Key Tax Provisions Were Implemented Correctly for the 2014 Filing Season

September 19, 2014

Reference Number: 2014-40-077

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:
1 = Tax Return/Return Information
2 = Law Enforcement Tolerance

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KEY TAX PROVISIONS WERE IMPLEMENTED CORRECTLY FOR THE 2014 FILING SEASON

Highlights

Final Report issued on September 19, 2014

Highlights of Reference Number: 2014-40-077 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

The filing season, defined as the period from January 1 through mid-April, is critical for the IRS because it is during this time that most individuals file their income tax returns and contact the IRS if they have questions about specific laws or filing procedures.

WHY TIGTA DID THE AUDIT

Our overall objective was to evaluate whether the IRS timely and accurately processed individual paper and electronically filed (e-filed) tax returns during the 2014 Filing Season.

WHAT TIGTA FOUND

The closure of Government operations between October 1 and October 16, 2013, reduced the time the IRS had to implement tax law changes and bring tax return processing systems online. As a result, the IRS delayed the start of the filing season from January 21 to January 31, 2014.

As of May 2, 2014, the IRS had received more than 135.5 million tax returns – more than 117 million (86.4 percent) were e-filed and nearly 18.5 million (13.6 percent) were filed on paper. The e-file volumes were 2.9 percent higher than the volumes for the same period in the 2013 Filing Season. The IRS had issued more than 99.9 million refunds totaling nearly $269.5 billion.

The IRS reported that it identified and confirmed 236,313 fraudulent tax returns involving identity theft as of April 30, 2014. Overall, the IRS identified 268,233 tax returns with more than $1.48 billion claimed in fraudulent refunds and prevented the issuance of more than $1.32 billion (88.9 percent) of those it identified. The IRS also identified 63,087 potentially fraudulent tax returns filed with prisoner Social Security Numbers for screening.

TIGTA's review of the tax provisions that created additional taxes or modified existing tax provisions for the 2014 Filing Season found that these key provisions were correctly implemented. However, TIGTA did identify a problem in which some taxpayers' nonrefundable credit claims were being improperly reduced due to employee error.

The IRS continues to offer more self-assistance options that taxpayers can access 24 hours a day, seven days a week. However, the IRS did not always ensure that the self-help tools were updated with the most current tax information before the start of the filing season. In addition, the number of taxpayers assisted at IRS Taxpayer Assistance Centers and through the telephone continues to decline.

Finally, TIGTA found that some taxpayers and return preparers continue to misuse the split refund option to direct a portion of a tax refund to a preparer for payment of services. TIGTA also found that some paid tax return preparers continue to be noncompliant with the Earned Income Tax Credit due diligence requirements, but the number has decreased substantially when compared to previous filing seasons.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, review the 308,986 tax returns for which it appears the split refund option was used to inappropriately direct a portion of the tax refund to the tax return preparer, implement computer programming to systemically ensure that taxpayers' claims for nonrefundable credits are allowed when applicable, ensure that Earned Income Tax Credit due diligence penalties are assessed on all paid tax return preparers who do not comply with the due diligence requirements, and ensure that YouTube videos are updated with the most current tax information.

The IRS agreed or partially agreed with three of TIGTA's four recommendations.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 19, 2014

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Key Tax Provisions Were Implemented Correctly for the 2014 Filing Season (Audit # 201440014)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) timely and accurately processed individual paper and electronically filed tax returns during the 2014 Filing Season. This audit is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Implementing the Affordable Care Act and Other Tax Law Changes.

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

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

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Abbreviations

AGI	Adjusted Gross Income
CADE 2	Customer Account Data Engine 2
e-file(d), e-filing	Electronically file(d); electronic filing
EITC	Earned Income Tax Credit
IRS	Internal Revenue Service
TAC	Taxpayer Assistance Center
TIGTA	Treasury Inspector General for Tax Administration

Background

The annual tax return filing season[1] is a critical period for the Internal Revenue Service (IRS) because it is when most individuals file their income tax returns and contact the IRS if they have questions about specific tax laws or filing procedures. As of May 2, 2014, the IRS received more than 135.5 million individual income tax returns. In addition, the IRS provided customer service assistance via telephone, website, social media, and face-to-face assistance to millions of taxpayers.

As of May 2, 2014, the IRS received more than 135.5 million individual income tax returns.

One of the challenges the IRS confronts each year in processing tax returns is the implementation of new tax law changes as well as changes resulting from expired tax provisions. Before the filing season begins, the IRS must identify the tax law and administrative changes affecting the upcoming filing season. Once identified, the IRS must revise the various tax forms, instructions, and publications. It also must reprogram its computer systems to ensure that tax returns are accurately processed. Errors in the IRS's tax return processing systems may delay tax refunds, affect the accuracy of taxpayer accounts, and/or result in incorrect taxpayer notices.

Tax law changes affecting the 2014 Filing Season

- ***The Patient Protection and Affordable Care Act*[2] –** Enacted March 23, 2010, this act contains revenue provisions designed to generate an estimated $438 billion to help pay for the overall cost of health care reform. The provisions that created additional taxes or modified existing tax provisions for taxpayers filing their Tax Year 2013 tax returns include:
    - Adding a 3.8 percent surtax on net investment income for certain taxpayers. The threshold amount is based on filing status and is equal to: $250,000 for married filing jointly or qualifying widow(er); $125,000 for married filing separately; and $200,000 for any other filing status.
    - Increasing the employee share of Medicare tax by an additional 0.9 percent of wages or self-employment income. The Additional Medicare Tax increases the employee share of Medicare tax by an additional 0.9 percent of covered wages in excess of threshold amounts based on the taxpayer's filing status. The Additional Medicare

[1] See Appendix IV for a glossary of terms.
[2] Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

Tax also increases Medicare tax on self-employment income by an additional 0.9 percent of self-employment income in excess of the threshold amounts based on filing status. The threshold wage/income amounts by filing status are: $250,000 for married filing jointly or qualifying widow(er); $200,000 for single or head of household; and $125,000 for married filing separately.

  - Increasing the adjusted gross income (AGI) threshold for the medical expense deduction. In prior tax years, taxpayers who itemized their deductions could claim a deduction for qualified unreimbursed medical expenses that exceeded 7.5 percent of their AGI. Starting with Tax Year 2013, the percentage by which expenses must exceed the AGI was increased to 10 percent. The only exception to this rule is for taxpayers who are age 65 or older before the close of the tax year. Taxpayers in this situation may still apply the 7.5 percent rule through Tax Year 2016, at which time it will be 10 percent for all taxpayers.

- ***American Taxpayer Relief Act of 2012***[3] – Enacted January 2, 2013, this act increased taxes for some taxpayers and generally extended or made permanent many of the tax provisions that were set to expire at the end of Calendar Year 2012 including:

  - Adding a 39.6 percent individual income tax rate for high-income earners. Income levels subject to the tax bracket differ based on filing status and are adjusted on a yearly basis for inflation. For Tax Year 2013, the income levels subject to the new tax rate by filing status are: $450,000 for married filing jointly or qualifying widow(er); $425,000 for head of household; $400,000 for single; and $225,000 for married filing separately.

  - Increasing the maximum rate on capital gains tax for high-income earners. The maximum rate was increased to 20 percent for certain individuals. The income levels subject to the increased rate differ based on filing status and are adjusted on a yearly basis for inflation. For Tax Year 2013, the income levels subject to the new rate by filing status are: $450,000 for married filing jointly or qualifying widow(er); $425,000 for head of household; $400,000 for single; and $225,000 for married filing separately.

  - Reinstating the limit on personal exemption. Income levels subject to the limitation differ based on filing status and are adjusted on a yearly basis for inflation. For Tax Year 2013, the income levels subject to the limitation by filing status are: $300,000 for married filing jointly; $275,000 for head of household; $250,000 for single; and $150,000 for married filing separately.

  - Reinstating the limit on itemized deductions (Pease limitation). Income levels subject to the limitation differ based on filing status and are adjusted on a yearly basis for

[3] Pub. L. No. 112-240, 126 Stat. 2313 (2013).

inflation. For Tax Year 2013, the income levels subject to the limitation by filing status are: $300,000 for married filing jointly; $275,000 for head of household; $250,000 for single; and $150,000 for married filing separately.

