The Tax Offset Program Continues to Allow Millions of Dollars to Be Erroneously Refunded to Taxpayers

December 2, 2024

Report Number: 2025-400-002

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HIGHLIGHTS: The Tax Offset Program Continues to Allow Millions of Dollars to Be Erroneously Refunded to Taxpayers

Final Audit Report issued on December 2, 2024 **Report Number 2025-400-002**

Why TIGTA Did This Audit

The Internal Revenue Code allows, and IRS procedures require, a taxpayer's overpayment to be offset to any outstanding federal tax debt before it may be offset to nontax debts or applied as a credit to a future tax period. In March 2016, we reported that programming and procedural errors resulted in some overpayments not being applied to tax debt. The overall objective of this review was to evaluate the IRS's processes to identify and offset overpayments associated with individual and business tax accounts with debt owed.

Impact on Tax Administration

From Tax Years 2020 through 2022 nearly $40.1 billion in overpayments were offset from individual and business tax accounts to pay off outstanding tax debt. However, the tax offset program continues to allow millions to be refunded to taxpayers in error. Satisfying tax debts with overpayments that have already been received from taxpayers can play an important role in bringing taxpayers into compliance and unnecessarily preventing their tax debts from moving into the IRS's Collection Program, critical portions of which have not returned to pre-Pandemic levels.

$40.1 Billion

in refunds were offset from individual and business tax accounts.

Millions

continue to be refunded to taxpayers in error.

What TIGTA Found

Procedural and programming errors continue to result in overpayments not being applied to outstanding tax debt. Thus, the IRS needs to reevaluate its processes and programming. We identified 2,093 individual and business tax accounts with overpayments totaling more than $8 million that were not offset because employees manually processed a refund or credit elect but did not correctly identify those taxpayers had outstanding tax debt. In addition, our review identified 287 individual tax accounts with overpayments totaling more than $2.5 million, and 2,139 business tax accounts with overpayments totaling $68.1 million for which overpayments were not applied to outstanding tax debt due to programming errors.

In addition, available data are still not being used to identify related sole proprietorships with tax debt. Our analysis identified 11,206 individual taxpayers who were issued more than $9.1 million in refunds since Calendar Year 2017 that should have been offset to outstanding sole proprietorship tax debt. In March 2016, we reported that the IRS needed to revise its identification processes to include sole proprietorship information from Form SS-4, *Application for Employer Identification Number*, to identify when an individual taxpayer is liable for outstanding business tax debt. The IRS agreed; however, it has not implemented the necessary programming changes.

Moreover, due to continued manual processing errors, some overpayments were not applied to Non-Master File tax debt. We identified more than $8.4 million in refunds that should have been applied to outstanding tax debt on the Non-Master File; and more than $357.9 million in outstanding Non-Master File tax debt that was not protected from erroneously refunding.

Finally, taxpayers were not notified of erroneous offsets to outstanding Limited Liability Company tax debt. Our analysis identified 441 taxpayers that were not sent Letter 3064C, *Integrated Data Retrieval System Special Letter*, providing them the opportunity to correct an erroneous offset.

What TIGTA Recommended

We made 11 recommendations that will help the IRS improve the tax offset program. These recommendations include: updating internal guidance and developing more robust training for employees; requesting necessary programming changes; issuing alerts to advise IRS functional areas not to reverse freezes or issue refunds on accounts with outstanding debt on the Automated Non-Master File; and sending letters to the taxpayers with an erroneous offset.

The IRS agreed with all recommendations and has taken or plans to take corrective actions.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

December 2, 2024

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

FROM: Danny Verneuille
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Tax Offset Program Continues to Allow Millions of Dollars to Be Erroneously Refunded to Taxpayers
(Audit No.: 202340024)

This report presents the results of our review to evaluate the Internal Revenue Service's processes to identify and offset overpayments associated with individual and business tax accounts with debt owed. This review was part of our Fiscal Year 2024 Annual Audit Plan and addresses the major management and performance challenge of *Tax Fraud and Improper Payments*.

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

Table of Contents

Appendices

Background

Tax refund offset is the process of offsetting tax overpayments (that would otherwise result in a refund) to outstanding government debt. The Internal Revenue Code allows, and Internal Revenue Service (IRS) procedures, *i.e.*, the Internal Revenue Manual, require, a taxpayer's overpayment to be offset to any outstanding federal tax debt, nontax child support, or nontax federal agency obligations, *e.g.*, federal student loans, state income tax obligations, or Unemployment Compensation debts, prior to issuing a refund or crediting a future tax period.[1]

An overpayment must be offset to an outstanding federal tax debt before it may be offset to non-federal tax debts or applied as a credit to a future tax period, also known as a credit elect. For example, if a taxpayer has any outstanding tax debt on the IRS's Individual Master File (IMF), Business Master File (BMF), or Automated Non–Master File (ANMF), the overpayment will offset to the federal tax debt.[2] Generally, the overpayment will first be applied to the oldest outstanding federal tax liability.

After satisfying any outstanding federal tax debt, the remaining overpayment amount is eligible to be offset by the Bureau of the Fiscal Service to non-federal tax debt, referred to as the Treasury Offset Program. Any overpayment amount that remains after offsets are performed by the IRS and the Bureau of the Fiscal Service can be applied to a future tax period. Taxpayers who choose to have their overpayment credited to a future tax period indicate on their tax return to have all, or a portion of their overpayment amount credited as an estimated tax payment to a succeeding tax year, this is referred to as a "credit elect." As shown in Figures 1, 2, and 3, from Tax Years 2020 through 2022 nearly $40.1 billion in overpayments were offset from individual and business tax accounts to pay off outstanding tax debt.

Offset process to satisfy individual tax debt

When an individual taxpayer files a tax return resulting in an overpayment, the IRS performs a systemic verification to determine if the taxpayer has any outstanding individual tax liabilities. Taxpayers with outstanding federal or non-federal tax liabilities will have a debt indicator placed on their account. Before issuing refunds, if the taxpayer has eligible outstanding tax debt, the overpayment will be manually or systemically offset to settle those liabilities. Tax debt is eligible for offset except for instances such as when the expiration of the time established by law to collect taxes has passed, bankruptcy, or when a hardship claim is present, *e.g.*, a taxpayer is unable to pay basic living expenses. Under these circumstances a taxpayer may be issued a refund even when having outstanding tax debt. Overpayments will also be offset to related tax debts, such as those held by a spouse. When offsets are processed, a notice is generated and sent to the taxpayer informing them of the refund offset, including to which tax period the overpayment was offset. Figure 1 provides the volume of refund offsets associated with individual tax accounts to pay off individual tax debts for Tax Years 2020 through 2022.

[1] Internal Revenue Code §§ 6402(a), (c), (d), (e), and (f).

[2] See Appendix IV for a glossary of terms.

The Tax Offset Program Continues to Allow Millions of Dollars to Be Erroneously Refunded to Taxpayers

Figure 1: Refund Offsets From Individual Tax Accounts to Pay Off Individual Tax Debt Tax Years 2020 Through 2022

Tax Year	Accounts With Refund Offsets	Amount Offset to Individual Tax Debt
2020	5,636,842	$10,034,476,922
2021	4,614,709	$ 8,483,806,538
2022	3,923,267	$ 5,922,424,147

Source: Treasury Inspector General for Tax Administration (TIGTA) Data Center Warehouse (DCW) IMF Transactions Table as of July 27, 2023.

