TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Programs Susceptible to Improper Payments Are Not Adequately Assessed and Reported

May 6, 2022

Report Number: 2022-40-037

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HIGHLIGHTS: Programs Susceptible to Improper Payments Are Not Adequately Assessed and Reported

Final Audit Report issued on May 6, 2022 **Report Number 2022-40-037**

Why TIGTA Did This Audit

This audit was initiated because TIGTA is required to annually assess and report on the IRS's compliance with the reporting requirements contained in the Payment Integrity Information Act of 2019. The objective of this review was to determine whether the IRS complied with the annual improper payment reporting requirements for Fiscal Year (FY) 2021.

Impact on Tax Administration

The Office of Management and Budget (OMB) defines an improper payment as any payment that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient. The IRS currently has identified four programs that meet the OMB's definition of a high-priority program susceptible to improper payments. The OMB defines high-priority programs as programs with improper payments resulting in monetary losses that exceed $100 million annually.

What TIGTA Found

The IRS was generally compliant with the reporting requirements contained in the Payment Integrity Information Act of 2019 for FY 2021. However, TIGTA identified concerns with two IRS programs. TIGTA found that the IRS inaccurately assessed the risk for the U.S. Coronavirus Economic Impact Payment program as not susceptible to improper payments despite reports issued by TIGTA suggesting otherwise. IRS management reassessed and agreed that the program is susceptible to improper payments. In addition, the IRS did not complete a risk assessment for the Sick and Paid Family Leave Credit and the Employee Retention Tax Credit as required. The IRS did not complete the accurate assessment until after our fieldwork had completed. As such, TIGTA was unable to review the IRS's assessment of improper payment risk for FY 2021.

The IRS did not calculate and report the dollar amount and percentage rate of improper payments for the Net Premium Tax Credit for FY 2021. The IRS plans to report this for FY 2022 and cites significant demands placed upon the Department of the Treasury and the IRS in connection with the Coronavirus Disease 2019 crisis as the reason for the delay in reporting.

The IRS started receiving transcripts from the Social Security Administration in a digital manner in July 2019. However, IRS management states that the Social Security Administration does not provide signed statements to the IRS for individuals who admitted to fraudulently reporting self-employment income for purposes of claiming the Earned Income Tax Credit. This information would assist the IRS in developing fraudulent intent and applying a 10-year ban on the individual claiming the credit in the future. Finally, TIGTA found that processes are needed to prioritize transcripts with impending statutes and that the Additional Child Tax Credit should be considered when determining whether potential tax changes meet the IRS's dollar criteria for selecting self-employment transcript cases.

What TIGTA Recommended

TIGTA made three recommendations in this report to improve the use of self-employment transcript information obtained from the Social Security Administration. This included reviewing transcripts more frequently and prioritizing those with short statutes, revising processes for filtering short-statute transcripts to not just look at the tax year but also consider the number of days remaining before statute expiration, and considering the Additional Child Tax Credit when computing the potential tax change and using this amount when selecting workable cases.

The IRS agreed with one of the three recommendations. IRS management revised the case selection criteria and updated the tax calculation to include the disallowance of the Additional Child Tax Credit when computing the potential tax change, when applicable.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

May 6, 2022

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

Michael E. McKenney

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Programs Susceptible to Improper Payments Are Not Adequately Assessed and Reported (Audit # 202240001)

This report presents the results of our review to determine whether the Internal Revenue Service complied with annual improper payment reporting requirements for Fiscal Year 2021. This review is part of our Fiscal Year 2022 Annual Audit Plan and addresses the major management and performance challenge of *Reducing Fraudulent Claims and Improper Payments*.

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

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

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Background

The Office of Management and Budget (OMB) defines an improper payment[1] as any payment that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient. Agency Inspectors General are responsible for evaluating agency information related to improper payments.

On March 2, 2020, the Payment Integrity Information Act of 2019 (PIIA)[2] repealed several improper payment laws but set forth similar improper payment reporting requirements.[3] For example, agencies must conduct a program-specific risk assessment for each program or activity identified by the agency as exceeding $10 million in annual outlays at least once every three years, provide the methodology for identifying and measuring improper payments, and report on actions the agency intends to take to prevent future improper payments. In addition, the following remains in effect:

