

# TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



## **Action Is Being Taken to Address the System Limitation That Contributed to the Destruction of Tax Year 2019 Paper-Filed Information Returns**

November 8, 2023

Report Number: 2024-406-007

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.

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# HIGHLIGHTS: Action Is Being Taken to Address the System Limitation That Contributed to the Destruction of Tax Year 2019 Paper-Filed Information Returns

Final Audit Report issued on November 8, 2023

Report Number 2024-406-007

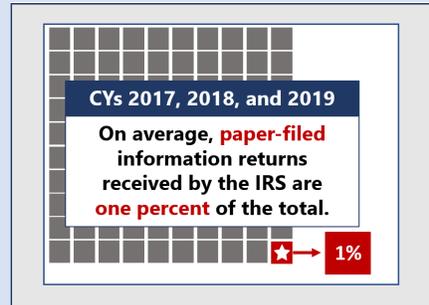
## Why TIGTA Did This Audit

This audit was initiated because the IRS destroyed approximately 30 million unprocessed Tax Year 2019 paper-filed information returns. Payers provide these information returns to the IRS to report transactions as required by law. The IRS uses these information returns to ensure compliance with tax laws.

This audit assesses IRS actions taken to mitigate the risk to the IRS and taxpayers associated with the decision to not process approximately 30 million paper information returns.

## Impact on Tax Administration

The IRS processes billions of information returns each year. Payers submit the majority of these information returns electronically.



When taxpayers provide information returns on paper, IRS employees convert paper-filed information returns to a digital record for use by IRS compliance processes.

Information returns are used in both pre- and post-refund examination activities, and payers who do not file required information returns may be assessed penalties.

## What TIGTA Found

System limitations prevent the IRS from processing certain timely filed paper information returns after the end of the calendar year in which they were filed. In October 2020, IRS management realized they could not process all Tax Year 2019 paper-filed information returns by the end of the year given their other priorities. The IRS prioritized processing the 13.5 million backlogged tax returns to ensure that taxpayers received refunds and other outstanding tax-related benefits. Given the events of 2020, the IRS is moving to expand its paper-filed information return processing capacity to include prior year filings.

By not completing processing of the paper-filed information returns, these returns would not have been searchable and storing them would have added no value to the IRS's systemic matching compliance activities. After requesting the expertise of the Office of Chief Counsel and the Records Office, the IRS destroyed these unprocessed information returns using existing procedures for sensitive document destruction as classified waste. Considering the circumstances surrounding the Coronavirus Disease 2019 pandemic, TIGTA found this decision reasonable.

In addition, few taxpayers and information return filers were subjected to compliance treatment because of the destruction of unprocessed information returns. Specifically, 1.3 million payers may have had their information returns destroyed. In addition, 484 (1 percent) of the 50,732 potential examination cases identified may have been selected because their information returns were destroyed. TIGTA also identified that few, if any, payers were assessed a failure to timely file penalty for an information return that the IRS destroyed.

The IRS generally followed established policy when destroying information returns. For example, the information returns that were destroyed were transported to the IRS locations' respective shredding facilities in locked trucks and moved into access-controlled areas within each facility for shredding. However, not all bins used to collect classified waste at the Austin, Texas, Tax Processing Center had locking lids as required.

## What TIGTA Recommended

TIGTA recommended that the IRS coordinate with the shred contractor and implement the use of lockable bins for all classified waste at the Austin, Texas, Tax Processing Center. IRS management, in coordination with the contractor, ordered and had delivered lockable bins for immediate use. In addition, management updated procedures to ensure that classified waste currently in unlocked bins remains in the secure extraction area until employees transfer the contents to a lockable container.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

**U.S. DEPARTMENT OF THE TREASURY**  
**WASHINGTON, D.C. 20024**

November 8, 2023

**MEMORANDUM FOR:** COMMISSIONER OF INTERNAL REVENUE

A handwritten signature in black ink, appearing to read "M. Weir", is positioned above the typed name.

**FROM:** Matthew A. Weir  
Acting Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Action Is Being Taken to Address the System  
Limitation That Contributed to the Destruction of Tax Year 2019  
Paper-Filed Information Returns (Audit # 202240625)

This report represents the results of our review to assess the actions taken to mitigate the risk to the Internal Revenue Service (IRS) and taxpayers associated with the approximately 30 million unprocessed non-Affordable Care Act information returns destroyed in March 2021. This review was part of our Fiscal Year 2023 Annual Audit Plan and addresses the major management and performance challenge of *Protecting Taxpayer Data and IRS Resources*.

Management's complete response to the draft audit report is included as Appendix II. If you have any questions, please contact me or Diana M. Tengesdal, Assistant Inspector General for Audit (Returns Processing and Account Services).

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## **Background**

An information return is any statement, return, form, or schedule that shows a payment of rent, salaries, wages, dividends, interest, or royalties made to another person. Information returns include, but are not limited to, Forms 1098, *Mortgage Interest Statement*, and the Forms 1099 series, *e.g.*, Form 1099-MISC, *Miscellaneous Information*. Any person, corporation, partnership, estate, or trust engaged in a trade or business that makes reportable transactions (hereafter referred to as payers) during the calendar year must file information returns to report those transactions to the Internal Revenue Service (IRS).