- Extending the American opportunity credit. Extended the credit up to $2,500 on $4,000 in qualified expenses incurred during the first four years of post-secondary or technical program education through Calendar Year 2017. Up to $1,000 of the credit is refundable.
- Extending the Earned Income Tax Credit (EITC) for families with three or more qualifying children. Extended the higher EITC available for families with three or more qualifying children through Calendar Year 2017. For Tax Year 2013, the maximum EITC for a family with three or more qualifying children is $6,044.
- Increasing the annual gift tax exclusion. For Tax Year 2013, up to $14,000 in gifts can be made tax free without affecting an individual's lifetime estate and gift tax exclusion.
- Extending the standard deduction and the 15 percent tax bracket for married filing jointly filers at double that of single filers. The standard deduction for married taxpayers filing as joint filers would have reverted to 167 percent of the standard deduction for single taxpayers.

- ***Federal Recognition of Same-Sex Marriage –*** On June 26, 2013, the U.S. Supreme Court struck down Section 3 of the Defense of Marriage Act[4] in the case *United States vs. Windsor*, allowing the IRS to recognize same-sex marriage for Federal tax purposes. The ruling was applied retroactively, enabling affected taxpayers to amend prior year tax returns for years not closed by the statute of limitations.

The 2014 Filing Season results are being presented as of several dates between April 30 and June 30, 2014, depending on when the data were available. This review was performed with information obtained from the Wage and Investment Division Headquarters in Atlanta, Georgia; the Wage and Investment Division Submission Processing function offices in Cincinnati, Ohio; and the Information Technology organization Headquarters in Lanham, Maryland. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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[4] Defense of Marriage Act (DOMA) Pub. L. No. 104-199 110 Stat. 2419 (1996) (codified at 1 U.S.C. § 7 and 28 U.S.C. § 1738C).

Results of Review

Processing Tax Returns

The IRS originally planned to begin processing individual tax returns on January 21, 2014. However, for the second consecutive year, the IRS delayed the start of the filing season. The 2014 Filing Season was delayed as a result of the closure of Government operations between October 1 and October 16, 2013. On December 18, 2013, the IRS announced it was delaying the start of the 2014 Filing Season until January 31, 2014, to allow adequate time to program and test the more than 50 IRS systems needed to process tax returns. According to the IRS, the October 2013 closure put preparations for the filing season nearly three weeks behind its already tight timetable.

As of May 2, 2014, the IRS received more than 135.5 million tax returns and issued more than $269 billion in refunds. A higher proportion of tax returns were filed electronically (e-filed) than in the 2013 Filing Season. Figure 1 presents comparative filing season statistics as of May 2, 2014.

Figure 1: Comparative Filing Season Statistics (as of May 2, 2014)

Cumulative Filing Season Data	2013 Actual (5-3-13)	2014 Actual (5-2-14)	% Change
Individual Income Tax Returns			
Total Returns Received (000s)	133,804	135,503	1.3%
Paper Returns Received (000s)	20,124	18,487	-8.1%
E-Filed Returns Received (000s)	113,680	117,016	2.9%
Practitioner Prepared (000s)	70,184	70,707	0.7%
Home Computer (000s)	43,496	46,309	6.5%
Free File (000s) *(also in the Home Computer total)*	2,871	3,155	9.9%
Fillable Forms (000s) *(also in the Home Computer total)*	457,457	324,980	-29.0%
Percent of Returns E-Filed	85.0%	86.4%	1.6%
Refunds			
Total Number Issued (000s)	99,551	99,948	0.4%
Total $ (in millions)	$264,420	$269,480	1.9%
Average $	$2,656	$2,696	1.5%
Total Number of Direct Deposits (000s)	79,226	79,622	0.5%
Total Direct Deposit $ (in millions)	$226,569	$226,990	0.2%

Source: IRS 2014 Weekly Filing Season reports. Totals and percentages shown are rounded.

The IRS continues to modernize its filing season applications through the Customer Account Data Engine (CADE) 2 database

The IRS indicated that it continued to modernize its filing season applications in Fiscal Year 2014 under the CADE 2 program, with the full filing season deployment of the CADE 2 database in January 2014. Performance, data quality, and operational processes were tested during Filing Season 2014 by running the initialized CADE 2 database in parallel with the Individual Master File throughout the filing season, validating the data quality and system performance. IRS management determined that the CADE 2 database performed as expected during parallel processing. According to the IRS, it plans to use the CADE 2 database as the source for downstream processing systems during the 2015 Filing Season.

The e-filing rate as well as the use of home computers and the Free File Program increased, whereas the use of the Free File Fillable Forms decreased

As of May 2, 2014, e-file volumes were 2.9 percent higher than the volumes for the same period in the 2013 Filing Season. More taxpayers are preparing their own tax returns using a home computer. For example, as of May 2, 2014, 39.6 percent of taxpayers used a home computer to e-file their tax return compared to 38.3 percent for the same period in the 2013 Filing Season. In addition, the number of individuals using the IRS's Free File Program increased by 9.9 percent from the 2013 Filing Season. The traditional IRS Free File Program is a free Federal online tax preparation and e-filing program that enables eligible taxpayers to use commercial tax software accessible for free through the IRS's website, IRS.gov. The Free File Program was developed through a partnership between the IRS and the Free File Alliance LLC (a group of private-sector tax preparation companies).

However, participation in the IRS's Free File Fillable Forms decreased to 324,980, a decrease of 29 percent from the 2013 Filing Season. Fillable Forms opens up the Free File Program to nearly everyone, with no income limitations. The IRS attributes the decrease in the use of Fillable Forms to the corresponding increase in the use of the traditional Free File Program. For example, the IRS stated that the number of Fillable Form returns with an adjusted gross income of $58,000 or less, which was the cutoff to qualify for the Free File Program decreased by 50 percent when compared to the 2013 Filing Season. The number of Fillable Form returns with an adjusted gross income over $58,000 increased by 3.4 percent when compared to the 2013 Filing Season.

Use of the savings bond and split refund options continues to grow, but some preparers are continuing to misuse the split refund option

Through May 1, 2014, tax refunds totaling nearly $18.5 million were converted into 47,071 savings bonds. In addition, 830,269 individuals chose to split tax refunds totaling more than $3.6 billion between two or three different checking and savings accounts. Figure 2 shows a comparison of taxpayers' use of the split refund and savings bond options for Processing Years 2013 and 2014 as of May 1, 2014.

Figure 2: Use of Savings Bonds and Split Refunds for Processing Years 2013 and 2014 (as of May 1, 2014)

Savings Bonds	2013 Actual	2014 Actual
Number of Bonds Requested	46,806	47,071
Total Refunds to Bonds $ (in millions)	$19.3	$18.5
Split Refunds		
Total Returns	766,465	830,269
Total Refunds Split $ (in millions)	$3,284	$3,602

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the IRS Individual Return Transaction File as of May 1, 2014. Totals are rounded.

Our analysis of Form 8888, *Allocation of Refund (Including Savings Bond Purchases)*, found that the potential misuse of the split refund option to pay tax return preparers for their services is continuing. Form 8888 instructions state that the form is to be used only for the deposit of a tax refund to an account in the taxpayer's name. Taxpayers are not to use Form 8888 to direct a portion of a tax refund to the tax return preparer for payment of services rendered or any other purpose. As of May 1, 2014, taxpayers filed 564,416 tax returns with a Form 8888 requesting direct deposits totaling more than $260 million into 36,337 bank accounts. Each of the 36,337 bank accounts we identified had three or more Form 8888 deposits from different taxpayers into these accounts during this filing season. For example, 16 accounts had more than 1,000 deposits made to them. In addition, we determined that 308,986 (55 percent) of the 564,416 tax returns were prepared by paid tax return preparers, and 9,626 of the 36,337 bank accounts listed on the Forms 8888 were associated with 7,736 paid tax return preparers.

During the 2013 Filing Season, TIGTA reported that it appeared paid preparers were misusing the split refund option.[5] TIGTA provided the IRS with 452 paid preparers associated with 248,027 direct deposits. The IRS reviewed the 452 paid preparers and as of February 13, 2014, determined that 28 of them already had open criminal investigations or had been referred for examination. The IRS chose not to pursue the remaining 424 preparers because it determined its resources could be better used elsewhere.