- Executive Order 13520, *Reducing Improper Payments*, signed by the President on November 20, 2009, increased Federal agencies' accountability for reducing improper payments while continuing to ensure that Federal programs serve and provide access to intended beneficiaries. It requires Federal agencies to provide agency Inspectors General with detailed information on efforts to identify and reduce the number of improper payments in Federal programs with the highest dollar value of improper payments.
- OMB revised Circular A-123 Appendix C, *Requirements for Payment Integrity Improvement,* issued June 2018. Appendix C provides agencies and Inspectors General with guidance on improper payment determinations and reporting. According to the OMB, the goal of the revised Appendix C is to transform the improper payment compliance framework to create a more unified, comprehensive, and less burdensome set of requirements. Every year, each agency Inspector General must review its agency's improper payment reporting in the Agency Financial Report (AFR) and any accompanying material, such as that provided on www.paymentaccuracy.gov, to determine if the agency complies with improper payment legislation and OMB guidance. The OMB revised the Circular again effective Fiscal Year (FY) 2021.
- On December 20, 2019, Congress enacted the *Consolidated Appropriations Act of 2020*.[4] This Act directed the Internal Revenue Service (IRS) to make the elimination of improper payments an utmost priority and to implement, within 270 days, all open and unimplemented recommendations from the Treasury Inspector General for Tax Administration (TIGTA) and the Government Accountability Office that address improper payments or report on impediments to implementation of each open recommendation.

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

[2] Pub. L. No. 116-117, 134 Stat. 113.

[3] *Improper Payments Information Act of 2002; Improper Payments Elimination and Recovery Act of 2010,* Pub. L. No. 111-204, 124 Stat. 2224; *Improper Payments Elimination and Recovery Improvement Act of 2012,* Pub. L. No. 112-248, 126 Stat. 2390; *Fraud Reduction and Data Analytics Act of 2015,* Pub. L. No. 114-186, 130 Stat. 546.

[4] Pub. L. No. 116-93, 133 Stat. 2317.

Process to identify IRS programs for improper payment risk assessment

Each program with annual outlays over $10 million must conduct an improper payment risk assessment at least once every three years. The Department of the Treasury (Treasury Department) identifies the programs that the IRS must assess for the risk of improper payments each fiscal year. For FY 2021, the Treasury Department selected eight program fund groups that required certification by the programs that there were no material changes to the program since the last risk assessment was completed and selected 14 IRS programs that required a risk assessment.[5]

The IRS uses two types of risk assessments:

- <u>Qualitative Risk Assessment</u> – used to assess a program's internal controls that could lead to susceptible improper payments. The OMB requires agencies to conduct risk assessments after the first 12 months of the program and at least once every three fiscal years thereafter. Once the IRS determines that a program is susceptible to improper payments, it must produce a statistically valid estimate of the improper payments the following fiscal year.
- <u>Quantitative Risk Assessment</u> – used to review a sample of disbursements to formulate the overall estimated improper payment rate. Quantitative assessments are required annually for programs that are identified as susceptible to improper payments.

For any program identified as susceptible to significant improper payments, the IRS must also provide the following information for the Treasury Department's annual AFR in the following fiscal year:

- The rate and amount of improper payments.
- The root causes of the improper payments.
- The actions taken to address the root causes.
- The annual improper payment reduction targets.
- A discussion of any limitations to the IRS's ability to reduce improper payments.

The Treasury Department and the IRS continue to request relief from reporting erroneous refundable tax credit claims under the PIIA

As we reported in May 2021,[6] the Treasury Department and the IRS informed the OMB in October 2020 that the tax system is primarily a collection system and not a payment program.[7] The Treasury Department and the IRS acknowledged that refundable tax credits currently fall under the scope of the PIIA but do not believe that the refundable tax credits meet the definition of payments in the traditional sense. Therefore, the Treasury Department believes the credits should be reported only under the Tax Gap framework that comprehensively assesses the tax collection system and no longer be reported under improper payment requirements.

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[5] Appendix II provides the list of the 14 IRS programs identified for improper payment risk assessments for FY 2021 and the type of risk assessment completed for each program.

[6] TIGTA, Report No. 2021-40-036, *Improper Payment Rates for Refundable Tax Credits Remain High* (May 2021).

[7] IRS, *Business Case to Eliminate Redundant Reporting of Refundable Tax Credits* (Oct. 30, 2020).

As we previously reported, in December 2020, officials at the Treasury Department and the IRS met with OMB officials to further discuss the request. On January 2021, the OMB requested additional information, and responses were provided on February 2021. The OMB immediately advised that it would provide a response on next steps once the full OMB leadership team was in place. However, as of February 23, 2022, the IRS stated that it had not received a response from the OMB.