Payers can file information returns on paper or electronically. Paper-filed information returns are generally due to the IRS by February 28 of the year following the tax year in which the payer made the reportable transaction, *e.g.*, February 28, 2023, for transactions paid in Calendar Year (CY) 2022. Similarly, electronically filed information returns are due by March 31 of the year following the tax year in which the reportable transaction was made. The payer must also furnish a copy of the information return to the recipient (payee), generally by January 31 of the year following the tax year in which the reportable transaction was made.

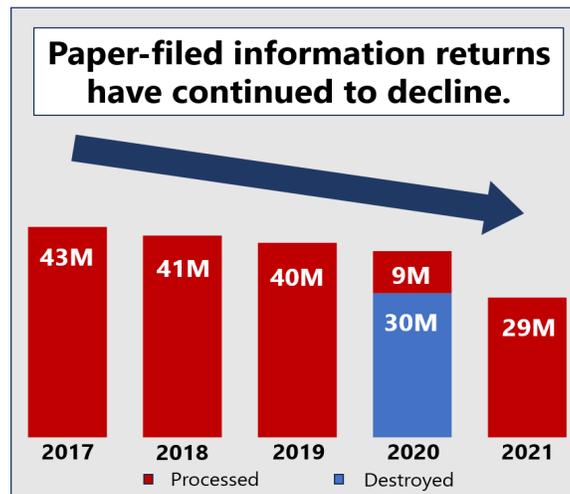
Certain payers who file paper information returns must also file Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, as a transmittal document.<sup>1</sup> Each type of submitted information return requires a separate Form 1096. For example, if a payer issues both Forms 1099-MISC and Forms 1099-INT, *Interest Income*, the payer must complete one Form 1096 for the Forms 1099-MISC and another for the Forms 1099-INT. The Form 1096 includes the payer information, type and number of information returns attached, and the total amount of the payments and income tax withheld that is reported on the attached returns. As shown in Figure 1, the volume of paper-filed information returns has decreased each year since CY 2017.<sup>2</sup>

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<sup>1</sup> Payers who file information returns electronically also transmit an "A" Record, which is like the Form 1096 and used to identify the payer information.

<sup>2</sup> Totals include Form 1096 "payer" transmittal documents.

**Figure 1: CYs 2017 Through 2021  
Paper-Filed Information Return Volume**



Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of Publication 6961, *Calendar Year Projections of Information and Withholding Documents for the United States and IRS Campuses, and IRS estimate of destroyed returns.*

Given ongoing changes to the reporting requirements for information returns, it is unclear whether paper-filing will continue to decrease at the same rate. For example, additional third-party reporting may take place due to the American Rescue Plan Act of 2021, enacted March 2021, that lowered the dollar reporting threshold associated with the Form 1099-K, *Payment Card and Third Party Network Transactions*.<sup>3</sup> Meanwhile, the Taxpayer First Act, enacted July 2019, provided the IRS the authority to lower the number of information returns a payer can file before they are required to file electronically (electronic filing threshold) starting in CY 2022, which will likely reduce third party paper-filings.<sup>4</sup> However, the IRS delayed implementation of the electronic filing threshold change until CY 2024.

### **Paper-filed information returns are normally destroyed after processing**

The IRS processes paper-filed information returns at its Tax Processing Centers in Kansas City, Missouri; Austin, Texas; and Ogden, Utah. IRS employees at the Tax Processing Centers open the information returns and date stamp each Form 1096 when they are filed late. The information returns are then sorted by type, and the volume is estimated based on weight.<sup>5</sup> Once weighed, IRS employees review each paper information return to identify possible errors,

<sup>3</sup> Pub. L. No. 117-2, 135 Stat. 4 (codified in scattered sections of 7, 12, 15, 19, 20, 26, 29, 42, and 45 U.S.C.). In December 2022, the IRS issued guidance delaying the implementation of the American Rescue Plan Act's changes to third-party payment reporting.

<sup>4</sup> Pub. L. No. 116-25, 133 Stat. 981 (codified in scattered sections of 26 U.S.C.).

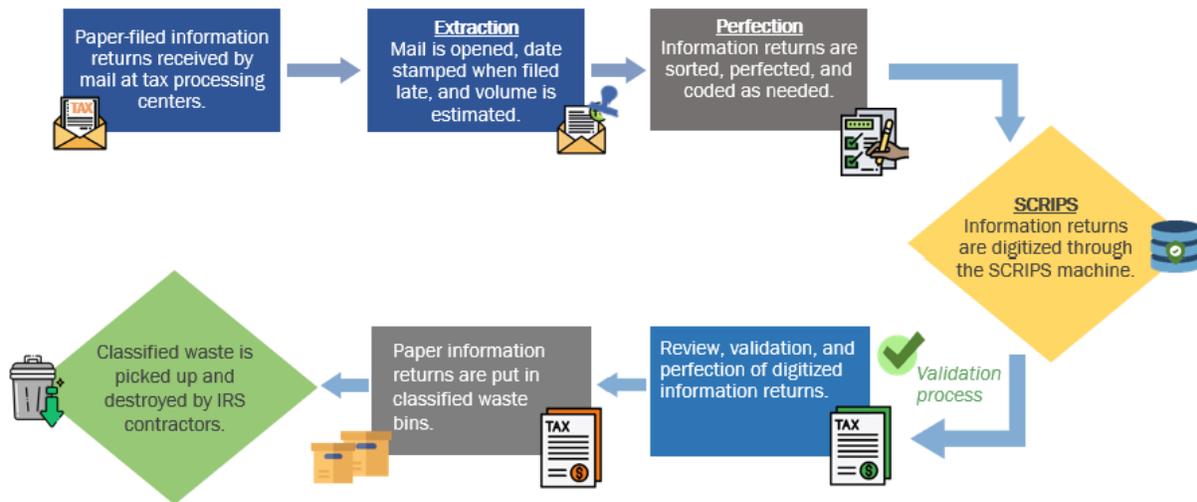
<sup>5</sup> The Austin and Kansas City Tax Processing Centers estimate information return volume based upon weight, whereas the Ogden Tax Processing Center uses a different method, known as the Batch/Block Tracking System, to estimate the number of information returns.