IRS management also indicated that the IRS is developing a systemic restriction to limit the number of deposits (three) to a single bank account. After three deposits to a single account,

[5] TIGTA, Ref. No. 2013-40-124, *Late Legislation Delayed the Filing of Tax Returns and Issuance of Refunds for the 2013 Filing Season* (Sept. 2013).

including situations in which refunds are split, the entire refund amount will be sent by paper check to the taxpayer at the address of record. The change is expected to reduce the number of preparers who inappropriately divert the client refund or the preparer fee into an account controlled by the preparer. It is also expected to reduce identity theft and fraud. This systemic restriction was not in place for the 2014 Filing Season. The IRS does expect to have the systemic restriction process in place for the 2015 Filing Season.

Evaluation of tax provisions affected by Tax Year 2013 tax law changes

We assessed the accuracy of the IRS's processing of individual tax returns affected by many of the tax law changes that had an impact on Tax Year 2013. We determined whether the following tax legislation was correctly implemented and/or whether the tax returns associated with the legislation were correctly processed:

- ***Net Investment Income Tax and the Additional Medicare Tax***. The IRS created two new forms, Form 8960, *Net Investment Income Tax – Individuals, Estates, and Trusts*, and Form 8959, *Additional Medicare Tax*, for taxpayers' use in computing the new taxes contained in the Patient Protection and Affordable Care Act legislation. Our assessment of these forms and related instructions found that the forms result in an accurate computation of the Net Investment Income Tax and the Additional Medicare Tax. As of May 22, 2014, the IRS received more than 2 million tax returns reporting the Net Investment Income Tax, and as of May 29, 2014, the IRS received more than 2 million tax returns reporting the Additional Medicare Tax. Our analysis of a judgmental sample[6] of 40 tax returns reporting the Net Investment Income Tax and 40 tax returns reporting the Additional Medicare Tax received by the IRS between January 11 and April 26, 2014, found that the IRS correctly validated taxpayers' computation of the tax when processing the tax return. Further analysis shows that most taxpayers who, based on information contained on the tax return, appear to be subject to these new taxes reported the tax on their tax return.

  The IRS rejected 582 returns because taxpayers had incorrectly entered a negative number on a specific line on Form 8960. This may be the result of the complexity of the Net Investment Income Tax computation as the number on this particular line could not be negative. However, the information/instructions provided to taxpayers with the form did not make this clear. The IRS will revise next year's tax products to provide additional clarification to taxpayers to address this issue. In addition, the media reported that some tax preparation software used by preparers contained calculation errors that contributed to mistakes made by preparers on Form 8960. The IRS was aware of this problem but was not able to quantify the number of errors caused by the incorrect software. The IRS also determined that one of its filters would have incorrectly rejected some returns, but it disabled the filter before the filing season began.

[6] A judgmental sample is a nonstatistical sample, the results of which cannot be used to project to the population.

- ***New 39.6 percent individual income tax rate, the increased capital gains and dividend rate (20 percent), and the Pease limitation and personal exemption phase-out.*** Our analysis of a judgmental sample of 80 tax returns filed by high-income-earning taxpayers processed by the IRS between January 31 and March 27, 2014, that were affected by these three new provisions found that the IRS accurately verified taxpayers' tax computations and identified potential noncompliance.
- ***Increased AGI threshold for the medical expense deduction.*** We found that the increase in the AGI threshold for the medical expense deduction was correctly implemented. Taxpayers under the age of 65 filing individual returns with claims for the medical expense deduction were subject to the new 10 percent rate while those taxpayers age 65 or older filing returns were subject to the old 7.5 percent rule.
- ***Federal recognition of same-sex marriage.*** The IRS accurately implemented computer programming that will allow married couples of the same sex to file as married filing jointly. Our analysis of tax returns processed through May 8, 2014, found that married couples of the same sex were successfully able to file as married filing jointly.

However, our review of tax returns associated with some of the error notices sent to taxpayers identified a problem in which nonrefundable credit claims were being improperly reduced by the IRS. These credits include the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child tax credit, the credit for interest on certain home mortgages, *etc*. These claims should not have been reduced as the American Taxpayer Relief Act of 2012 allowed taxpayers to take nonrefundable credits to the full amount of the individual's regular tax and alternative minimum tax. We alerted the IRS to the errors on March 4, 2014. In their response, dated March 24, 2014, IRS management stated that the credits were improperly reduced due to employee error and took steps to correct the cases that were erroneously processed. The IRS issued a formal caution to employees reminding them of the correct processing procedures. In addition, IRS management stated that they will request a computer programming correction for implementation in January 2016 that will systemically implement the legislative change.

Paid tax return preparers who file tax returns claiming the EITC without a completed due diligence checklist decreased substantially

The IRS estimates that 22 to 26 percent, or between $13.3 billion and $15.6 billion, of EITC payments were issued improperly in Fiscal Year 2013. The number of paid tax return preparers who prepared tax returns claiming the EITC with a missing or incomplete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, has declined significantly when compared to Processing Year 2012. Figure 3 shows the number of tax return preparers the IRS identified during the 2012 through 2014 Filing Seasons who were not compliant with the Form 8867 requirement.

Figure 3: Comparison of Preparer Noncompliance With Form 8867 Requirements – 2012 Through 2014 Filing Seasons (as of May each year)[7]

	2012	2013[8]	2014
Noncompliant Preparers	48,162	122,133	29,623
Number of Tax Returns[9]	533,817	708,298	75,346

Source: IRS Wage and Investment Division research and analysis for the 2012 Filing Season. TIGTA analysis for the 2013 and 2014 Filing Seasons.

Since enactment of the Form 8867 requirement and the related due diligence penalty, the IRS has conducted extensive outreach and education to inform paid preparers of the requirement. In addition, the IRS has worked with tax return preparation software developers to include requirements in their software applications that will assist tax return preparers in being compliant with the Form 8867 requirement.

However, some tax return preparers continue to file tax returns claiming millions of dollars in EITCs without a completed Form 8867, and the IRS has yet to assess the due diligence penalty. As of May 3, 2014, we identified 29,623 paid tax return preparers filing 75,346 tax returns claiming nearly $156.3 million in EITCs without a completed Form 8867. This equates to nearly $37.7 million in penalties that the IRS can assess.

In October 2011, Congress increased the penalty for tax return preparers who do not comply with the EITC due diligence rules from $100 to $500 effective January 1, 2012. According to the House of Representatives report,[10] the penalty was increased to deter noncompliance and for budgetary offset purposes. Beginning with the 2012 Filing Season, paid tax return preparers who prepare a tax return claiming the EITC must include a completed Form 8867 with the tax return. Preparers who do not adhere to this requirement can be assessed a $500 due diligence penalty for each tax return they submit with an incomplete or missing Form 8867.

- Internal Revenue Code Section 6695(g) states: *Any person who is a tax return preparer with respect to any return or claim for refund who fails to comply with due diligence requirements imposed by the Secretary by regulations with respect to determining*

[7] The 2012 Filing Season is through May 3, 2012; the 2013 Filing Season is through May 2, 2013; and the 2014 Filing Season was through May 1, 2014.
[8] According to the IRS, the increase in the number of noncompliant tax return preparers during the 2013 Filing Season was due in part to errors in the software used to prepare tax returns.
[9] The number of tax returns for 2013 and 2014 includes both missing and incomplete Forms 8867.
[10] H.R. Rep. No. 112-239, at [20-21] (2011).

eligibility for, or the amount of, the credit allowable by section 32 shall pay a penalty of $500 for each such failure.

- Section 1.6695–2 of Title 26 of the Code of Federal Regulations states: *The tax return preparer must complete Form 8867, Paid Preparer's Earned Income Credit Checklist, or such other form and such other information as may be prescribed by the Internal Revenue Service.*
- Form 8867 states: *If you checked "No" on line 20, 21, 22, 23, 24, or 25, you have not complied with all the due diligence requirements and may have to pay a $500 penalty for each failure to comply.*

In both our 2012 and 2013 Filing Season reports, we raised concerns to the IRS regarding the lack of assessment of the due diligence penalty against tax return preparers who do not comply with the Form 8867 requirement.[11] Figure 4 shows potential due diligence penalties the IRS could have assessed on tax return preparers who did not comply with the Form 8867 requirement during the 2012 and 2013 Filing Seasons.