Offset process to satisfy business tax debt

Like the individual offset process, overpayments from business taxpayers can also be offset to the businesses' tax debt prior to refunds being issued. The business offset program allows for the application of an overpayment from one business type of tax or tax period to satisfy an unpaid balance on another type of tax or tax period for the same taxpayer. However, not all business returns or business entities are eligible to receive offsets, this includes accounts from large corporations or employment taxes.

An individual taxpayer's overpayment can also be offset to outstanding business tax debt incurred by a sole proprietorship owned by the taxpayer. A sole proprietorship is an unincorporated business that is owned by one individual and has no existence apart from the owner. All liabilities held by the sole proprietorship are undertaken as personal liabilities of the owner.

When an individual files a Form 1040, *U.S. Individual Income Tax Return*, resulting in an overpayment and that tax return includes an Employer Identification Number (EIN) on [redacted] to determine if the business account, *i.e.*, the sole proprietorship, has outstanding tax debt. If the [redacted] the individual overpayment will not offset to the outstanding sole proprietorship tax debt, resulting in a refund. Figures 2 and 3 provide the volume of refund offsets associated with individual tax accounts and business tax accounts to pay off business tax debts for Tax Years 2020 through 2022.

Figure 2: Refund Offsets From Individual Tax Accounts to Pay Off Business Tax Debt Tax Years 2020 Through 2022

Tax Year	Accounts With Refund Offsets	Amount of Offsets to Business Tax Debt
2020	13,630	$10,421,463
2021	12,510	$8,964,041
2022	6,259	$4,418,740

Source: TIGTA DCW BMF Transactions Table as of July 27, 2023.

The Tax Offset Program Continues to Allow Millions of Dollars to Be Erroneously Refunded to Taxpayers

Figure 3: Refund Offsets From Business Tax Accounts to Pay Off Business Tax Debt Tax Years 2020 Through 2022

Tax Year	Accounts With Refund Offsets	Amount of Offset to Business Tax Debt
2020	592,477	$4,947,996,457
2021	468,998	$8,453,678,856
2022	281,193	$2,203,422,113

Source: TIGTA DCW BMF Transactions Table as of July 27, 2023.

Offset process to satisfy Non-Master File tax debt

Due to system limitations, the IRS's current Master File system cannot process certain tax accounts. The system limitations could be that the account balance is too large or the account has too many transaction codes for the Master File to process. The IRS processes these accounts, known as Non-Master File (NMF) accounts, through the ANMF system. Any NMF account with an existing balance is considered an open account. Our analysis of the most recent ANMF data provided to the audit team on Oct. 13, 2023, showed that there were 10,561 open NMF accounts with an outstanding debit or credit balance. As of Oct. 31, 2018, all NMF processing was centralized in the Tax Processing Center located in Kansas City, Missouri, and worked by the NMF team.

When a taxpayer has an outstanding balance on an NMF account, a freeze will be placed on the taxpayer's Master File account to prevent refunds from being issued until the NMF tax debt is satisfied or the freeze is manually reversed. Overpayments will offset to the outstanding NMF tax debt when the freeze code is present. The freeze code is generated systemically on individual tax accounts. Whereas IRS employees manually input the freeze code for business taxpayers by using Form 3177, *Notice of Action for Entry on Master File*. When an individual taxpayer has an overpayment eligible to be offset while having a freeze code for outstanding NMF tax debt, a notice is sent to the taxpayer, notifying them of the tax debt. The overpayment would then offset to the tax liability on the NMF. The process of offsetting an overpayment to a tax liability on an NMF account occurs after any offsetting to individual and/or business liabilities on the respective Master Files.

Results of Review

Procedural and Programming Errors Continue to Result in Overpayments Not Being Applied to Outstanding Tax Debt

In March 2016, we reported on procedural and programming errors impacting several aspects of the IRS's tax offset program, including offsets from individuals to businesses, and to tax debts retained on the ANMF.[3] We revisited this analysis, the results of which are subsequently discussed. Our overall results show that the IRS needs to reevaluate the processes and programming that promote the use of tax offsets. Satisfying tax debts with overpayments that have already been received from taxpayers can play an important role in bringing taxpayers into compliance and unnecessarily preventing their tax debts from moving into the IRS's Collection Program, critical portions of which have not returned to pre-Pandemic levels.[4]

Our review identified that since Calendar Year 2017, there have been 754 individual taxpayers and 3,765 business taxpayers who received more than $78.6 million in refunds or credit elects that should have been applied to associated outstanding tax debt.[5] We systemically identified 44,938 tax accounts (9,206 individuals and 35,732 businesses) with outstanding tax debt that did not currently have an account freeze or other condition that would have prevented an offset from occurring.[6] We provided 20 tax accounts with refund and credit elect issues to IRS management on Feb. 26, 2024, and March 6, 2024. IRS management reviewed these cases and identified that there were procedural and programming errors that resulted in the overpayments not being offset as they should.

Over 4,500 individual and business taxpayers received **more than $78.6 million** in refunds or credit elects that should have been applied to associated **outstanding tax debt.**

Procedural errors associated with individual and business tax accounts

We identified 2,093 individual and business tax accounts with overpayments totaling more than $8 million that were not offset due to procedural errors, as follows:

- 311 individual tax accounts with refunds totaling more than $1.1 million.
- 156 individual tax accounts with credit elects totaling more than $800,000.
- 1,626 business tax accounts with credit elects totaling nearly $6.1 million.

These overpayments were not offset because employees manually processed a refund or credit elect but did not correctly identify that the taxpayers had outstanding tax debt. IRS guidelines state that employees must ensure that a taxpayer has no outstanding tax debt before manually processing refunds or credit elects.

Programming errors associated with individual tax accounts

Using the criteria that the IRS provided for the programming errors it identified when reviewing our potential exception cases, we identified 287 individual tax accounts with overpayments

[3] TIGTA, Report No. 2016-40-028, *Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program* (March 2016).

[4] In December 2023, TIGTA reported that the IRS's Automated Collection System's business metrics and overall production have generally not recovered to pre-Pandemic levels. As of Fiscal Year 2022, the Automated Collection System was second only to the collection notice stream in terms of revenue collected on delinquent taxpayer accounts. TIGTA, Report No. 2024-300-008, *Post-Pandemic Actions Have Contributed to Declines in Automated Collection System Level of Service and Collection Inventories* (December 2023).

[5] Throughout our report, the dollar amounts presented as not being offset to outstanding tax debt are conservative estimates based on the conditions at the time of our review.

[6] These tax accounts were identified based on data extracted as of Dec. 28, 2023.

totaling more than $2.5 million that were not applied to outstanding tax debt for the following reasons:

- 248 individual tax accounts with refunds totaling nearly $2.4 million were not offset due to a programming error associated with the presence of a payment regarding a Notice of Federal Tax Lien or Levy that erroneously bypassed the offset program.