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*e.g.*, missing payer information, and add processing codes. The IRS refers to this process as “perfecting” the return.

Perfected paper-filed information returns are sent to the Service Center Recognition/Image Processing System (SCRIPS) area for scanning. The SCRIPS machine uses software templates to scan each information return. The scanned image of the return is validated and checked for errors. Once validated, the return information is posted to the appropriate Master File account, and the paper documents are destroyed as classified waste. Figure 2 illustrates the steps involved for processing paper-filed information returns.

**Figure 2: Paper Information Return Processing**

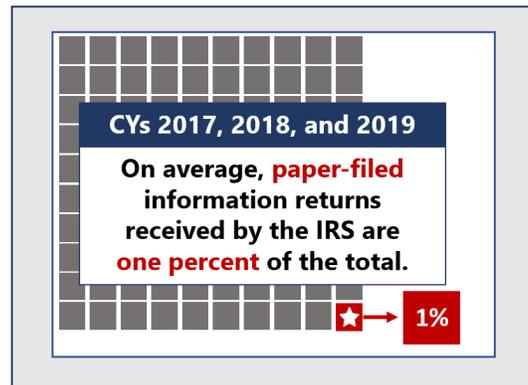


Source: TIGTA analysis of the paper-filed information return digitization process.

### IRS management assessed the risks associated with the destruction of unprocessed paper Tax Year (TY) 2019 information returns

In October 2020, IRS management realized that, given other priorities, they would not complete the processing of approximately 30 million TY 2019 paper-filed information returns by December 31, 2020. Based on prior year filing statistics, IRS management estimated the majority of these unprocessed information returns were paper-filed Forms 1099 submitted with a Form 1096. The IRS processes billions of information returns each year, and as shown in Figure 3, paper-filed information returns average 1 percent of the total.

**Figure 3: Percentage of Information Returns Filed on Paper**



Source: TIGTA analysis of IRS Publication 6961.

IRS management assessed the potential impact of the unprocessed paper-filed information returns on taxpayers and its compliance programs. They determined the impact was low given the mitigations and processing workarounds that were implemented. IRS management also considered retaining the unprocessed paper information returns but determined that merely storing the unprocessed returns would add no value to the IRS's systemic compliance matching processes. The returns would not have a Document Locator Number or other identifier needed to facilitate the filing of the forms and manual retrieval of documents for downstream processes.<sup>6</sup>

In December 2020, IRS management in the Wage and Investment Division requested the expertise of the IRS Office of Chief Counsel and the IRS Records Office to determine whether the 30 million unprocessed TY 2019 information return documents could be treated as classified waste. IRS Wage and Investment Division management was advised that these returns could be destroyed under existing classified waste rules. In addition, the National Archives and Records Administration (NARA) completed an unauthorized disposition case in December 2022 regarding the IRS decision to destroy these information returns.<sup>7</sup> Based on information provided by the IRS, NARA determined the records were destroyed in compliance with the applicable Records Control Schedule and not an unauthorized disposition.<sup>8</sup>

The IRS destroyed the unprocessed information returns as classified waste during January through March 2021. Figure 4 shows the timeline of events associated with the unprocessed TY 2019 paper-filed information returns and IRS management's decision to destroy the returns as classified waste.

<sup>6</sup> A Document Locator Number is a 14-digit number assigned to certain documents received, consisting of a file location code, tax class, document code, Julian date, blocking series, serial number, and tax year. Many types of tax records, including tax returns, examination case files, payments, and additional tax assessments or abatements, are assigned document locator numbers to identify, locate, and retrieve individual tax records when requested.