Figure 4: Potential Due Diligence Penalties That Could Have Been Assessed During the 2012 and 2013 Filing Seasons (as of May each year)[12]

Filing Season	Tax Returns[13]	EITC Claimed	Potential Penalties	Penalties Assessed
2012	533,817	$1,541,031,460	$266,908,500	$0
2013	708,298	$2,042,003,113	$354,149,000	$0
2014	75,346	$156,299,246	$37,673,000	N/A
Total	**1,317,461**	**$3,739,333,819**	**$658,730,500**	**$0**

Source: TIGTA analysis of tax returns processed during the 2012 and 2013 Filing Seasons.

The IRS informed us that in reviewing the tax return preparers who appeared to be noncompliant with the Form 8867 requirement during the 2013 Filing Season, it determined that some of the missing or incomplete Forms 8867 may be the result of errors in some of the tax preparation software preparers are using. The IRS later notified us that it had determined that 134,254 tax

[11] TIGTA, Ref. No. 2012-40-119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sept. 2012) and TIGTA, Ref. No. 2013-40-124, *Late Legislation Delayed the Filing of Tax Returns and Issuance of Refunds for the 2013 Filing Season* (Sept. 2013).
[12] The 2012 Filing Season is through May 3, 2012; the 2013 Filing Season is through May 2, 2013; and the 2014 Filing Season was through May 1, 2014.
[13] The number of tax returns for both the 2013 and 2014 Filing Seasons includes both missing and incomplete Forms 8867.

returns prepared by 47,070 tax return preparers did not include a Form 8867 during the 2013 Filing Season. The IRS informed us that on January 24, 2014, it sent 778 of the 47,070 tax return preparers a penalty letter proposing penalties totaling more than $13 million. The IRS only sent penalty letters to those preparers who had received a warning letter at the conclusion of the 2012 Filing Season and who filed 10 or more tax returns claiming the EITC during the 2013 Filing Season. Tax return preparers had 30 calendar days to respond to the penalty letter and request an Appeals hearing. The IRS is currently in various stages of reviewing and analyzing the 778 penalty proposals, but as of June 30, 2014, no penalties have been assessed.

As in previous filing seasons, the IRS indicated that it is identifying tax returns filed without a completed Form 8867 throughout the 2014 Filing Season and will assess due diligence penalties against noncompliant tax return preparers at the completion of the filing season. At the beginning of the 2013 Filing Season, TIGTA suggested notifying paid preparers who are not complying with the Form 8867 requirement early in the filing season to allow them to become compliant and thus reduce the amount of the penalty that they will be assessed. The IRS notified paid preparers this year each time an e-filed return was submitted without a required Form 8867 attached. Paid preparers submitting paper returns without a required Form 8867 attached were notified by a letter for the first occurrence. According to the IRS, 6,667 letters were sent to noncompliant preparers as of May 1, 2014. In addition, the IRS issued 1,298 alerts on electronic returns.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Review the 308,986 tax returns we identified that were prepared by paid tax return preparers on which it appears the Form 8888 was used to inappropriately direct a portion of the tax refund to the tax return preparer.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS has reviewed the information provided by TIGTA regarding tax returns for which it appears portions of the refunds were inappropriately directed to the tax return preparers. On July 28, 2014, the information was provided to the Small Business/Self-Employed Division to determine appropriate follow-up actions based on available resources and other priorities.

Recommendation 2: Implement computer programming to systemically ensure that taxpayers' claims for nonrefundable credits are allowed to the full extent of their regular tax and alternative minimum tax when applicable.

> ***Management's Response:*** The IRS agreed with TIGTA's finding; however, the IRS disagreed with the recommended corrective action. Computer programming is subject to the availability of limited funding and resources and its completion cannot be reasonably assured. On April 14, 2014, Servicewide Electronic Research Program Alert 14A0241

was issued to remind employees of the procedures to be followed in ensuring that nonrefundable credits are not erroneously denied.

Office of Audit Comment: We believe management should continue to pursue systemic computer programming to address the problem we reported. Although management indicated that they issued an alert to employees to remind them of the procedures to be followed, the errors we identified with the improper reduction of nonrefundable credit claims was due to employee error. A systemic process would eliminate the risk of continued employee errors.

Recommendation 3: Ensure that EITC due diligence penalties are assessed on all paid tax return preparers who do not provide a completed Form 8867 when filing a tax return claiming the EITC.

Management's Response: The IRS partially agreed with this recommendation. The IRS will continue pursuing assertion of the due diligence penalties under Internal Revenue Code Section 6695(g) ***************2********************
********************2************. The IRS will also continue outreach efforts to all paid preparers to promote compliance, ********2*********************
*************************2****************************.

Office of Audit Comment: IRS management did not agree to pursue due diligence penalties on those preparers who provide a Form 8867 that is incomplete. Their focus is solely on those preparers who have not attached a Form 8867. Section 1.6695-2 of Title 26 of the Code of Federal Regulations requires tax return preparers to complete Form 8867 when filing a return with the EITC and IRS instructions for Form 8867 clearly state that the tax return preparer may be subject to the due diligence penalty if specific sections of the Form 8867 are not completed.

In addition, in its response the IRS states that TIGTA's number of tax return preparers who failed to comply with EITC due diligence requirements is higher than the IRS's figures for Tax Years 2012 and 2013. The difference is that the IRS's figures incorrectly include only those tax return preparers with no Form 8867 attached to a filed tax return, whereas our figures include tax returns for which tax return preparers did not include the Form 8867 or included an incomplete Form 8867.

Detecting and Preventing Tax Refund Fraud

As of May 3, 2014, the IRS reported that it identified 268,233 tax returns with more than $1.48 billion[14] claimed in fraudulent refunds and prevented the issuance of more than $1.32 billion (88.9 percent) of those refunds. Figure 5 shows the number of fraudulent tax

[14] The IRS indicated that of the $1.48 billion claimed and $1.32 billion stopped in fraudulent refunds, ******1***
*************1**************.

returns identified by the IRS, including those filed with the Social Security Number of a prisoner and identity theft tax returns, for Processing Years 2011 through 2013 as well as the refund amounts that were claimed and stopped.

Figure 5: Fraudulent Returns and Refunds Identified and Stopped in Processing Years 2011 Through 2013

Processing Year	Number of Fraudulent Refund Returns Identified	Number of Fraudulent Refund Returns Stopped	Amount of Fraudulent Refunds Identified	Amount of Fraudulent Refunds Stopped
2011	2,176,657	1,756,242	$16,186,395,218	$14,353,795,007
2012	3,422,505	3,110,788	$20,721,203,369	$19,247,812,922
2013	2,556,935	2,360,180	$16,456,632,993	$15,690,434,978

Source: IRS fraudulent tax return statistics for Processing Years 2011 through 2013.

Overall, the decrease in the number of fraudulent tax refunds, including prisoner and identity theft tax returns, the IRS detected and stopped in Processing Year 2014 may be attributed to expanded IRS processes to prevent fraudulent tax returns from entering the tax processing system (*i.e.*, rejecting attempts to e-file a fraudulent tax return). According to the IRS, expanded use of controls to identify fraudulent refund claims before they are accepted into the processing system had identified more than 1.28 million fraudulent tax returns as of April 30, 2014. We are unable to determine the dollar amount of fraudulent refunds the IRS protected as a result of its efforts to prevent fraudulent tax returns from entering the processing system because this information is not captured by the IRS.

Detection of tax returns involving identity theft

The IRS continues to expand identity theft filters to identify fraudulent tax returns at the time they are processed. The IRS expanded the number of identity theft filters it uses to identify potentially fraudulent tax returns and prevent the issuance of fraudulent tax refunds from 80 filters during Processing Year 2013 to 114 filters during Processing Year 2014. The identity theft filters incorporate criteria based on characteristics of confirmed identity theft tax returns. These characteristics include amounts claimed for income and withholding, filing requirements, prisoner status, taxpayer age, and filing history.

