disagree with this recommendation. We will ensure that all tax returns with a recertification indicator that meet our examination selection criteria and break a Dependent Database rule are considered for examination. We will continue our current practices of auditing the most egregious returns, which may or may not be the returns with a recertification indicator, and provide effective coverage for all of our programs.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

2

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 3

Develop processes and procedures to manually set a recertification indicator on tax accounts associated with refundable credit claims that were disallowed through the AQC program until a systemic process is implemented.

CORRECTIVE ACTION

We agree with this recommendation. We do not have the ability to manually set the recertification indicators without updated programming. We have requested updated programming for Automated Questionable Credit (AQC) disallowance treatment to include setting the recertification indicators as applicable. However, all programming requests are contingent upon budget and Information Technology (IT) resource availability. Consequently, we cannot provide an implementation date. Until programming can be implemented, we will identify another process to identify returns that should be referred for treatment.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 4

Add recertification indicators to the tax accounts of the 6,259 cases we identified with a refundable credit claim disallowed through the AQC program. In addition, the IRS should identify additional taxpayers whose refundable credit claim was disallowed by the AQC program since December 2018 and add recertification indicators to these tax accounts.



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

3

CORRECTIVE ACTION

We do not have the ability to manually set the recertification indicators without updated programming. The manual process for setting the two-year or 10-year ban only applies to the bans and cannot be used to set the recertification indicators that generate the Computer Paragraph (CP) 79, *Denied Credit Eligibility Requirement* letter, and request the taxpayer recertify with the Form 8862, *Information To Claim Certain Credits After Disallowance*. The IRS requested updated programming for AQC disallowance treatment to include setting the recertification indicators as applicable. However, all programming requests are contingent upon budget and IT resource availability. Until programming can be implemented, we will identify another process to identify returns that should be referred for treatment.

IMPLEMENTATION DATE

October 15, 2020

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 5

Ensure that a systemic process is implemented to set the recertification indicator on taxpayers' accounts when refundable credit claims are disallowed as part of the IRS's AQC program.

CORRECTIVE ACTION

We agree with this recommendation. We have requested updated programming for the AQC disallowance treatment to include setting the recertification indicators as applicable. However, all programming requests are contingent upon budget and IT resources being available. Consequently, we cannot provide an implementation date. Unified Work Request (UWR) 219878 was already denied due to budget restraints and IT resources. This UWR will be reinput.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

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



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

4

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 6

Update the systemic process to include applying the two-year ban for disallowed ACTC and AOTC claims.

CORRECTIVE ACTION

We partially agree with this recommendation. We will research the effectiveness of the recertification process for the Additional Child Tax Credit (ACTC) and American Opportunity Tax Credit (AOTC) to determine whether the extension of the systemic process for applying the two-year ban to these credits is warranted.

We are conducting an analysis to determine if a systemic ban assertion for the ACTC and AOTC is warranted. If it is determined the systemic assertion of the two-year ban is warranted, the earliest the ban could be implemented would be fiscal year 2021.

IMPLEMENTATION DATE

April 15, 2021

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 7

Modify the systemic process for applying the two-year ban to apply the ban at the time the IRS concludes the second audit for which the IRS disallows the taxpayer's EITC, ACTC, and AOTC claims.

CORRECTIVE ACTION

We do not agree that the systemic assertion of the ban should occur in the second year of audit. However, we will continue to reinforce that examiners consider the assertion of the ban during the audit, when warranted.

IMPLEMENTATION DATE

N/A



Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims

5

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 8

Develop an implementation plan in coordination with the SSA that identifies key actions such as working with the SSA to *****2***** and the estimated timeframe to begin receiving *****2*****. The implementation plan should also include the processes and procedures that will be put in place to *****2*****
*****2*****
*****2*****.

CORRECTIVE ACTION

We disagree with this recommendation. Our development of proposed internal procedures for *****2***** is contingent on the Social Security Administration (SSA) providing *****2***** and procedures. We will continue to support the SSA's efforts in this area and ultimately intend to complete internal procedures *****2***** when we begin receiving it from the SSA.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A