Results of Review

For FY 2021, the IRS calculated and reported the following dollar amount and percentage rate of improper payments for three of its high-priority programs susceptible to improper payments:

- Earned Income Tax Credit (EITC) – The IRS estimates 28 percent ($19.0 billion) of the total EITC payments of $68.3 billion were improper.
- Additional Child Tax Credit (ACTC) – The IRS estimates 13 percent ($5.2 billion) of the total ACTC payments of $39.4 billion were improper.
- American Opportunity Tax Credit (AOTC) – The IRS estimates 26 percent ($1.9 billion) of the total AOTC payments of $7.1 billion were improper.

Assessment of Fiscal Year 2021 Compliance With Improper Payment Reporting Requirements

Our review found that the IRS was generally compliant with the reporting requirements contained in the PIIA for FY 2021. Figure 1 provides a summary of our evaluation of the IRS's compliance with the various improper payment reporting requirements for FY 2021.

Figure 1: Compliance With Improper Payment Requirements for FY 2021

Improper Payment Requirement	Source of Requirement	IRS Compliance
Published payment integrity information with the annual financial statement.	PIIA	✓
Posted the annual financial statement and accompanying materials to agency website.	PIIA/Executive Order	✓
Conducted Improper Payment (IP) risk assessments for each program with annual outlays greater than $10 million at least once in the last three years.[8]	PIIA	✗

[8] The IRS incorrectly completed a qualitative risk assessment for U.S. Coronavirus Refundable Credits for the Recovery Rebate Credit rather than the Sick and Paid Family Leave Credit and the Employee Retention Tax Credit.

Improper Payment Requirement	Source of Requirement	IRS Compliance
Adequately concluded whether programs are likely to make IPs and Unknown Payments (UP)[9] above or below statutory threshold.[10]	PIIA	✗
Published IP and UP estimates for programs susceptible to IPs and UPs in accompanying materials to the annual financial statement.[11]	PIIA	✓
Published corrective action plans for each program for which an estimate above the statutory threshold was published in the accompanying materials to the annual financial statement.	PIIA	✓
Published an IP and UP reduction target for each program for which an estimate above statutory threshold was published in the accompanying materials to the annual financial statement.	PIIA	✓
Demonstrated improvements to payment integrity or reached a tolerable IP and UP rate.	PIIA	✓
Developed a plan to meet the IP and UP reduction target.	PIIA/Executive Order	✓
Reported an IP and UP estimate of less than 10% for each program for which an estimate was published in the accompanying materials to the annual financial statement.	PIIA	✗
Established targets for reducing and recovering improper payments.	Executive Order	✓
Provided the methodology for identifying and measuring improper payments.	Executive Order	✓
Provided plans and supporting analysis for ensuring that the initiatives undertaken do not unduly burden program access and participation by eligible beneficiaries.	Executive Order	✓
Reported all unimplemented recommendations to Congress related to improper payments.[12]	Consolidated Appropriations Act	✓

Source: TIGTA's review of the IRS's compliance with improper payment requirements for FY 2021 for the programs listed in Appendix II.

[9] Unknown payments are payments made by a program for which it is still unknown whether the payment is proper or improper. Payments are reported as unknown so that a program does not unintentionally over- or underreport the payment type results.

[10] We disagreed with the IRS's assessment that the U.S. Coronavirus Economic Impact Payment program is not susceptible to improper payments. However, IRS management subsequently reassessed the program and agreed the program is susceptible to improper payments.

[11] Per OMB guidance, Net Premium Tax Credit (PTC) improper payments were required to be reported beginning in FY 2020. However, the Treasury Department notified the OMB on August 2020 (for FY 2020) and April 2021 (for FY 2021) that it would delay reporting Net PTC information due to significant demands placed upon the Treasury Department and the IRS in connection with the Coronavirus Disease 2019 (COVID-19) crisis. Although the IRS did not report the Net PTC improper payment rate for FY 2021, the OMB guidance issued in June 2021 allows them to prioritize COVID-19 work over financial reporting requirements.

[12] Our review was limited to unimplemented recommendations from reports specific to improper payment reporting and not on all TIGTA reviews with recommendations that may reduce improper payments of refundable credits.

However, the IRS is still not be in compliance with the goal to reduce the overall improper payment rate for the EITC, ACTC, and AOTC to less than 10 percent. As we have previously reported, the OMB advised the IRS that, as an alternative to reducing the improper payment rate to less than 10 percent, a reduction target may remain constant given the complexities of the programs as long as the complexities are clearly explained in a footnote in the AFR, which the IRS did.[13] In addition, the IRS did not report the dollar amount and percentage rate of improper payments for the Net Premium Tax Credit (PTC) for FY 2021. The IRS plans to report this for FY 2022 and cites significant demands placed upon the Treasury Department and the IRS in connection with the Coronavirus Disease 2019 (COVID-19) crisis as the reason for the delay in reporting.