Tax returns identified by these filters are held during processing until the IRS can verify the taxpayer's identity. The IRS attempts to contact the individual who filed the tax return and, if this individual's identity cannot be confirmed, the IRS removes the tax return from processing. This prevents the issuance of many fraudulent tax refunds. As of April 30, 2014, the IRS reported that it identified and confirmed 236,313 fraudulent tax returns and prevented the issuance of nearly $1.2 billion in fraudulent tax refunds as a result of the identity theft filters. Figure 6 shows the number of identity theft tax returns the IRS identified and confirmed as fraudulent in Processing Years 2012 through 2014.

Figure 6: Identity Theft Tax Returns Confirmed As Fraudulent in Processing Years 2012 Through 2014 (as of April 30 of each year)

Processing Year	Number of Identity Theft Returns
2012	591,746
2013	382,398
2014	236,313

Source: IRS fraudulent tax return statistics for Processing Years 2012 through 2014 as of April 30, 2014.

We are currently conducting a review of the IRS's efforts to detect and prevent identity theft. We are also conducting a separate review of the IRS's efforts to assist victims of identity theft. We will issue these reports later this fiscal year.

Screening of prisoner tax returns

As of May 3, 2014, the IRS reports that it identified 63,087 potentially fraudulent tax returns filed with prisoner Social Security Numbers for screening. Figure 7 shows the number of prisoner tax returns identified for screening in Processing Years 2012 through 2014.

Figure 7: Prisoner Tax Returns Identified for Screening in Processing Years 2012 Through 2014 (as of May 3, 2014)

Processing Year	Number of Prisoner Tax Returns Identified for Screening
2012	98,441
2013	69,258
2014	63,087

Source: IRS fraudulent tax return statistics for Processing Years 2012 through 2014 as of May 3, 2014.

We are currently conducting a separate review of the IRS's efforts to improve the detection and prevention of prisoner tax fraud and plan to issue a report later this fiscal year.

Providing Customer Service

Taxpayers have several options to choose from when they need assistance from the IRS, including telephone assistance through the toll-free telephone lines, face-to-face assistance at the Taxpayer Assistance Centers (TAC) and/or Volunteer Program sites, and self-assistance through IRS.gov and social media channels.

Face-to-face assistance at the TACs

Each year, many taxpayers seek assistance from one of the IRS's 388 walk-in offices, called TACs. However, the IRS estimates that the number of taxpayers it will assist at its TACs will decrease this fiscal year. The IRS assisted more than 6.5 million taxpayers in Fiscal Year 2013 and plans to assist 5.6 million taxpayers in Fiscal Year 2014, which is 14 percent fewer than in Fiscal Year 2013. From January 1 through April 30, 2014, the IRS assisted 2,276,462 taxpayers at its TACs.

The IRS indicated that budget cuts and its strategy of not offering services at TACs that can be obtained through other service channels, such as the IRS's website, resulted in the reduction of the number of taxpayers the IRS plans to assist at the TACs. Furthermore, in Fiscal Year 2014, the IRS eliminated or reduced services at TACs. For example, TACs are no longer preparing tax returns. Taxpayers seeking this assistance will be referred to Volunteer Income Tax Assistance sites or other free preparation options for assistance. TAC assistors will only answer basic tax law questions during the filing season and will not answer any tax law questions after April 15, 2014. After April 15, 2014, the IRS will direct all tax law inquiries to alternative services such as IRS.gov, Tele-Tax, commercial software packages, or a tax professional. In addition, TACs will no longer answer taxpayers' tax refund inquiries unless the taxpayer has waited more than 21 days for the refund. Taxpayers with refund inquiries will be referred to the "Where's My Refund?" application on IRS.gov. Finally, the TACs are transitioning to no longer provide transcripts upon request without extenuating circumstances. For the 2014 Filing Season, TACs will still provide transcripts but are encouraging taxpayers to obtain them through the IRS's online application "Get Transcript" on IRS.gov. Figure 8 shows the number of contacts by product line at the TACs for Fiscal Years 2012 through 2014.

Figure 8: Contacts for Fiscal Years 2012 Through 2014 (in millions)

Contacts/Product Lines	Fiscal Year 2012	Fiscal Year 2013	Fiscal Year 2014 Projections
Tax Accounts Contacts	4.3	4.4	3.6
Forms Contacts	0.6	0.5	0.4
Other Contacts[15]	1.7	1.5	1.5
Tax Law Contacts	0.2	0.2	0.1
Tax Returns Prepared[16]	N/A	N/A	N/A
Totals	**6.8**	**6.5**	**5.6**

Source: IRS management information reports. Totals shown are rounded.

We recently issued a separate review of the effectiveness and efficiency of the TAC Program.[17]

Toll-free telephone assistance

As of May 3, 2014, approximately 65 million taxpayers contacted the IRS by calling various Accounts Management toll-free telephone assistance lines seeking help to understand the tax law and meet their tax obligations.[18] The IRS answered more than 30.4 million calls through automated scripts and more than 11 million calls by an IRS assistor. The Average Speed of Answer for an IRS assistor-answered telephone call was 14.4 minutes. Figure 9 shows a comparison of the Accounts Management toll-free telephone statistics through May 3, 2014, for Fiscal Years 2012 through 2014.

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[15] Other Contacts includes but is not limited to: Form 2063, *U.S. Departing Alien Income Tax Statement*, date-stamping tax returns brought in by taxpayers, screening taxpayers for eligibility of service, scheduling appointments, and helping taxpayers with general information such as addresses and directions to other IRS offices or other Federal Government agencies.

[16] In Fiscal Years 2012, 2013, and 2014, Tax Returns Prepared is included in Other Contacts.

[17] TIGTA, Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 2014).

[18] The IRS refers to the suite of 29 Accounts Management function telephone lines to which taxpayers can make calls as "Accounts Management Toll-Free."

Figure 9: Toll-Free Filing Season Telephone Statistics for Fiscal Years 2012 Through 2014 (as of May 3, 2014)

Statistic	Fiscal Year 2012	Fiscal Year 2013	Fiscal Year 2014
Total Calls Received	90,014,692	82,517,568	65,096,176
Total Calls Not Answered[19]	31,636,293	27,049,782	23,430,679
Total Calls Answered	58,011,624	55,375,127	41,509,124
Calls Answered by Assistors	*14,620,233*	*15,609,615*	*11,061,209*
Automated Calls Answered	*43,391,391*	*39,765,512*	*30,447,915*
Calls Unable to be Categorized[20]	366,775	92,659	156,373

Source: IRS Toll-Free Reports as of May 3, 2014.

As of May 3, 2014, the IRS reported a 70.8 percent Level of Service for calls answered by an assistor. However, the IRS Level of Service only measures the percentage of total telephone calls forwarded to an assistor line that are ultimately answered. In addition, the IRS can manage its reported Level of Service by increasing or decreasing the number of calls it allows in to the assistor queue.

Tax preparation assistance at Volunteer Income Tax Assistance Program sites

The Volunteer Income Tax Assistance Program continues to play an important role in the IRS's efforts to improve taxpayer service and facilitate participation in the tax system. It provides no-cost Federal tax return preparation and e-filing to underserved taxpayer segments, including low-income, elderly, persons with disabilities, rural, Native Americans, and limited-English proficient taxpayers. As of May 4, 2014, more than 3.5 million tax returns have been prepared at the 12,319 Volunteer Program sites nationwide. Figure 10 shows the number of tax returns prepared by volunteers for Fiscal Years 2012 through 2014 as of May 4.

[19] Includes calls received during non-business hours. Total calls received during non-business hours totaled 6,553,018 during FY 2012, 5,642,483 during FY 2013, and 4,648,780 as of May 3, 2014.
[20] The IRS phone system recorded the call attempt but was unable determine the final disposition.

Figure 10: Volunteer Program Statistics for Calendar Years 2012 Through 2014

	Calendar Year 2012	Calendar Year 2013	Calendar Year 2014	Percentage Change (Fiscal Year 2013 to Fiscal Year 2014)
Tax Returns[21]	3,167,183	3,296,058	3,533,908	7.2%
Volunteers	98,978	91,820	93,082	1.4%
Sites	13,143[22]	13,081	12,319	-5.8%

Source: IRS management information system containing Fiscal Years 2012 through 2014 information. Percentages are rounded.