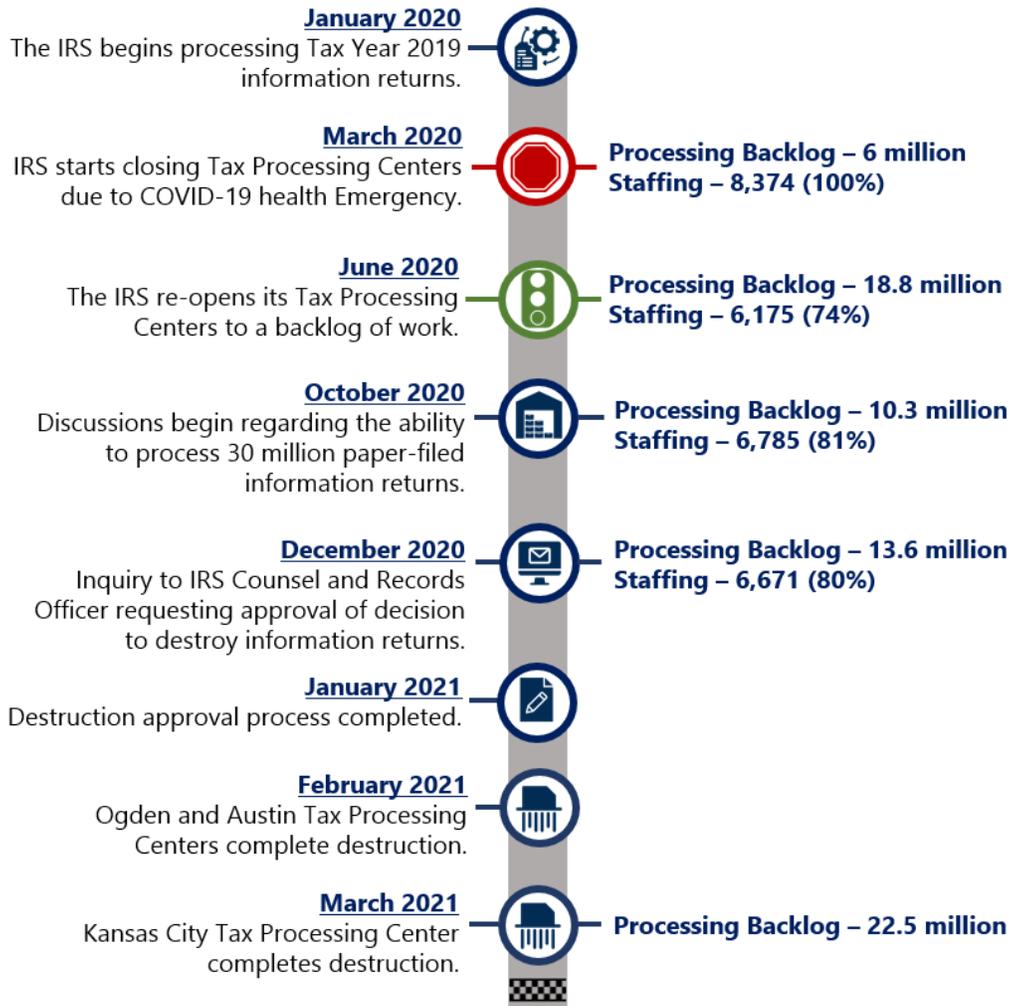
<sup>7</sup> An unauthorized disposition case involves the unlawful removal, defacing, alteration, or destruction of Federal records.

<sup>8</sup> Document 12990, *Records Control Schedules*, is a compilation of authorized disposition schedules for multiple IRS records approved by NARA.

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**Figure 4: Timeline of the Decision to Destroy Unprocessed Paper-Filed Information Returns<sup>9</sup>**



*Source: TIGTA interviews with IRS management, analysis of IRS communications, and historical staffing and inventory levels.*

This review evaluated the factors that contributed to the IRS’s inability to process all TY 2019 paper-filed information returns. In addition, we assessed the reasonableness of the IRS’s decision to destroy the unprocessed information returns, the potential impact on the IRS’s compliance programs, and if taxpayers were inappropriately identified for compliance treatment.

<sup>9</sup> The Processing Backlog reflects the total of unprocessed individual and business paper tax return inventory, as well as tax returns within the Rejects inventory and the Error Resolution System.

## **Results of Review**

### **Considering the Circumstances, the Decision to Destroy the Unprocessed Tax Year 2019 Paper-Filed Information Returns Was Reasonable**

Based on our assessment of the tax return processing status during CY 2020, we agree with IRS management’s assessment that the IRS would not have completed the processing of the approximately 30 million TY 2019 information returns before December 31, 2020, without delaying other priorities. In addition, we found the IRS’s decision to destroy the TY 2019 unprocessed information returns reasonable in the context of the COVID-19 pandemic. The following is a detailed discussion of the factors we considered in our assessment of IRS management’s actions regarding TY 2019 unprocessed paper-filed information returns.

#### **Significant processing backlogs and COVID-19-related staffing shortages limited the processing of paper-filed information returns**

The IRS’s closure of its Tax Processing Centers from March 20, 2020, through June 29, 2020, during the normal course of the tax filing season, created significant inventory backlogs. For example, in October 2020, the IRS had 10.3 million paper-filed individual and business income tax returns still to process or needing error correction, an increase of 405 percent over the 2 million returns in October 2019.<sup>10</sup> As shown in Figure 5, unprocessed paper-filed tax returns exceeded 11.5 million by December 2020, an increase of 2,629 percent from December 2019.

**Figure 5: Tax Return Inventory Estimates for December 2019 and 2020**

Type of Work Remaining	CY		Percentage Change
	2019	2020	
Unprocessed Paper Tax Returns	422,000	11,517,000	2,629%
Error Resolution <sup>11</sup>	20,957	214,267	922%
Rejects <sup>12</sup>	165,288	1,831,781	1,008%
<b>Total</b>	<b>608,245</b>	<b>13,563,048</b>	<b>2,130%</b>

*Source: Analysis of IRS Filing Season and inventory statistics for December 2019 and 2020.*

At that same time, the IRS was dealing with significant COVID-19-related staffing shortages in its Tax Processing Centers. In June 2020, TIGTA reported that much of the work performed at the IRS’s Tax Processing Centers, including the processing of paper-filed tax returns, was not

<sup>10</sup> The percentage increase is based on actual filing statistics and not the rounded figures presented.