Management Action: In response to our bringing this to management's attention, management implemented programming to correct the identified deficiency. Management stated on April 4, 2024, that the programming was corrected.

- 39 individual tax accounts with credit elects totaling $157,341 were not offset to accounts with outstanding tax debt due to a duplicate return freeze not properly preventing credit elects from being issued. IRS management indicated they plan to implement additional programming changes by the middle of Calendar Year 2024 to ensure that the duplicate return freeze will properly prevent credit elects from being allowed when an account has an outstanding tax debt.

For individual tax accounts, the IRS's systems allow for manual review of historical tax account information. As described previously, of the 9,206 individual tax accounts with refunds or credit elects, our review identified 467 tax accounts with procedural errors and 287 tax accounts with programming errors. For the remaining 8,452 individual tax accounts, we identified statistically valid samples of the 6,400 tax accounts with refunds and the 2,052 tax accounts with credit elects. We manually reviewed the historical account information in an effort to determine whether there were freeze codes on the accounts that may have created processing errors, or whether the freeze codes on the account at that point in time may have properly prevented an offset from occurring.

We reviewed a statistically valid sample of 266 of the 6,400 individual tax accounts with refunds.[7] We determined the following:

- 184 (69 percent) of 266 individual tax accounts had a freeze code that properly prevented the overpayment from offsetting.
- 82 (31 percent) of 266 individual tax accounts did not have a freeze code or other characteristic that would have prevented the overpayment from offsetting to outstanding tax debt. Therefore, we estimate that there were 1,984 individual tax accounts with refunds totaling nearly $4.3 million that could have been offset to satisfy outstanding tax debt.[8]

We also reviewed a statistically valid sample of 253 of the 2,052 individual tax accounts with credit elects.[9] We determined the following:

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[7] Our sample was selected using a 90 percent confidence interval, 40 percent error rate, and ±5 percent precision factor. The 40 percent error rate was the actual error rate based on our review of some cases.

[8] Our results were projected using a 90 percent confidence interval, 31 percent error rate, and ±5 percent precision factor. When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount is between $1,747,873 and $6,804,777.

[9] Our sample was selected using a 90 percent confidence interval, 50 percent error rate, and ±5 percent precision factor.

- 50 (20 percent) of 253 individual tax accounts had a freeze code or other characteristic that properly prevented the overpayment from offsetting.
- 79 (31 percent) of 253 individual tax accounts were related to a specific offset overflow freeze code which was not working.[10] Therefore, we estimate that there were 636 individual tax accounts with credit elects totaling $8.9 million that were due to the offset overflow programming error.[11]

Management Action: In response to our bringing this to management's attention, management implemented programming to correct the identified deficiency. Management stated on April 24, 2024, that the programming was corrected.

- 124 (49 percent) of 253 individual tax accounts did not have a freeze code or other characteristic present on the account that would have prevented the overpayment from offsetting to outstanding tax debt. Therefore, we estimate that there were 1,005 individual tax accounts with credit elects totaling $7.2 million that could have been offset to satisfy outstanding tax debt.[12]

Programming errors associated with business tax accounts

Using the criteria that the IRS provided for the programming errors it identified when reviewing our potential exception cases, we identified 2,139 business tax accounts with overpayments totaling $68.1 million that were not applied to outstanding tax debt for the following reasons:

- [redacted] business tax accounts with refunds totaling more than $68.1 million were not offset to outstanding tax debt because a programming error was causing overpayments to not offset to tax debt on Form 720, *Quarterly Federal Excise Tax Return*.

Management Action: In response to our bringing this to IRS management's attention, management implemented programming to correct the identified deficiency. According to IRS management, this programming was implemented as of April 25, 2024.

- [redacted] We were unable to project the criteria associated with [redacted] to the remaining population. As of May 22, 2024, IRS management stated that they were working on a solution to correct the identified programming error.
- 3 business tax accounts with credit elects totaling nearly $4,500 that were not offset. The IRS's review identified that a programming error caused a freeze code associated with a telephone excise tax to not properly prevent the credit elect's issuance.

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[10] This freeze delays offsets, credit elects, and refunds from processing and can be generated for several reasons. For example, it can be set on current year tax returns that claim certain refundable credits filed before Feb. 15th to hold the refund.

[11] Our results were projected using a 90 percent confidence interval, 31 percent error rate, and ±5 percent precision factor. When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount is between $4,527,282 and $13,312,546.

[12] Our results were projected using a 90 percent confidence interval, 49 percent error rate, and ±5 percent precision factor. When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount is between $4,415,646 and $9,931,728.

Unlike our ability to research historical individual tax account information, the IRS's systems do not have the ability to manually research historical account information for business tax accounts. As previously described, of the 35,732 business tax accounts with refunds or credit elects, our review identified 1,626 tax accounts with procedural errors and 2,139 tax accounts with programming errors. For the remaining 31,967 business tax accounts, we were unable to determine whether there were freeze codes on the accounts that may have created processing errors, and whether the freeze codes on the account at that point in time may have properly prevented an offset from occurring.

The Chief, Taxpayer Services, and Chief, Tax Compliance Officer, should:

Recommendation 1: Update internal guidance and develop more robust training to ensure that employees perform adequate research of tax accounts to identify outstanding tax debt prior to initiating manual refunds or credit elects.

> **Management's Response:** IRS management agreed with the recommendation and will review and update internal guidance and develop more robust training that reinforces the requisite research to be performed so that outstanding tax debt is appropriately identified and addressed when initiating manual refunds or processing credit elects.

Recommendation 2: Request the necessary programming changes to ensure that the duplicate return freeze and the telephone excise tax freeze code function appropriately. In addition, request programming changes to ensure that overpayments from undelivered refunds and interest offset appropriately.

> **Management's Response:** IRS management agreed with the recommendation and will analyze a sample of individual and business accounts to ascertain any procedural and programming changes needed to permit the duplicate return and telephone excise freeze codes to function as intended, and that overpayments associated with undelivered refunds and interest offset correctly.

Recommendation 3: Identify the functional areas allowing refunds or credit elects for taxpayers with existing tax debt, and issue alerts/reminders to them, advising that refunds or credit elects should not be allowed until any associated tax debt is satisfied.

> **Management's Response:** IRS management agreed with the recommendation and will issue an alert to remind employees who manually process adjustments resulting in refunds or credit elects of the procedures to follow when associated tax debt exists.

Recommendation 4: Verify that the programming changes associated with overpayments offsetting to tax debt on Form 720, the offset overflow freeze, and to payments associated with the Notice of Federal Tax Lien or Levy, are operating correctly.

> **Management's Response:** IRS management agreed with the recommendation and will verify the programming changes associated with overpayments offsetting to tax debt on Form 720, the offset overflow freeze, and to payments associated with the Notice of Federal Tax Lien or Levy, are operating correctly.

Recommendation 5: Analyze the 8,452 individual and 31,967 business cases that we identified and determine whether additional programming or procedural errors exist in the process of offsetting refunds and credit elects. Take appropriate corrective action to prevent erroneous refunds and credit elects in the future.