Self-assistance through IRS.gov and social media channels

The IRS continues to offer more self-assistance options that taxpayers can access 24 hours a day, seven days a week. For example, the IRS offers IRS2Go, which is a mobile application that lets taxpayers interact with the IRS using their mobile device to access information and a limited number of IRS tools. In addition, the IRS uses various forms of social media including YouTube, Twitter, Tumblr, and Facebook. As of April 30, 2014, the IRS reported approximately 2.75 million new downloads and updates of its IRS2Go mobile application, for a total of 6.2 million since its inception. As of April 30, 2014, there have been more than 1 million new views of IRS YouTube videos and a 12 percent increase in Twitter followers, for a total of 85,882 total followers.

Foremost is the IRS's public Internet site, IRS.gov. The IRS reports 284.8 million visits to IRS.gov through May 3, 2014. One of the most recent online applications added to IRS.gov is the "Get Transcript" option. As of April 30, 2014, the IRS reports over 5.9 million taxpayers used this option. In addition, the IRS reports that more than 169 million taxpayers obtained their refund information online via the "Where's My Refund?" application found on IRS.gov. Our review of the "Where's My Refund?" application confirmed that the application provided taxpayers with accurate information. Figure 11 shows the year-to-date comparisons of various IRS.gov activity levels for the 2011 through 2014 Filing Seasons.

[21] The Calendar Year 2014 tax returns are through May 4, 2014; the Calendar Year 2013 tax returns are through May 5, 2013; and the Calendar Year 2012 returns are through May 6, 2012.
[22] The Tax Returns and Sites totals do not include tax returns prepared using Facilitated Self-Assistance kiosks.

Figure 11: Year-to-Date Comparisons of the IRS.gov Activity Levels for the 2012 Through 2014 Filing Seasons[23]

	2012 Actual	2013 Actual	2014 Actual
IRS.gov Visits	250,654,312	312,001,989	284,825,618
"Where's My Refund?"	113,674,118	176,932,855	169,767,248

Source: IRS 2011 through 2014 Weekly Filing Season reports.

Some self-assistance tools were not timely updated with the most current tax information

Although the IRS is increasing its reliance on self-assistance options to help taxpayers, not all of the self-assistance tools were updated with the most current tax information before the filing season began. For example, in January 2014, the IRS promoted ("tweeted" via Twitter) its self-service interactive tools available on IRS.gov. A review of those tools found that 25 of the 28 tools promoted by the IRS were not updated to reflect Tax Year 2013 information.

The majority of the tools that were not updated are available through the Interactive Tax Assistant. The Interactive Tax Assistant tool is a tax law resource that takes users through a series of questions and provides them with responses to tax law questions. The IRS did provide users of those tools with a disclaimer on the homepage of the Interactive Tax Assistant that read:

> *The tool is currently being updated for tax year 2013. Be aware that using the 2012 tax year will generally provide a correct answer, however changes to income and adjusted gross incomes include thresholds for 2013 [and] may result in an incorrect answer if those thresholds are applicable.*

We informed the IRS of our concerns with the accuracy of the self-assistance tools on January 30, 2014. On February 13, 2014, IRS management responded to our concerns, explaining that the IRS's education and communication process starts in advance of the start of tax return processing and involves raising visibility or awareness about the availability of a general service or product even before the service is available. The "go-live" dates for tools vary but are optimally current before or when the filing season opens. According to the IRS, highly specialized training is required to properly develop and maintain the self-assistance tools. The sequester and the Federal Government shutdown along with newly enacted travel restrictions for specialized training negatively affected the IRS's implementation plan for delivery of these topics. IRS management also informed us that the IRS is in the process of updating the

[23] The 2011 Filing Season is through May 5, 2011; the 2012 Filing Season is through May 5, 2012; the 2013 Filing Season is through May 3, 2013; and the 2014 Filing Season is through May 2, 2014.

self-assistance tools. As of June 25, 2014, we confirmed that the self-assistance tools were updated.

<u>YouTube videos were not updated with the most current tax information</u>

We reviewed the YouTube videos available on the IRS YouTube channels for 18 tax subjects that directly relate to the 2014 Filing Season. When exceptions were noted, we also reviewed the American Sign Language version of the videos. We found that the following videos were outdated and therefore contained inaccurate information:

- *Medical and Dental Expenses* – the video did not include the new 10 percent of AGI restriction for taxpayers under age 65.
- *Gift Taxes* – the video stated that the gift exemption is $13,000, but for Tax Year 2013, the correct amount is $14,000.
- *Do I have to File a Tax Return*? – the video states that single taxpayers who earned a little more than $9,000 need to file, but that figure is now $10,000.

We notified the IRS of our concerns with the YouTube videos on February 6, 2014. On February 12, 2014, IRS management informed us that they are in the process of updating the YouTube videos we identified, and the outdated versions of the videos were removed from IRS.gov. The IRS released a new and accurate *Medical and Dental Expenses* video on February 25, 2014. As of June 23, 2014, the remaining two videos have not been updated.

Figure 12 provides examples of the extensiveness of the tax topics available to taxpayers via IRS's interactive self-help tools and YouTube videos.

Figure 12: Interactive Self-Help Tools and YouTube Videos

Interactive Self-Help Tools	IRS YouTube Videos Reviewed
• Do I Need to File a Tax Return? • Who Can I Claim as a Dependent? • How Much Can I Deduct for Each Exemption I Claim? • What is My Filing Status? • What is the simplest form to use to file my taxes? • How Do I File a Deceased Person's Tax Return? • Can I Claim My Personal and/or Spousal Exemption? • How Much is My Standard Deduction? • Can I Deduct My Charitable Contributions? • Can I Deduct My Mortgage Related Expenses? • Can I Claim My Expenses as Miscellaneous Itemized Deductions on Schedule A (Form 1040)? • Do I Need To Claim My Gambling Winnings and Can I Deduct My Gambling Losses? • Can I Deduct My Medical and Dental Expenses? • Can I Deduct My Moving Expenses? • Can I Claim a Deduction For Student Loan Interest? • Am I Eligible for the Child Tax Credit? • Am I Eligible to Claim an Education Credit? • Do I Qualify for the Credit for the Elderly or Disabled? • Am I Eligible for the Making Work Pay Credit or Government Retiree Credit? • Is My Pension or Annuity Payment Taxable? • Are My Social Security or Railroad Retirement Tier I Benefits Taxable? • Do I Have Cancellation of Debt Income on My Personal Residence? • Is My Residential Rental Income Taxable and/or Are My Expenses Deductible? • Earned Income Tax Credit (EITC) Assistant • Sales Tax Deduction Calculator • Alternative Minimum Tax Assistant • First-Time Homebuyer Credit Account Look-up • Where's My Refund?	• Medical and Dental Expenses • Do I Have To File a Tax Return? • Gift Tax • First-Time Homebuyer Credit Account Look-Up Tool • IRS Withholding Calculator • Selling Your Home • Standard Versus Itemized Deductions • Split Refunds–Savings Bonds • Year-End Tax Tips – 2013 • Charitable Contributions • Earned Income Tax Credit • Education Tax Credits • Education Tax Credits and Deductions • Estimated Tax Payments • Home Office Deduction • Additional Medicare Tax • IRS Free File • Is Social Security Taxable?

Source: www.YouTube.com and www.IRS.gov.

Accounts Management function over-age correspondence inventory continues to grow

The over-age correspondence inventory rose from approximately 181,000 at the end of Processing Year 2010 to almost 1.19 million at the end of Processing Year 2013, representing an increase of 556 percent.[24] As of June 14, 2014, the over-age correspondence inventory totaled 855,860. Correspondence inventory includes but is not limited to amended tax returns, responses to taxpayer notices, identity theft cases, and applications for Individual Taxpayer Identification Numbers and is considered over-aged when it has been in inventory for more than 45 calendar days. Figure 13 provides a comparison of the correspondence inventory for Processing Years 2010 through 2014 as of June 14, 2014.