<sup>11</sup> Tax returns identified with an error condition are suspended from processing and sent to a tax examiner for correction.

<sup>12</sup> Tax returns that cannot be processed, usually due to missing or incomplete information. Tax examiners correspond with the taxpayer to clarify an entry on a return. When the taxpayer responds, the tax examiner will resolve the issue and the return will continue processing.

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conducive to a telework environment.<sup>13</sup> As such, the number of tax returns and other tax documents the IRS can process at these facilities before the end of a processing year is dependent on staffing levels.<sup>14</sup> As shown in Figure 6, as of October 30, 2020, the number of employees working in the Tax Processing Centers ranged from 68 percent to 96 percent of those employees working in the Centers prior to the COVID-19-related closures.

**Figure 6: Comparison of Tax Processing Center Staffing Levels**

Location	March 2020	October 2020		Working Staff (October vs. March)
	Staffing Prior to Closure	Staff on Weather and Safety Leave	Total Working Staff	
Kansas City, Missouri	2,680	755	2,207	82%
Austin, Texas	3,188	798	2,162	68%
Ogden, Utah	2,506	543	2,416	96%

Source: TIGTA analysis of IRS management reports.

Throughout CY 2020, in addition to concerns over the safety of their staff, IRS management’s primary focus was individual and business income tax returns processing to ensure that taxpayers received refunds and other outstanding tax-related benefits. In October 2020 IRS management realized that due to their priorities, they would be unable to process all paper-filed information returns submitted with a Form 1096 before the end of the processing year.

**NARA closures created significant space and storage challenges for the IRS**

The IRS uses NARA Federal Records Centers to store tax forms, schedules, and records associated with its tax law administration responsibilities. Although the IRS had reopened its Tax Processing Centers, the Federal Records Centers remained closed. The prolonged Federal Records Centers closures meant the IRS had to store records at its Tax Processing Centers that would otherwise normally be stored offsite. In addition, as discussed previously, the IRS had significantly higher than normal paper document inventories waiting to be processed. As such, the IRS needed more space than usual to stage this work.

**SCRIPS limitations prevented the IRS from processing Forms 1096 and attached information returns after December 31, 2020**

The IRS uses SCRIPS machines to process Forms 1096 and the attached information returns, including other tax forms. The SCRIPS machine uses templates specific to each form to

<sup>13</sup> TIGTA, Report No. 2020-46-041, *Interim Results of the 2020 Filing Season: Effect of COVID-19 Shutdown on Tax Processing and Customer Service Operations and Assessment of Efforts to Implement Legislative Provisions* p. 12 (June 2020).

<sup>14</sup> A processing year is the calendar year in which the tax return or document is processed by the IRS.

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accurately scan and upload the data. The templates are updated before the start of each processing year to reflect form and tax law changes for the new processing year. The SCRIPS machine uses a six-digit Form ID printed on each tax form to determine which processing year template to use to process the form. The use of the six-digit Form ID enables SCRIPS to continue to process tax forms received after the processing year ends. However, information returns submitted with a Form 1096 do not have a Form ID. In addition, the IRS only maintains one template for each of these forms and updates the template each year. As a result, the IRS must process all Forms 1096 and attached information returns before the end of the processing year in which they were due. IRS management stated that a small number of information returns received in early December 2020 were destroyed because they were unable to process them before the system was shut down for software changes.

IRS management stated that prior to CY 2020, they had not encountered a situation in which they were unable to process paper-filed Forms 1096 and attached information returns before the end of the processing year. However, in September 2019, we raised concerns to IRS management about the IRS's ability to process prior year information returns that were filed late.<sup>15</sup> TIGTA found that the IRS did not process 24,826 Tax Year 2015 Forms 1096 with more than 85,000 attached information returns. In addition, we identified 90,485 TY 2016 Forms 1096 the IRS processed with no corresponding information returns attached.

We recommended the IRS retain prior year paper information returns and input these returns into IRS databases. While IRS management agreed that digitizing all data submitted to the IRS is ideal, they disagreed with our recommendation based on the number of affected returns. IRS management stated that the IRS Modernization Business Plan provides the capability for a consistent solution for the acceptance, perfection, management, and use of information return data. As such, IRS management could not justify the cost to upgrade a legacy system.

Given the events of CY 2020, IRS management has begun evaluating the expansion of SCRIPS capabilities. These expanded capabilities include adding Form IDs to TY 2024 and subsequent tax years' information returns and storing prior year SCRIPS templates to process prior year paper-filed information returns.

### **Few Taxpayers and Information Return Filers Were Selected for Compliance Treatment As a Result of the Destruction of Unprocessed Information Returns**

Our analysis of information return data for payers who potentially filed TY 2019 paper Forms 1099-MISC found that few, if any, payers were assessed a failure to timely file penalty for an information return that the IRS destroyed.<sup>16</sup> In addition, our assessment of IRS examination and prerefund data as of December 31, 2022, found that few taxpayers were selected for compliance treatment because the income reported on the tax return was not supported. Specifically, we found that only 484 (1 percent) of the 50,732 taxpayers selected for an

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<sup>15</sup> TIGTA, Report No. 2019-40-071, *Strengthened Validation Controls Are Needed to Protect Against Unauthorized Filing and Input of Fraudulent Information Returns* (Sept. 2019).