> **Management's Response:** IRS management agreed with the recommendation and will analyze a sample of individual and business accounts to determine whether programming or procedural modifications are needed to prevent erroneous refunds and will take the appropriate action.

Available Data Are Still Not Being Used to Identify Related Sole Proprietorships With Tax Debt

The IRS's process is ineffective at identifying sole proprietors with tax debt that are related to individual taxpayers with overpayments on their personal accounts. We identified 11,206 individual taxpayers who were issued more than $9.1 million in refunds since Calendar Year 2017 that should have been offset to outstanding sole proprietorship tax debt.

When an individual taxpayer files Form 1040, the determination of whether the taxpayer has an outstanding sole proprietorship tax debt is [redacted] the IRS does not identify the tax debt of the sole proprietorship as being related to the individual; therefore, the offset does not occur.

In March 2016, we recommended that the IRS revise its identification processes to include sole proprietorship information from Form SS-4, *Application for Employer Identification Number*, to identify when an individual taxpayer is liable for outstanding business tax debt.[13] The IRS agreed to the recommendation, with the IRS's Wage and Investment Division requesting the necessary programming changes five times since Calendar Year 2018.[14] However, each time the Information Technology Division denied the request due to reasons such as limited resources or legislative priorities. In January 2024, IRS management submitted a sixth request for the programming changes and advised that the Information Technology Division agreed to a January 2026 implementation.

Our analysis of the Form SS-4 information identified that the IRS could have offset more than $6.6 million (73 percent) of the $9.1 million for 8,654 of the 11,206 individual taxpayers, had it implemented our prior recommendation. Each year that passes without our corrective action being implemented means more revenue lost by the IRS. Although the IRS indicated the corrective action should be implemented by January 2026, we are concerned that it will once again be denied due to other priorities.

Recommendation 6: The Chief Information Officer should ensure that the requested programming changes are implemented by January 2026.

> **Management's Response:** IRS management agreed with the recommendation and will ensure that the requested programming changes are implemented by January 2026.

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[13] TIGTA, Report No. 2016-40-028, *Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program* p.5 (March 2016).

[14] The IRS's Wage and Investment Division was renamed Taxpayer Services effective April 7, 2024.

Due to Continued Manual Processing Errors, Some Overpayments Were Not Applied to Non–Master File Tax Debt

Our review identified 169 individual taxpayers and 53 business taxpayers that were issued more than $8.4 million in refunds since Calendar Year 2017, that should have been applied to an associated outstanding tax liability on the ANMF. According to the IRS, overpayments were not applied to outstanding tax debt due to IRS employees manually issuing the refund causing the offset program to be bypassed. In addition, freeze codes that would have prevented the refund from being issued were reversed by another business operating division. The erroneous reversal of the freeze code allowed the refund to be issued.

We previously reported similar concerns and recommended that the IRS develop a systemic process to ensure that freezes are not erroneously reversed if an outstanding tax debt remains on an NMF account.[15] The IRS agreed with our recommendation and developed a process to systemically identify and re-add the freeze code to the accounts. Although this process is performed quarterly, it does not prevent freeze codes from being reversed. Instead, it identifies and corrects accounts that are not frozen.

Over 200 individual and business taxpayers received refunds totaling **more than $8.4 million.** These refunds were not correctly applied to an associated **outstanding tax liability** on the ANMF.

As we previously reported, there continues to be a significant potential for future improper refunds of other accounts. We analyzed all NMF accounts with an outstanding tax liability and identified 283 individual taxpayers and 117 business taxpayers where the required freeze codes were not posted to the associated Master File tax account. Absent the freeze codes, overpayments from these taxpayers could generate refunds rather than offsetting to NMF tax liabilities of more than $357.9 million.

IRS management agreed that freeze codes should be placed on the tax accounts we identified. The IRS explained that the tax accounts did not have the required freeze codes either because they were not being applied correctly or were being reversed in error.

The Chief, Taxpayer Services, and Chief, Tax Compliance Officer, should:

Recommendation 7: Analyze the accounts we identified, noting trends in the functional areas reversing the freeze codes in error and issue alerts or reminders to them advising not to reverse freezes or issue manual refunds on accounts that have an outstanding debt on the ANMF.

> **Management's Response:** IRS management agreed with the recommendation and will issue an alert reminding all functional areas of the research to be performed and the correct processing actions to take when account debts exist on the NMF.

Recommendation 8: Revisit the process developed in response to our prior report and correct the weaknesses that are continuing to allow refunds to be issued to taxpayers that have outstanding tax debt on their NMF account.

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[15] TIGTA, Report No. 2016-40-028, *Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program* p.7 (March 2016).

Management's Response: IRS management agreed with the recommendation and increased the frequency of the review process from quarterly to monthly so that accounts with erroneously reversed freeze transactions can have them reapplied.

Recommendation 9: Review all NMF accounts with outstanding tax debt to ensure that all taxpayers have the required freeze code on the associated Master File account.

Management's Response: IRS management agreed with the recommendation and reviewed 336 ANMF accounts with outstanding liabilities and where there were no freeze codes on the corresponding Master File account. Corrective actions to reapply the freeze code to the Master File accounts were completed on August 2, 2024.

Individual Taxpayers Were Not Notified of Erroneous Offsets to Outstanding Limited Liability Company Tax Debt

A Limited Liability Company (LLC) is an entity created by state statute. Depending on elections made by the LLC and the number of members, the IRS will treat an LLC either as a corporation, partnership, or as part of the owner's individual tax return. For federal tax purposes, an LLC is recognized and treated as a corporation that is separate and distinct from individual owners and is therefore liable for taxes. Treasury Regulations stipulate that for specific tax debt, single member LLCs are to be treated as a corporation.[16] Employment tax liabilities accrued on or after Jan. 1, 2009, may no longer be reported in the name and EIN of the single member owner. As a result, refunds from the single member owner's individual tax account should not be used to satisfy the LLC's tax debt. In March 2016, we reported that the systemic process used to identify sole proprietors does not consider whether there is an LLC indicator on the tax account.[17]

IRS management previously acknowledged our concern, explaining that the original computer programming for the systemic offset did not contain any exclusionary criteria. In addition to recommending that the IRS ensure that it implemented the necessary computer programming, we also recommended that the IRS identify other impacted accounts until the programming was implemented. The IRS agreed, and as part of its corrective action, sent the affected taxpayers a Letter 3064C, *Integrated Data Retrieval System Special Letter*. Letter 3064C gives the taxpayer the choice to leave the money in the LLC tax account or have the offset reversed to have the money refunded to them.

Our review identified 441 taxpayers with 511 offsets that were not notified with Letter 3064C providing the opportunity to correct the erroneous offset. The 511 offsets had overpayments totaling more than $499,000 that were incorrectly offset to outstanding tax debts on the associated LLC business tax account. In January 2024, we provided a list of the erroneous offsets to the IRS for review. IRS management agreed that the taxpayers should be sent a Letter 3064C and noted that a letter would be sent to those taxpayers with tax periods where the refund statute expiration date remains open.

[16] 26 CFR § 301.7701-2.