Figure 13: Comparison of Correspondence Inventory for Processing Years 2010 Through 2014

	2010	2011	2012	2013	2014 (as of June 14, 2014)
Total Inventory	1,292,453	2,013,556	2,401,845	2,580,527	2,364,643
Over-Age Volume	180,938	605,739	592,536	1,187,255	855,860
Percent Over-Aged	14.0%	30.1%	24.7%	46.0%	36.2%

Source: IRS Accounts Management Inventory Report – Inventory Age Reports.

IRS management indicated that the continued increase in the over-age correspondence inventory is the result of reduced Accounts Management function resources. According to IRS management, allocating these limited resources requires difficult decisions to handle the numerous programs throughout the Accounts Management function. IRS management stated that their focus has been to maximize taxpayer assistance on the toll-free telephone lines during filing season while concentrating any remaining resources toward various priority programs such as identity theft and aged work. The IRS anticipates additional resource availability for the remaining inventory types as a result of continued reduction in identity theft inventories and additional benefits derived from the IRS's demand management strategies.

IRS management raised concerns with the inclusion of internal notices in our calculation of the correspondence over-age inventory. The IRS indicated these notices are generated internally to alert the IRS that action is needed on a taxpayer's account and are not the result of a taxpayer contacting the IRS. We do not agree that these notices should be excluded from the IRS's correspondence over-age inventory because they are included in the IRS's correspondence

[24] Numbers have been rounded. The percentage of change is based on the actual inventory volumes as of the end of Processing Years 2010 and 2013. See Figure 13 for actual inventory volumes.

program and tracked by the IRS as part of that program's over-age inventory. Therefore, including these notices is consistent with the IRS's own inventory tracking for the correspondence inventory.

We are planning to conduct a separate review of the IRS's processing of Accounts Management function correspondence during Fiscal Year 2015.

Recommendations

Recommendation 4: The Commissioner, Wage and Investment Division, should ensure that YouTube videos on *Gift Taxes* and *Do I Have to File a Tax Return* are updated with the most current tax information.

> ***Management's Response:*** The IRS agreed with this recommendation and will coordinate with National Office Media Relations and Corporate Television to update both of these YouTube videos.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate whether the IRS timely and accurately processed individual paper and e-filed tax returns during the 2014 Filing Season.[1]

I. Identified the volume of paper and e-filed tax returns received through May 2, 2014, from the IRS Weekly Filing Season reports that provide a year-to-date comparison of scheduled return receipts to actual return receipts. The reports also provide a comparison to Fiscal Year 2013 receipts for the same period.

II. Monitored online news outlets and forums to identify any preparation, filing, or processing issues that taxpayers are experiencing.

III. Determined if the IRS has correctly implemented selected tax legislation that affects the processing of individual taxpayer returns during the 2014 Filing Season.

  A. The indexed alternative minimum tax adjustment.

  B. Estate and gift taxes.

  C. The requirement for vehicle identification numbers to be 17-digits long in order to claim the Plug-in Drive Motor Vehicle Credit.

  D. The new 39.6 percent tax bracket for high-income earners.

  E. The increased capital gains and dividend rate to 20 percent for high-income earners.

  F. The Pease limitation and personal exemption phase-out for high-income earners.

  G. The medical expense deduction increase from 7.5 percent of AGI to 10 percent of AGI for individuals under age 65.

  H. Surtax on net investment income, Form 8960, *Net Investment Income Tax – Individuals, Estates, and Trusts*.

  I. Additional Medicare Tax, Form 8959, *Additional Medicare Tax*.

  J. All legal same-sex marriages will be recognized for Federal tax purposes.

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

IV. Followed up on findings previously reported by TIGTA to ensure that the IRS has taken the agreed-upon action to resolve the issues.

A. Evaluated the IRS's efforts to assess EITC due diligence penalties on paid tax return preparers who did not comply with the Form 8867, *Paid Preparer's Earned Income Credit Checklist*, during Tax Year 2012. In addition, we assessed paid tax return preparers' compliance with the Form 8867 requirements during the 2014 Filing Season.

B. Assessed the IRS's efforts to address individuals' and/or paid tax return preparers' misuse of the split refund option to redirect a portion of a tax refund for the payment of tax return preparer services.

V. Identified online self-help applications provided by the IRS and ensured that the information and results provided are accurate.

A. Determined that the "Where's My Refund" application on www.IRS.gov provided accurate information by tracking a judgmental sample[2] of 20 tax returns, received on February 16, 2014, through processing and comparing what showed on the Integrated Data Retrieval System to the results provided by the application. We used judgmental sampling to select the returns because we did not plan to project our results.

B. Determined if the YouTube videos from the IRS YouTube channels for 18 tax subjects accurately presented information applicable to Tax Year 2013.

C. Determined if 28 Internet applications and calculators offered by the IRS related to the tax items for the 2014 Filing Season accurately reflect information applicable to Tax Year 2013.

VI. Determined if the IRS monitoring systems indicate that individual tax returns are being processed timely and accurately.

A. Attended weekly Wage and Investment Division Filing Season Production Meetings to keep informed on any issues occurring nationwide.

B. Monitored the IRS Submission Processing website, the IRS public website, and other applicable websites to identify significant issues or new tax legislation passed after the filing season begins that may impact processing of Tax Year 2013 individual tax returns.

VII. Compiled statistical information that is of interest to external stakeholders.

A. Quantified fraudulent tax returns and tax returns filed by prisoners.

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[2] A judgmental sample is a nonstatistical sample, the results of which cannot be used to project to the population.

B. Determined whether individuals are using the savings bond option for direct purchase of savings bonds from their refunds.

C. Determined whether individuals have significantly increased their use of the split refund option for depositing their refunds.

VIII. Identified results for the TAC Program.

A. Obtained statistics of taxpayers served at the TACs from the IRS Field Assistance Office.

B. Reviewed the IRS Weekly Filing Season reports, which provide a year-to-date comparison of various TAC activity levels for Fiscal Years 2011 through 2014.

IX. Identified results for the Toll-Free Telephone Assistance Program.

X. Identified results for the Volunteer Income Tax Assistance Program by reviewing weekly reports from the Stakeholder Partnership, Education & Communication organization.

XI. Identified results for IRS self-assistance through IRS.gov from the IRS Weekly Filing Season reports of IRS.gov activity levels for the 2011 through 2014 Filing Seasons.

XII. Identified results for the Accounts Management function correspondence inventory by reviewing Joint Operation Center inventory reports for the Accounts Management function.

Data Reliability

To assess the reliability of computer-processed data residing on the TIGTA Data Center Warehouse, computer programmers in the TIGTA Office of Strategic Data Services validated the data that were extracted, and we verified the data with appropriate documentation. In addition, we selected and reviewed judgmental samples to ensure that the tax return data contained in the applicable TIGTA Data Center Warehouse files were supported by external sources. We found the data to be sufficiently reliable.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the processes for planning, organizing, directing, and controlling program operations for the 2014 Filing Season. We also evaluated the controls that are incorporated directly into computer applications to help ensure the validity, completeness, accuracy, and confidentiality of transactions and data during application processing of tax returns for the 2014 Filing Season.

Appendix II

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Wage and Investment Division SE:W
Director, Business Modernization Office, Wage and Investment Division SE:W:BMO
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division SE:W:CAR
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Chief, Program Evaluation and Improvement, Wage and Investment Division SE:W:S:PEI
Director, Accounts Management, Wage and Investment Division SE:W:CAS:AM
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Director, Joint Operation Center, Wage and Investment Division SE:W:CAS:JOC
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Appendix IV

Glossary of Terms

Adjusted Gross Income	Gross income minus adjustments to income.
Average Speed of Answer	The average number of seconds taxpayers waited in the assistor queue (on hold) before receiving services.
Earned Income Tax Credit	A refundable Federal tax credit for low-income working individuals and families.
Facilitated Self-Assistance	An initiative to provide self-help assistance kiosks at the TACs. The kiosks can be used by taxpayers to access IRS.gov to file their tax returns, print tax forms and publications, or conduct tax research.
Filing Season	The period from January 1 through mid-April when most individual income tax returns are filed.
First-Time Homebuyer Credit	A refundable Federal tax credit for individuals who purchase a home.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Free File	A free Federal tax preparation and e-filing program for eligible taxpayers developed through a partnership between the IRS and the Free File Alliance LLC. The Alliance is a group of private sector tax software companies.
Individual Master File	The IRS database that maintains transactions or records of individual tax accounts.
Individual Return Transaction File	A database the IRS maintains that contains information on the individual returns it receives.
Level of Service	The primary measure of service to taxpayers. It is the relative success rate of taxpayers who call for live assistance on the IRS toll-free telephone lines.
Processing Year	The calendar year in which the return or document is processed by the IRS.