<sup>16</sup> IRS management indicated that the approximately 30 million destroyed information returns were mostly Forms 1099. Our analysis was limited to Forms 1099-MISC because these forms represent the majority of Forms 1099 filed on paper.

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examination or prerefund review were potentially selected because the IRS destroyed the taxpayer's Form 1099-MISC.<sup>17</sup>

The results of our assessment are consistent with IRS management's risk assessment and subsequent analysis of their compliance workstreams. As discussed previously, IRS management determined the destruction of TY 2019 unprocessed information returns presented a low risk to taxpayers and IRS compliance programs, *e.g.*, underreporter, examination. The IRS performed an analysis of its compliance workstreams from June 2022 through August 2022 to assess the impact of processing delays associated with the backlog of tax returns and the destroyed paper-filed information returns. The IRS found that the income reporting discrepancies identified by its matching programs may have decreased by as much as 14 percent from TY 2018 to TY 2019.<sup>18</sup> However, the IRS noted that the impact on its broad compliance efforts was minimal because the IRS routinely identifies more income reporting discrepancies than it can review annually.

### **A limited number of penalties may have been assessed as a result of the destruction of TY 2019 Forms 1099-MISC**

Payers who do not timely file the required information returns can be assessed a failure to timely file penalty. In its May 2022 announcement, the IRS stated that payers would not be subject to penalties resulting from its decision to destroy TY 2019 unprocessed information returns. It later issued internal guidance to examiners to accept oral testimony and not assert penalties when payers stated that they filed TY 2019 paper information returns.

Our analysis of IRS information return data identified 1.3 million payers that may have filed paper TY 2019 Forms 1099-MISC that were destroyed. These payers filed paper Forms 1099-MISC in TYs 2017, 2018, and 2020, but have no record of filing in TY 2019.<sup>19</sup> Of the 1.3 million payers, we found that 345 payers (less than 1 percent) were assessed a penalty for failure to timely file an information return. We evaluated a judgmental sample of 50 payers that were assessed this penalty and determined that only [REDACTED] may have been erroneously assessed a penalty associated with a potentially destroyed Form 1099-MISC.<sup>20</sup> The remaining [REDACTED] were assessed penalties on information returns that were not associated with those that were destroyed. Although we are unable to project our results, our analysis supports that very few, if any, penalties may have been assessed in error.

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<sup>17</sup> Tax returns selected for prerefund review are suspended from processing and refunds are held until the review is completed.

<sup>18</sup> The IRS evaluated both Business and Individual Underreporter inventory volumes, in addition to its general examination inventory.

<sup>19</sup> TYs 2017 and 2018 are based upon paper-filed Forms 1099-MISC. TY 2020 is based upon paper-filed Forms 1099-MISC and 1099-NEC, *Nonemployee Compensation*. Beginning with TY 2020, the IRS began using Form 1099-NEC for the purposes of reporting nonemployee compensation and revised Form 1099-MISC to no longer include this type of income.

<sup>20</sup> [REDACTED] A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

## **Taxpayers were generally not selected for a prerefund review or examination as a result of the destruction of TY 2019 Forms 1099-MISC**

We worked with the IRS to identify the compliance workstreams that select tax returns for manual review because the income reported on the taxpayer's tax return is not supported. Our review of IRS data for these workstreams as of December 31, 2022, identified 50,732 taxpayers whose TY 2019 tax return was potentially selected for an examination or prerefund review because the reported Form 1099 income was not supported. However, analysis of IRS information return data found that only 484 (1 percent) of the 50,732 taxpayers may have had a TY 2019 Form 1099-MISC destroyed by the IRS.<sup>21</sup> Payers filed paper Forms 1099-MISC for these taxpayers in TYs 2017, 2018, and 2020, but no forms were filed in TY 2019.<sup>22</sup> Based on the information return filing history for these taxpayers, we expected that these payers also likely filed a paper information return for these taxpayers in TY 2019. The 484 taxpayers included taxpayers whose TY 2019 tax returns were potentially selected for an examination as well as taxpayers who were selected for prerefund review.

IRS management stated that internal guidance was issued to examiners for the acceptance of oral testimony regarding paper information returns, along with administrative relief associated with failure to file penalties for those taxpayers filing TY 2019 information returns. We did not evaluate the actions taken by the IRS to review the 484 tax returns once selected.

## **The IRS Generally Followed Classified Waste Procedures When Destroying Tax Year 2019 Paper-Filed Information Returns**

The IRS's Clean Desk Policy requires employees to dispose of sensitive documents (referred to as classified waste) in lockable bins to limit the risk of loss or theft of Personally Identifiable Information. These bins are moved to the loading dock and secured while awaiting transport to the contract shredding facility. Locked bins are transported to the contract shredding facility in a locked vehicle provided by the contractor and secured in a controlled access area within the shredding facility until the documents are shredded. Our assessment of the actions taken to destroy the TY 2019 unprocessed information returns found that the IRS generally followed the established classified waste procedures.

We performed site visits at the three IRS Tax Processing Centers and contract shredding facilities and interviewed local IRS officials from Facilities Management and Security Services and the Submission Processing function.<sup>23</sup> We confirmed that all three Tax Processing Centers use specified bins to collect classified waste. In addition, we confirmed the contractors for each Tax

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<sup>21</sup> We excluded examinations and prerefund reviews where the taxpayer agreed with the IRS's determination that there was a reporting discrepancy on their tax return.