[17] TIGTA, Report No. 2016-40-028, *Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program* p.8 (March 2016).

LLC indicators are being placed on tax accounts in error

Our review also identified 76 sole proprietorship entities that had an LLC indicator placed on the tax account in error. This LLC indicator affects how entities are treated for tax purposes and will cause the entity to be classified as an LLC. When an entity is assigned a Taxpayer Identification Number, the IRS classifies the entity based on its structure, such as a partnership, corporation, or an LLC. An entity typically cannot be changed to an LLC without applying for a new EIN.

76 **sole proprietorship entities that had an LLC indicator placed on the tax account in error.**

The IRS agreed that the sole proprietorships with an erroneous LLC indicator on the tax account should have the indicator removed. The IRS stated that the error occurred due to tax examiners inputting the LLC indicator when working Form 2553, *Election by a Small Business Corporation*, or a Form 8832, *Entity Classification Election*. Tax examiners should not change the LLC indicator on tax accounts when working these forms, as these will only affect the name of the entity or the filing requirements.

Management Action: In response to our bringing this to management's attention, the IRS updated its internal guidance for working Form 2553 and held meetings with the BMF entity teams to discuss and prevent sole proprietorships from having an LLC indicator placed in error.

The Chief, Taxpayer Services, and Chief, Tax Compliance Officer, should:

Recommendation 10: Send Letter 3064C to the taxpayers we identified with an erroneous offset to an LLC account, and whose refund statute has not yet expired.

> **Management's Response:** IRS management agreed with the recommendation and sent Letter 3064C to 161 taxpayers whose refund statute expiration date had not yet passed. The taxpayers were instructed to reply if they wanted the offset reversed. The IRS requested a response within 30 days and monitored the accounts for 45 days for a response. No offset reversals were requested or required for these accounts. The actions were completed by June 12, 2024.

Recommendation 11: Remove the erroneous LLC indicator from the 76 sole proprietorship accounts.

> **Management's Response:** IRS management agreed with the recommendation and will research the 76 sole proprietorship accounts and remove any erroneous LLC indicators.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the IRS's processes to identify and offset overpayments associated with individual and business tax accounts with debt owed. To accomplish our objective, we:

- Determined whether offsets were processed for all eligible individual and business taxpayers who had outstanding federal tax debt. To accomplish this, we reviewed IRS procedures and interviewed IRS management officials to determine the processing of federal tax offsets on individual and business accounts. We also quantified the number of offsets processed from individual and business tax accounts to outstanding tax debt, and the number of individuals and businesses who received a refund instead of having their overpayment offset to an outstanding tax debt. TIGTA's contracted statistician assisted with developing and reviewing the sampling plans to analyze the population of taxpayers with tax debt who received refunds and credit elects, as well as projecting our results. Our sample of 266 from 6,400 individual tax accounts with refunds was selected using a 90 percent confidence interval, 40 percent expected error rate, and ±5 percent precision factor. The 40 percent error rate was the actual error rate based on our review of some cases. Our sample of 253 from 2,052 individual tax accounts with credit elects was selected using a 90 percent confidence interval, 50 percent error rate, and ±5 percent precision factor.
- Determined the methods the IRS used to evaluate if an individual is responsible for associated sole proprietorship business tax debt when processing a tax return. To accomplish this, we determined the effectiveness of the IRS's reliance on the EINs [redacted]
- Determined whether overpayments from individual tax accounts were incorrectly offset to outstanding LLC business tax debt, and quantified the number of offsets that were processed.
- Determined the effectiveness of the processes for offsetting taxpayer overpayments to NMF accounts with tax debt.

Performance of This Review

This review was performed with information obtained from the IRS's IMF and BMF as of Dec. 28, 2023, and July 27, 2023, and an extract of the IRS's ANMF provided in October 2023. We also relied on information obtained from the IRS's Information Technology organization located in Washington, D.C., as well as the Office of Taxpayer Services located in Atlanta, Georgia, during the period November 2023 through August 2024. We conducted this performance audit in accordance with generally accepted government auditing standards. These 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.

Major contributors to the report were Diana Tengesdal, Assistant Inspector General for Audit (Returns Processing and Account Services); Sharla Robinson, Director; Ashley Burton, Acting Audit Manager; Curtis Kirschner, Audit Manager; Ryan Kenaley, Lead Auditor; and Zachary Caraccilo, Auditor.

Data Validation Methodology

During this review we obtained data extracts from the IRS's IMF, BMF, and ANMF. We evaluated the data by performing electronic testing of required data elements, reviewing existing information about the data, and selecting random samples to verify the data to a source, *i.e.*, the Integrated Data Retrieval System and the ANMF. 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: various IRS policies, procedures, and guidelines associated with the IRS's tax offset program. We evaluated these controls by reviewing the policies, procedures, and guidance associated with the tax offset program; analyzing tax account data associated with refunds, credit elects, and outstanding tax debt; and through interviews with personnel from the Office of Taxpayer Services and the Information Technology organization.

Appendix II

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:

- Cost Savings (Funds Put to Better Use) – Potential; 1,629 business tax accounts with credit elects totaling $6,102,479 that were not offset to outstanding tax debt (see Recommendations 1, 2, and 3).

Methodology Used to Measure the Reported Benefit:

We analyzed 3,771,660 business tax accounts with an outstanding federal tax debt and determined that 3,486,198 of the accounts did not have a freeze code that would prevent an offset. We matched these accounts to the BMF and identified 241,196 of the accounts had a credit elect issued since Calendar Year 2017. We further reduced this population for conditions that would prevent an offset from being processed such as bankruptcy or Criminal Investigation activity. We calculated the tax debt at the time of the credit elect, and netted the credit elect against the outstanding tax debt to ensure that our potentially reported benefit did not exceed the amount of tax debt. Our initial analysis resulted in 5,157 business tax accounts with credit elects totaling $28,003,334 that may not have been appropriately offset to outstanding tax debt.

Working with the IRS, we identified three business tax accounts with credit elects totaling $4,495 that were not offset to outstanding tax debt because of a programming error that caused a freeze code associated with a telephone excise tax to not properly prevent a credit elect from being issued.

In addition, we identified 1,626 business tax accounts with credit elects totaling $6,097,984 that were not offset due to procedural errors caused by employees not looking for outstanding tax debt prior to issuing manual credit elects.

Our results determined there was $6,102,479 ($4,495 + $6,097,984) in credit elects that were issued to 1,629 business tax accounts (3 + 1,626) that should have been applied to outstanding tax debt.

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; 1,836 individual tax accounts with credit elects totaling $17,054,865 that were not offset to outstanding tax debt (see Recommendations 1, 2, 3, 4, and 5).

Methodology Used to Measure the Reported Benefit:

We analyzed 18,650,460 individual tax accounts with an outstanding federal tax debt and determined that 14,590,868 of the accounts did not have a freeze code that would prevent an offset. We matched these accounts to the IMF and identified 275,140 of the accounts had a credit elect issued since Calendar Year 2017. We further reduced this population for conditions that would prevent an offset from being processed such as bankruptcy, injured spouse claims, or Criminal Investigation activity. We calculated the tax debt at the time of the credit elect, and netted the credit elect against the outstanding tax debt to ensure that our potentially reported benefit did not exceed the amount of tax debt. Our initial analysis resulted in 2,247 individual tax accounts with credit elects totaling $25,661,245 that may not have been appropriately offset to outstanding tax debt.