Sequester	About $1 trillion in automatic, arbitrary across the board budget cuts that started to take effect in Fiscal Year 2013.
Submission Processing Site	The data processing arm of the IRS. The sites process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Tax Year	The 12-month period for which tax is calculated. For most individual taxpayers, the tax year is synonymous with the calendar year.
Taxpayer Assistance Centers	Walk-in sites where taxpayers can obtain answers to both account and tax law questions as well as receive assistance in preparing their tax returns.
Volunteer Program	Includes the Volunteer Income Tax Assistance Program, including the Volunteer Income Tax Assistance Grant Program and the Tax Counseling for the Elderly Program. The Volunteer Program provides free tax assistance to persons with low to moderate income (generally $52,000 and below), the elderly, persons with disabilities, rural, Native Americans, and persons with limited-English proficiency.

Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

AUG 26 2014

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Debra Holland Debra S. Holland
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Key Tax Provisions Were Implemented Correctly for the 2014 Filing Season (Audit # 201440014)

We appreciate the opportunity to review the subject draft report and provide comments. We are also appreciative of the Treasury Inspector General for Tax Administration's (TIGTA) recognition that a successful filing season was delivered, despite external challenges that impacted critical programming and testing activities in preparation for the filing season. Although the October 2013 government shutdown caused a setback of almost three weeks in the preparation schedule, we were able to complete all activities and open the filing season within 10 days of the originally planned date.

We also appreciate the TIGTA's acknowledgment of the extensiveness of the tax topics available to taxpayers via the IRS interactive self-help tools and YouTube videos.

In order to effectively meet demand and address the effect of reduced funding, the IRS implemented several initiatives for the 2014 filing season that leveraged automated self-service applications available to taxpayers through IRS.gov. These applications give taxpayers the ability to use online options for needs such as obtaining transcripts, determining the status of their refund, and researching basic tax law questions. These new approaches benefited taxpayers by eliminating the need for them to visit an IRS location to obtain these services, and improved the ability of other taxpayers, with more complex needs, to receive face to face assistance. Our education, communication, and outreach to taxpayers starts in advance of the filing season, and we strive to ensure that the tools and products offered are appropriately updated before taxpayers begin using them during the filing season.

The report addresses suspected misuses of the split refund program by tax return preparers who appear to be directing a portion of the claimed refunds to their own bank accounts for payment of services rendered or other purposes. The IRS has been concerned about this issue and, in recent years has reached out to other stakeholders in the refund process, including the Treasury Bureau of the Fiscal Service, which disburses refunds for the IRS, and the banking industry, to implement controls to stop the inappropriate diversion of refund checks to anyone other than the taxpayer. To supplement these efforts, we intend to prevent the electronic deposit of multiple refunds into the same bank account. Starting January 2015, the number of direct deposits into a single account or prepaid debit card will be limited to three refunds. The fourth and subsequent refunds will be converted to paper and mailed. Taxpayers whose refunds were converted to paper, due to this limit, will receive a notice informing them to expect a refund check. The notice also will provide identity theft information in case the taxpayer did not file the return.

We have reviewed the list of refunds the TIGTA identified that may have been improperly diverted to the accounts of the tax return preparers. It is important to note that the TIGTA did not identify the owners of the bank accounts and the information provided on the tax return does not identify the account owner. Also, the TIGTA's analysis is based on the information that was submitted by the taxpayer, and does not consider subsequent actions taken during processing that reduced the refund amount or otherwise prevented it from being paid to the suspect accounts. We found 45,933 of the 308,986 tax returns identified by the analysis had refunds that were reduced or eliminated due to other taxes owed, or the refund was used to pay other certified debts, such as back child support and delinquent student loans, through the Treasury Offset Program. We also found that some refunds had been returned by the banks because the payee and the account owner were not the same.

We believe the substantial decrease in the number of paid preparers who failed to attach the required Form 8867, *Paid Preparer's Earned Income Credit Checklist*, to client returns, was a result of our extensive preparer outreach and collaboration with software developers. We would like to highlight that the number of preparers filing returns without the Form 8867 attached are lower than the numbers shown in the report for Tax Years 2012 and 2013, since, as noted in footnote 13, the report includes returns with incomplete forms as well. Our records show the following:

- For Tax Year 2012, there were 47,070 return preparers who did not attach Form 8867, compared to the reported 122,133.
- For Tax Year 2013, there were 27,745 return preparers who did not attach the form, compared to the reported 29,623.

The potential preparer penalties associated with the returns for missing Forms 8867 would also differ - $240 million for Tax Year 2011, $67 million for Tax Year 2012, and $33 million for Tax Year 2013, compared to $267 million, $354 million and $38 million, respectively. Further, fewer return preparers prepared *********2****************** returns claiming the Earned Income Tax Credit. The respective number of preparers with *********2********************** returns for Tax Years 2011 through 2013 were 8,656; 1,951; and 813; with the associated returns and potential penalties commensurately less as well. The IRS is focusing its limited resources on penalizing those return preparers filing 10 or more noncompliant returns, and ensuring outreach and education efforts address all preparers.

We have either implemented, or will soon implement, the recommended actions on three of the report's recommendations. Although we do not agree to implement the programming changes to systemically address the erroneous disallowance of nonrefundable credit claims, that disagreement is based solely on the dependency the programming changes have on available funding and Information Technology resources. We have put manual processes in place to address the errors that were made, and we intend to request programming changes for the 2016 filing season. Without reasonable assurance that the programming will be funded and scheduled, we cannot commit to an agreement to implement.

Attached are our comments to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Ivy McChesney, Director, Customer Account Services, Wage and Investment Division, at (404) 338-8910.

Attachment

Attachment

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1
Review the 308,986 tax returns we identified that were prepared by paid tax return preparers on which it appears the Form 8888 was used to inappropriately direct a portion of the tax refund to the tax return preparer.

CORRECTIVE ACTION
We have reviewed the information provided by the Treasury Inspector General for Tax Administration (TIGTA) regarding tax returns where it appears portions of the refunds were inappropriately directed to the tax return preparers. On July 18, 2014, the information was provided to the Small Business/Self-Employed Division to determine appropriate follow-up actions, based on available resources and other priorities.

IMPLEMENTATION DATE
Implemented

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

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 2
Implement computer programming to systemically ensure that taxpayers' claims for nonrefundable credits are allowed to the full extent of their regular tax and alternative minimum tax when applicable.

CORRECTIVE ACTION
We agree with the TIGTA's finding; however, we disagree with the recommended corrective action. Computer programming is subject to the availability of limited funding and resources and its completion cannot be reasonably assured. On April 14, 2014, Servicewide Electronic Research Program Alert 14A0241 was issued to remind employees of the procedures to be followed in ensuring nonrefundable credits are not erroneously denied.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 3
Ensure that EITC due diligence penalties are assessed on all paid tax return preparers who do not provide a completed Form 8867 when filing a tax return claiming the EITC.

CORRECTIVE ACTION
We will continue pursuing assertion of the due diligence penalties under Internal Revenue Code section 6695(g) ******************2*********************************
*******************************2***
*******************2*************************

IMPLEMENTATION DATE
Implemented

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

CORRECTIVE ACTION MONITORING PLAN
N/A

Recommendations

RECOMMENDATION 4
The Commissioner, Wage and Investment Division, should ensure YouTube videos on Gift Taxes and Do I Have to File a Tax Return are updated with the most current tax information.

CORRECTIVE ACTION
We agree with this recommendation and will coordinate with National Office Media Relations and Corporate Television to update both of these YouTube videos.

IMPLEMENTATION DATE
January 15, 2015

RESPONSIBLE OFFICIAL
Director, Communications and Liaison, Wage and Investment Division

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