<sup>22</sup> TYs 2017 and 2018 are based upon paper-filed Forms 1099-MISC. TY 2020 is based upon paper-filed Forms 1099-MISC and 1099-NEC, *Nonemployee Compensation*. Beginning with TY 2020, the IRS began using Form 1099-NEC for the purposes of reporting nonemployee compensation and revised Form 1099-MISC to no longer include this type of income. This analysis considers filing histories for taxpayers with closed cases and the results were projected to taxpayers with open cases.

<sup>23</sup> Facilities Management and Security Services is a support services organization within the IRS that provides nationwide facilities and security services. In addition to document destruction, its responsibilities include, but are not limited to, property services and management, building and energy management, logistics services, mail services, office supply contract management, as well as security and safety services.

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Processing Center transport the classified waste bins to their respective shredding facilities in locked cargo trucks, where the bins are moved into access-controlled areas within each facility for shredding. However, we found that not all bins used in the Austin Tax Processing Center had lockable lids as required. Instead of lids, employees seal these bins with plastic shrink wrap. Local IRS officials stated that these same bins were used at the time the TY 2019 information returns were destroyed.

Based on the security and controls we observed at the IRS Tax Processing Centers and secure contractor shredding facilities, overall controls appear sufficient to prevent loss of taxpayer information despite the lack of locking lids used at the Austin Tax Processing Center. In addition, our review of Forms 15035, *Records Loss Reporting*, for the Austin Tax Processing Center found that no loss of information returns was reported between December 2020 and March 2021 when the unprocessed TY 2019 documents were destroyed. IRS management also stated that they were unaware of any theft, unauthorized destruction, deletion, or removal of records not documented on Form 15035 during this same period.

**Recommendation 1 (E-Mail Alert):** On May 5, 2023, we notified IRS management of our concerns with the use of nonlocking bins in the Austin Tax Processing Center. We recommended that the IRS coordinate with the contractor or subcontractor and implement the use of lockable bins for classified waste.

**Management's Response to E-Mail Alert:** IRS management, in coordination with the contractor, ordered locking shred bins on May 19, 2023, and they were delivered for immediate use on June 7, 2023. Management also updated procedures to ensure that waste currently stored in unlocked bins remains in the secure extraction area until employees transfer the contents to a lockable container.

## **Appendix I**

### **Detailed Objective, Scope, and Methodology**

The overall objective of this audit was to assess the actions taken to mitigate the risk to the IRS and taxpayers associated with the approximately 30 million unprocessed non-Affordable Care Act information returns destroyed in March 2021. To accomplish our objective, we:

- Established a timeline for decisions leading up to the destruction of the paper-filed unprocessed information returns through interviews and reviews of IRS communications.
- Determined whether the IRS evaluated alternatives to destroying unprocessed TY 2019 information returns and whether the classification as classified waste was consistent with applicable law, regulations, and policies.
- Identified and documented limitations of the SCRIPS system that contributed to the need to destroy these information returns, and reviewed the extent to which the IRS is working to mitigate this limitation moving forward.
- Determined whether any potential taxpayers were inappropriately identified by the IRS's prerefund or post-refund compliance workstreams because the income reported on the tax return was not supported. We quantified the number of taxpayers using historical paper-filing patterns.
- Obtained, reviewed, and evaluated the extent to which the IRS assessed risk associated with the information return destruction.
- Determined whether any potential taxpayers were erroneously penalized with failure to timely file penalties. We quantified potentially erroneous taxpayer penalties using historical filing patterns for the most common form type that was historically paper-filed. We used a judgmental sample to conduct our analysis due to available resources. We used data analysis software to randomly generate a judgmental sample of 50 of the 345 taxpayers we identified with a failure to timely file penalty.
- Determined whether the IRS followed the classified waste disposal process when destroying these information returns. We interviewed IRS management, Tax Processing Center employees, and contractors involved in the destruction and obtained available documentation associated with the destruction process.

#### **Performance of This Review**

This review was performed at the Kansas City, Missouri; Austin, Texas; and Ogden, Utah, Tax Processing Centers in the Wage and Investment Division's Submission Processing function during the period January through July 2023. 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.

## **Action Is Being Taken to Address the System Limitation That Contributed to the Destruction of Tax Year 2019 Paper-Filed Information Returns**

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Major contributors to the report were Diana M. Tengesdal, Assistant Inspector General for Audit (Returns Processing and Account Services); Deann L. Baiza, Director; Curtis J. Kirschner, Audit Manager; Aaron B. Skaggs, Lead Auditor; Jeffrey L. Felshaw, Auditor; and Johnathan D. Elder, Information Technology Specialist (Data Analytics).

### **Data Validation Methodology**

We performed tests to assess the reliability of data from the Individual Master File, Business Master File, Information Return Master Files, and the Examination Audit Information Management System. We evaluated reliability by selecting data from each extract and verifying that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System.<sup>1</sup> We also reviewed data ranges to ensure that our data contained only valid fields. We determined that the data were sufficiently reliable for purposes of this report.

### **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: policies and procedures outlined in the Internal Revenue Manual associated with processing paper-filed information returns and classified waste disposal, and employee desk guides and Sensitive Document Destruction contracts associated with classified waste disposal. We evaluated these controls by performing on-site walkthroughs, interviewing IRS personnel, and analyzing relevant documentation related to these processes.