Working with the IRS, we identified 39 tax accounts with credit elects totaling $157,341 that were not offset to outstanding tax debt because of a programming error that caused a freeze code associated with duplicate returns to not properly prevent credit elects from being issued. In addition, we identified 156 individual tax accounts with credit elects totaling $803,923 that were not offset due to procedural errors caused by employees not looking for outstanding tax debt prior to manual credit elects being issued.

For the remaining 2,052 individual tax accounts (2,247 – 39 – 156) we could not identify a reason the offset did not occur from our data files, so we evaluated a statistically valid sample of 253 tax accounts and determined:[1]

- 50 (20 percent) of the 253 tax accounts had a freeze code or other characteristic at the time of the credit elect posting that would have correctly prevented the offset from posting.
- 79 (31 percent) of the 253 tax accounts had an offset overflow freeze on the account at the time of the credit elect posting that was not properly preventing credit elects from being issued. These taxpayers had $1,099,775 in credit elects that could have been offset to outstanding tax debt.
- 124 (49 percent) of the 253 tax accounts did not have a freeze code on the account that would explain why a credit elect was issued while the taxpayer was liable for an outstanding tax debt. These tax accounts had $884,475 in credit elects that could have been offset to outstanding tax debt.

Based on our statistical sample, we are 90 percent confident that there were 1,005 tax accounts (2,052 * 49 percent actual error rate) with no explanation as to why the credit elect was issued before satisfying the outstanding tax debt. We project that the IRS could have offset $7,173,687 to outstanding tax debt for these 1,005 tax accounts.[2]

We are also 90 percent confident that there were 636 tax accounts (2,052 * 31 percent actual error rate) where the tax account had an offset overflow freeze that did not properly prevent the credit elect from being issued. We project that the IRS could have offset $8,919,914 to outstanding tax debt for these 636 tax accounts.[3]

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[1] Our sample was selected using a 90 percent confidence interval, 50 percent error rate, and ±5 percent precision factor.

[2] When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount paid in error is between $4,415,646 and $9,931,728.

[3] When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount paid in error is between $4,527,282 and $13,312,546.

Overall, our results determined there was $17,054,865 ($157,341 + $803,923 + $7,173,687 + $8,919,914) in credit elects that were issued to 1,836 tax accounts (39 + 156 + 1,005 + 636) that should have been applied to outstanding tax debt.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; 2,543 individual tax accounts with refunds totaling $7,770,334 that were not offset to outstanding tax debt (see Recommendations 1, 3, 4, and 5).

Methodology Used to Measure the Reported Benefit:

We analyzed 18,650,460 individual tax accounts with an outstanding federal tax debt and determined that 14,590,868 of the accounts did not have a freeze code that would prevent an offset. We matched these accounts to the IMF and identified 15,472,381 individual tax accounts that were issued a refund while also having a tax debt. We further reduced this population for conditions noted on the taxpayer's account that would prevent an offset from being processed such as bankruptcy, injured spouse claims, or Criminal Investigation activity. We calculated the tax debt at the time of the refund, and netted the refund against the outstanding tax debt to ensure that our potentially reported benefit did not exceed the amount of tax debt. Our initial analysis resulted in 6,959 tax accounts with refunds totaling $24,032,538 that may not have been appropriately offset to outstanding tax debt.

Working with the IRS, we identified 248 individual tax accounts with refunds totaling $2,376,556 that were not offset due to outstanding tax debt because of a programming error that allowed overpayments generated from lien or levy payments in the same year of a Shared Responsibility Payment to bypass the offset program. In addition, we identified 311 individual tax accounts with refunds totaling $1,117,453 that were not offset due to procedural errors caused by employees not looking for outstanding tax debt prior to manual refunds being issued.

For the remaining 6,400 individual tax accounts (6,959 – 248 – 311) we could not identify a reason the offset did not occur from our data files, so we evaluated a statistically valid sample of 266 tax accounts and determined:[4]

- 184 (69 percent) of the 266 tax accounts had a freeze code at the time of the refund posting that would have correctly prevented the offset from posting.
- 82 (31 percent) of the 266 tax accounts did not have a freeze code or other characteristic present on the account that would explain why a refund was issued while the taxpayer was liable for an outstanding tax debt. These tax accounts had $177,209 in refunds that could have been offset to outstanding tax debt.

Based on our statistical sample, we are 90 percent confident that there were 1,984 tax accounts (6,400 * 31 percent actual error rate) with no explanation as to why the refund was issued before satisfying the outstanding tax debt. We project that the IRS could have offset $4,276,325 to outstanding tax debt for these 1,984 tax accounts.[5]

[4] Our sample was selected using a 90 percent confidence interval, 40 percent error rate, and ±5 percent precision factor.

[5] When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount paid in error is between $1,747,873 and $6,804,777.

Overall, our results determined there was $7,770,334 ($2,376,556 + $1,117,453 + $4,276,325) in refunds that were issued to 2,543 tax accounts (248 + 311 + 1,984) that should have been applied to outstanding tax debt.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; 2,136 business tax accounts with refunds totaling [redacted] that were not offset to outstanding tax debt (see Recommendations 2 and 4).

Methodology Used to Measure the Reported Benefit:

We analyzed 3,771,841 business tax accounts with an outstanding federal tax debt and determined that 3,486,277 of the tax accounts did not have a freeze code that would prevent an offset. We matched these accounts to the BMF and identified the business tax accounts that were issued a refund while also having a tax debt. We further reduced this population for conditions noted on the taxpayer's account that would prevent an offset from being processed such as bankruptcy or Criminal Investigation activity. We calculated the tax debt at the time of the refund, and netted the refund against the outstanding tax debt to ensure that our potentially reported benefit did not exceed the amount of tax debt. Our initial analysis resulted in 30,654 business tax accounts with refunds totaling $262,771,909 that may not have been appropriately offset to outstanding tax debt.

Working with the IRS, we identified [redacted] business tax accounts with refunds totaling $68,106,118 that were not offset to outstanding tax debt because of a programming error that caused overpayments to not offset to tax debt on Form 720. In addition, there was [redacted] We are not projecting an outcome for the remaining 28,518 tax accounts because we were unable to accurately identify if there [redacted]

Overall, our results determined there was a total [redacted] ($68,106,118 + [redacted]) in refunds that were issued to 2,136 tax accounts [redacted] that should have been applied to outstanding tax debt.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; 8,654 individual tax accounts with refunds totaling $6,638,325 that could have been offset to outstanding sole proprietorship tax debt, had the IRS matched to the Form SS-4 during processing (see Recommendation 6).

Methodology Used to Measure the Reported Benefit:

We analyzed 273,305 business sole proprietorship accounts with outstanding federal tax debt that were associated with individuals (the sole proprietors) who received $3,493,794,980 in refunds. We limited our data to those refunds issued since Calendar Year 2017 and removed accounts that had conditions that would prevent an offset from being processed such as bankruptcy, injured spouse claims, or Criminal Investigation activity. This resulted in

11,206 individual tax accounts with refunds totaling $9,162,131 that could have been offset to the associated sole proprietorship tax debt.

We calculated the tax debt at the time of the refund, then netted the refund against the outstanding tax debt to ensure that our potentially reported benefit did not exceed the amount of tax debt. We matched the sole proprietorships to the IRS's Form SS-4 file to identify the individual associated with each sole proprietorship and determined that the IRS could have offset $6,638,325 to outstanding tax debt for 8,654 sole proprietor accounts.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; 169 individual tax accounts and 53 business tax accounts with refunds totaling $8,444,759 that were not offset to outstanding tax debt on the ANMF (see Recommendations 7 and 8).

Methodology Used to Measure the Reported Benefit:

We analyzed an extract of the ANMF that was provided to the audit team on Oct. 13, 2023. We matched the tax accounts on that extract to both the IMF and BMF and identified 2,972 individual tax accounts and 7,022 business tax accounts. We determined that 1,701 of the individual and 2,931 of the business tax accounts that had an outstanding federal tax debt on the NMF were in a collectable status. We removed accounts that had conditions that would prevent an offset from being processed such as bankruptcy, injured spouse claims, or Criminal Investigation activity. Working with the IRS, we identified 169 individual tax accounts and 53 business tax accounts that were issued $8,444,759 in refunds that should have been applied to outstanding tax debt.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; 283 individual tax accounts and 117 business tax accounts with $357,940,294 in tax debt on the NMF where the required freeze code was not currently posted to the associated Master File tax account (see Recommendation 9).

Methodology Used to Measure the Reported Benefit:

We analyzed an extract of the ANMF that was provided to the audit team on Oct. 13, 2023. We identified that 2,970 individual tax accounts and 7,021 business tax accounts had outstanding federal tax debt on their NMF account. We removed those in a non-collectable status and further identified those that did not have the required transaction code on their account to freeze the account from refund issuance. Working with the IRS, we identified 283 individual tax accounts and 117 business tax accounts on the NMF that were not protected by the appropriate account freeze. These accounts held $254,446,400 and $103,493,894 respectively, in outstanding federal tax debt.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 441 taxpayers involving 511 offsets for which the taxpayers were not notified with Letter 3064C providing the opportunity to correct an erroneous offset. The 511 offsets had overpayments totaling $499,507 that were incorrectly offset to outstanding tax debts on the associated LLC business tax account (see Recommendation 10).

Methodology Used to Measure the Reported Benefit:

We analyzed 36,929,324 business tax accounts where an LLC indicator was present. We matched those LLC accounts to the IMF and initially identified 895 unreversed offsets. We further evaluated LLC business name changes and worked with the IRS to remove those LLCs that had already been issued Letter 3064C. We identified that there were 511 erroneous offsets totaling $499,507 where the taxpayer was not notified with Letter 3064C.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 76 sole proprietorship entities had an LLC indicator placed on their tax account in error (see Recommendation 11).

Methodology Used to Measure the Reported Benefit:

We analyzed 36,929,324 business tax accounts, where an LLC indicator was present. We matched those LLC accounts to the IMF and initially identified 895 unreversed offsets. We further evaluated LLC business name changes by matching the LLC entities to IRS historical data to determine if the entity was originally established as an LLC or appeared to have an LLC indicator placed in error. Overall, we determined that 76 sole proprietorship entities had an LLC indicator placed on the tax account in error.

Appendix III

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

CHIEF
TAXPAYER SERVICES

October 18, 2024

MEMORANDUM FOR DANNY R. VERNEUILLE
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kenneth C. Corbin Digitally signed by Kenneth C. Corbin Date: 2024.10.18 09:41:39 -04'00'
Chief, Taxpayer Services Division

SUBJECT: Draft Audit Report – The Tax Offset Program Continues to Allow Millions of Dollars to Be Erroneously Refunded to Taxpayers (Audit No.: 202340024)

Thank you for the opportunity to review and provide comments on the subject draft report. The ability to apply overpayments of tax to outstanding debt provides a significant benefit to tax administration by resolving unpaid accounts without more costly collection activity. A primary challenge encountered by the IRS in directing overpayments to unpaid tax debt is that our systems of record for maintaining tax accounts, the Individual Master File and the Business Master File, currently rely on batch processing that is not performed in real time and does not permit the databases to talk to one another as they process transactions. Consequently, we have a greater reliance on manual processes that can be prone to occasional error. We are on a path toward modernizing our processing systems with the use of much-needed supplemental funding provided by the Inflation Reduction Act of 2022[1]. Modernization will be key to improving our agility and ability to apply overpayments more accurately to existing debt.

We note that the report reflects $40.1 billion in overpayments as having been correctly applied over the three-year period, from tax years 2020 to 2022, to outstanding tax debt associated with other tax periods or related entities. The amount of payments identified as having been incorrectly refunded to taxpayers, rather than offsetting existing tax debt, totaling approximately $96.1 million ($78.6 million attributed to procedural and programming errors; $9.1 million attributed to unmatched related entities; and $8.4 million attributed to Non-Master File debts), cover a six-year period from calendar years 2017 through 2022. This timing mismatch skews comparison such that if the total amount of missed offsets were adjusted to reflect a commensurate three-year period,

[1] Pub. L. 117–169

the amount would be approximately one-half of the $96.1 million reported, or $48.1 million. When the applicable periods for correctly applied offsets and incorrect refunds are equal, the results indicate that the error rate is 0.12 percent ($48.1 million divided by $40.1 billion). In other words, $1.20 was refunded for every $1,000 properly offset.

We agree with the recommendations contained in the report and have either implemented them or are taking action to do so in the future. Our responses to the specific recommendations are attached. If you have any questions, please contact me, or a member of your staff may contact Joseph Dianto, Director, Customer Account Services, at 470-639-3504.

Attachment

Attachment

Recommendations

The Chief, Taxpayer Services and Chief, Tax Compliance Officer, should:

RECOMMENDATION 1
Update internal guidance and develop more robust training to ensure that employees perform adequate research of taxpayer accounts to identify outstanding tax debt prior to initiating manual refunds or credit elects.

CORRECTIVE ACTION
We agree. We will review and update internal guidance and develop more robust training that reinforces the requisite research to be performed so that outstanding tax debt is appropriately identified and addressed when initiating manual refunds or processing credit elects.

IMPLEMENTATION DATE
February 15, 2025

RESPONSIBLE OFFICIAL
Director, Accounts Management, Customer Account Services, Taxpayer Services Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2
Request the necessary programming changes to ensure that the duplicate return freeze and the telephone excise tax freeze code function appropriately. In addition, request programming changes to ensure that overpayments from undelivered refunds and interest offset appropriately.

CORRECTIVE ACTION
We agree. We will analyze a sample of individual and business accounts to ascertain any procedural and programming changes needed to permit the duplicate return and telephone excise freeze codes function as intended, and that overpayments associated with undelivered refunds and interest offset correctly.