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<sup>1</sup> IRS computer system capable of retrieving information, which works in conjunction with a taxpayer's account.

**Management's Response to the Draft Report**



COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

October 16, 2023

MEMORANDUM FOR HEATHER M. HILL  
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Action is Being Taken to Address the  
System Limitation That Contributed to the Destruction of Tax  
Year 2019 Paper-Filed Information Returns (Audit # 202240625)

Thank you for the opportunity to review and provide comments on the subject draft report. Each year, the IRS receives and processes billions of information returns reflecting various payments remitted to or received from individual and business taxpayers. In fiscal year 2018, we processed over 2.4 billion information returns, exclusive of those processed by the Social Security Administration and transmitted to us. By fiscal year 2022, the volume processed had increased to more than 5.1 billion documents. Most information returns are filed electronically and, with more payors subject to electronic filing requirements, the percentage of information returns filed on paper has diminished from approximately 1.4 percent of the total in 2018, to one-half of one percent in 2022. Even at such a low percentage of the total, the volume of paper returns still ranged from 27 million to 40 million documents in those years.

Information returns filed on paper travel through the same processing pipeline as do individual and business income tax returns and other submissions. The transcription of data from information returns is automated with high-speed scanners; however, there remains a significant need for processing employees to sort and batch the documents, prepare them for scanning, and perform validation of the data after scanning. These are the same employees who process tax returns. In a normal year, information return processing is completed by the end of the calendar year and the data is stored in the Information Returns Master File.

In March 2020, in response to the effects of the COVID-19 pandemic and local evacuation orders affecting our three Submission Processing Centers (SPCs), the sites were shut down for a period of three to four months, depending on the location of the

**Action Is Being Taken to Address the System Limitation That Contributed  
to the Destruction of Tax Year 2019 Paper-Filed Information Returns**

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facility. Paper remittances, returns, and other documents continued to arrive at the SPCs during this time. When the facilities reopened, they did so with a reduced workforce that struggled to address the accumulated receipts as well as those that continued to arrive each day. By October 2020, more than 30 million paper-filed information returns had accumulated, in addition to 10.3 million paper-filed individual and business income tax returns that still needed to be processed. When it became evident that our available human resources were not sufficient to eliminate the backlog of paper receipts before the end of the year, decisions had to be made on which work to prioritize. Factors considered in prioritizing the work included the adverse economic impact to taxpayers whose claims for refunds had yet to be processed and paid, the adverse impact to the government from the delayed assessment of taxes due, the comparatively low number of unprocessed information returns to the total that had been processed, and the nature of information returns not being documents on which assessments or refunds are directly based. Ultimately, it was decided that the best use of our limited resources was to process the backlog of tax returns and refund claims.

When the decision was made to focus efforts on return processing, conversations were held with the business functions that act on the data obtained from information returns. Contingency plans were developed and implemented to minimize the impact of data from the unprocessed documents on downstream users of the information. Since 2021, the processing of paper information returns has been completed timely. We are also taking action to secure the ability to scan prior-year information returns should we once again be in a position where unprocessed information returns remain on hand at year-end.

We appreciate the thoroughness with which the Treasury Inspector General for Tax Administration conducted this review, which led to the findings that the destruction of unprocessed tax year 2019 information returns in 2021 was reasonable and that the impact of that action on potential filers or recipients of the unprocessed information returns was minimal. The impact of the pandemic and its aftermath significantly affected our operations and illuminated many areas where improvements are needed. We are committed to reducing our reliance on paper processes to the greatest extent possible, and improving the effectiveness and efficiency of tax administration for the benefit of all taxpayers.

Our response to your recommendation is attached. If you have questions, please contact me, or a member of your staff may contact Dietra D. Grant, Director, Customer Account Services, at 470-639-3504.

Attachment

**Action Is Being Taken to Address the System Limitation That Contributed  
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Attachment

**RECOMMENDATION 1 (E-Mail Alert):**

On May 5, 2023, we notified IRS management of our concerns with the use of nonlocking bins in the Austin Tax Processing Center. We recommended that the IRS coordinate with the contractor or subcontractor and implement the use of lockable bins for classified waste.

**CORRECTIVE ACTION**

We agree with the recommendation, and we coordinated with the contractor on May 19, 2023, to order lockable shred bins at the Austin Tax Processing Center. On June 7, 2023, lockable bins were delivered for immediate use.

**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

Chief, Facilities Management and Security Services

**CORRECTIVE ACTION MONITORING PLAN**

N/A

## **Appendix III**

### **Abbreviations**

COVID-19	Coronavirus Disease 2019
CY	Calendar Year
IRS	Internal Revenue Service
NARA	National Archives and Records Administration
SCRIPS	Service Center Recognition/Image Processing System
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year



**To report fraud, waste, or abuse,  
contact our hotline on the web at [www.tigta.gov](http://www.tigta.gov) or via e-mail at  
[oi.govreports@tigta.treas.gov](mailto:oi.govreports@tigta.treas.gov).**

**To make suggestions to improve IRS policies, processes, or systems  
affecting taxpayers, contact us at [www.tigta.gov/form/suggestions](http://www.tigta.gov/form/suggestions).**

Information you provide is confidential, and you may remain anonymous.