IMPLEMENTATION DATE
December 15, 2025

RESPONSIBLE OFFICIAL
Director, Accounts Management, Customer Account Services, Taxpayer Services Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 3
Identify the functional areas allowing refunds or credit elects for taxpayers with existing tax debt, and issue alerts/reminders to them, advising that refunds or credit elects should not be allowed until any associated tax debt is satisfied.

CORRECTIVE ACTION
We agree. We will issue a Servicewide Electronic Research Program (SERP) Alert to remind employees who manually process adjustments resulting in refunds or credit elects of the procedures to follow when associated tax debt exists.

IMPLEMENTATION DATE
February 15, 2025

RESPONSIBLE OFFICIAL
Director, Accounts Management, Customer Account Services, Taxpayer Services Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 4
Verify that the programming changes associated with overpayments offsetting to tax debt on Form 720, the offset overflow freeze, and to payments associated with the Notice of Federal Tax Lien or Levy, are operating correctly.

CORRECTIVE ACTION
We agree. We will verify the programming changes associated with overpayments offsetting to tax debt on Form 720, *Quarterly Federal Excise Tax Return*, the offset overflow freeze, and to payments associated with the Notice of Federal Tax Lien or Levy, are operating correctly.

IMPLEMENTATION DATE
July 15, 2025

RESPONSIBLE OFFICIAL
Deputy Director, Corporate Data, Information Technology

3

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 5
Analyze the 8,452 individual and 31,967 business cases that we identified and determine whether additional programming or procedural errors exist in the process of offsetting refunds and credit elects. Take appropriate corrective action to prevent erroneous refunds and credit elects in the future.

CORRECTIVE ACTION
We agree. We will analyze a sample of individual and business accounts to determine whether programming or procedural modifications are needed to prevent erroneous refunds and will take the appropriate action.

IMPLEMENTATION DATE
January 15, 2026

RESPONSIBLE OFFICIAL
Director, Accounts Management, Customer Account Services, Taxpayer Services

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

Recommendation

RECOMMENDATION 6
The Chief Information Officer should ensure that the requested programming changes are implemented by January 2026.

CORRECTIVE ACTION
We agree. We will ensure that the requested programming changes are implemented by January 2026.

IMPLEMENTATION DATE
January 15, 2026

RESPONSIBLE OFFICIAL
Deputy Director, Corporate Data, Information Technology

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

4

Recommendations

The Chief, Taxpayer Services and Chief, Tax Compliance Officer, should:

RECOMMENDATION 7
Analyze the accounts we identified, noting trends in the functional areas reversing the freeze codes in error and issue alerts or reminders to them advising not to reverse freezes or issue manual refunds on accounts that have an outstanding debt on the ANMF.

CORRECTIVE ACTION
We agree. We will issue a SERP Alert reminding all functional areas of the research to be performed and the correct processing actions to take when account debts exist on the Non-Master File.

IMPLEMENTATION DATE
December 15, 2024

RESPONSIBLE OFFICIAL
Director, Submission Processing, Customer Account Services, Taxpayer Services Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 8
Revisit the process developed in response to our prior report and correct the weaknesses that are continuing to allow refunds to be issued to taxpayers that have outstanding tax debt on their NMF account.

CORRECTIVE ACTION
We agree. We increased the frequency of the review process from quarterly to monthly so that accounts with erroneously reversed freeze transaction can have them reapplied. The first monthly review was completed on July 25, 2024.

IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director, Submission Processing, Customer Account Services, Taxpayer Services Division

5

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 9
Review all NMF accounts with outstanding tax debt to ensure that all taxpayers have the required freeze code on the associated Master File account.

CORRECTIVE ACTION
We agree. We reviewed 336 Automated Non-Master File accounts with outstanding liabilities and where there were no freeze codes on corresponding Master File account. Corrective actions were completed on August 2, 2024, to reapply the freeze code to the Master File accounts.

IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director, Submission Processing, Customer Account Services, Taxpayer Services Division

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 10
Send Letter 3064C to the taxpayers we identified with an erroneous offset to an LLC account, and whose refund statute has not yet expired.

CORRECTIVE ACTION
We agree. We identified, and sent Letter 3064C, *IDRS Special Letter (CNOTE),* to 161 taxpayers whose refund statute expiration date had not yet passed. The taxpayers were instructed to reply if they wanted the offset reversed. We requested a response within 30 days and monitored the accounts for 45 days for a response. No offset reversals were requested or required for these accounts. The actions were completed by June 12, 2024.

IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director, Accounts Management, Customer Account Services, Taxpayer Services Division

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 11
Remove the erroneous LLC indicator from the 76 sole proprietorship accounts.

CORRECTIVE ACTION
We agree. We will research the 76 sole proprietorship accounts and remove any erroneous Limited Liability Company indicators present.

IMPLEMENTATION DATE
January 15, 2025

RESPONSIBLE OFFICIAL
Director, Submission Processing, Customer Account Services, Taxpayer Services Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

Appendix IV

Glossary of Terms

Term	Definition
Automated Non-Master File	An IRS database of individual and business tax transactions and accounts that cannot be maintained on either the IMF or the BMF.
Business Master File	An IRS database of federal tax-related transactions and accounts for businesses that includes employment taxes, income taxes on businesses, and excise taxes.
Individual Master File	An IRS database that maintains transactions or records of individual tax accounts.
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
Internal Revenue Manual	The primary source of instructions to employees relating to the administration and operation of the IRS. The Manual contains the directions employees need to carry out their operational responsibilities.
Levy	A method used by the IRS to collect outstanding taxes from sources such as bank accounts and wages or a legal seizure of property to satisfy a tax debt.
Lien	An encumbrance on property or rights to property as security for outstanding taxes.
Manual Refund	A refund that is not generated through normal computer processing.
Minimum Essential Coverage	Health insurance coverage that contains essential health benefits including emergency services, maternity and newborn care, and preventive and wellness services. Minimum essential coverage also includes doctor visits, hospitalization, mental health services, and prescription drugs.
Notice of Federal Tax Lien	A notice filed with the appropriate local government office, protecting the federal government's interest in the taxpayer's assets by providing public notice of the amount of unpaid tax.
Shared Responsibility Payment	Through Tax Year 2018, if anyone in the taxpayer's tax household did not have minimum essential coverage, and did not qualify for a coverage exemption, the taxpayer needed to make an individual shared responsibility payment when filing a federal income tax return. However, this payment was reduced to zero for Tax Years 2019 and after.
Tax Year	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.
TIGTA Data Center Warehouse	A collection of IRS data files containing several types of tax account information that is maintained by TIGTA for the purpose of analyzing the data for audits and investigations.

Term	Definition
Transaction Codes	Three-digit codes used to identify actions being taken on a tax account.

Appendix V

Abbreviations

ANMF	Automated Non-Master File
BMF	Business Master File
DCW	Data Center Warehouse
EIN	Employer Identification Number
IMF	Individual Master File
IRS	Internal Revenue Service
LLC	Limited Liability Company
NMF	Non-Master File
TIGTA	Treasury Inspector General for Tax Administration

To report fraud, waste, or abuse,
contact our hotline on the web at www.tigta.gov or via email at
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.

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