Finally, we disagreed with the IRS's initial improper payment rating of the risk associated with the U.S. Coronavirus Economic Impact Payment (EIP) program as not susceptible to improper payments. IRS management subsequently reassessed the program and agreed the program is susceptible to improper payments. In addition, the IRS did not complete a risk assessment for the Sick and Paid Family Leave Credit or the Employee Retention Tax Credit as required. IRS management noted that they misinterpreted which U.S. Coronavirus Refundable Credit fund account was required by the Treasury Department to have a risk assessment performed for FY 2021. The required risk assessment was completed in FY 2022 after our fieldwork was completed. As such, we were unable to determine the sufficiency of the IRS's assessment of improper payment risk for FY 2021.

The Net Premium Tax Credit Improper Payment Amount and Rate Are Still Not Included in the Treasury Department's Agency Financial Report

Per OMB guidance, Net PTC improper payments were required to be reported beginning in FY 2020. However, the Treasury Department notified the OMB on August 2020 (for FY 2020) and April 2021 (for FY 2021) that it would delay reporting Net PTC information due to significant demands placed upon the Treasury Department and the IRS in connection with the COVID-19 crisis. The IRS states it anticipates reporting in FY 2022. Although the amount and rate were not reported, the IRS's methodology to calculate the Net PTC was completed in May 2020. In addition, the latest IRS estimates of improper payments of Net PTC (for FY 2019) show that 27.4 percent ($540.9 million) of the total Net PTC payments were improper. As such, the improper payment estimate calculated by the IRS associated with Net PTC payments meets the PIIA guidelines for rating as a high-priority program.[14]

Our analysis of Tax Year 2020 tax returns processed as of August 5, 2021, found 3.8 million returns that obtained nearly $29 billion in PTCs that were either received in advance or claimed at the time of filing. A total of $2.2 billion in Advance Premium Tax Credits (APTC) claimed by these filers was in excess of the amount of the PTCs to which they were entitled. However, Section 9662 of the American Rescue Plan Act of 2021 temporarily suspended the requirement

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[13] The AFR describes five barriers to reducing refundable tax credit improper payments. The five barriers are 1) complexity and lack of data to verify statutory eligibility requirements; 2) lack of correctable error authority; 3) high turnover of eligible taxpayers; 4) unscrupulous and incompetent tax return preparers; and 5) fraud.

[14] The OMB defines a high-priority program as programs with improper payments resulting in monetary losses that exceed $100 million annually.

to reconcile advance payments of the PTC on Tax Year 2020 returns. Figure 2 compares PTC statistics for Tax Years 2018 through 2020.

Figure 2: PTC Statistics for Tax Years 2018 Through 2020

	Tax Year 2018 Tax Returns Processed as of May 2, 2019	Tax Year 2019 Tax Returns Processed as of July 30, 2020[15]	Tax Year 2020 Tax Returns Processed as of August 5, 2021[16]
Total Tax Returns With PTC or APTC	4.8 million	4.6 million	3.8 million
Sum of APTC and PTC Claimed at Filing in Excess of the APTC	$37.7 billion	$35.9 billion	$29.0 billion
Total APTC Amount	$36.4 billion	$34.6 billion	$27.3 billion
Total PTC Claimed in Excess of the APTC	$1.3 billion	$1.3 billion	$1.6 billion
Tax Returns With Excess APTC Payments – *(taxpayer receives more APTC payments than the PTC amount to which they are entitled)*			
Total Tax Returns	2.6 million	2.4 million	1.4 million
Total PTC Amount	$13.5 billion	$12.8 billion	$7.2 billion
Total APTC Amount	$18.0 billion	$17.1 billion	$9.4 billion
Total APTC Reported in Excess of the PTC	$4.5 billion	$4.3 billion	$2.2 billion

Source: TIGTA's analysis of Individual Master File. Totals may not add due to rounding.

The Economic Impact Payment Program Was Incorrectly Rated As Not Susceptible to Significant Improper Payments

The IRS completed a qualitative risk assessment for the EIP program in July 2021 and rated the program as not susceptible to significant improper payments. We disagree with the IRS's conclusion based on our own assessment using the same factors and criteria the IRS used. Specifically, the OMB defines high-priority programs as programs with improper payments resulting in monetary losses that exceed $100 million annually.

OMB guidance encourages agencies to review the results of audits by the Inspectors General and take into account whether they impact the risk of improper payments in the program evaluated. In May 2021, we reported that, of the more than 157 million EIPs processed, the IRS had issued more than 4.4 million EIPs totaling nearly $5.5 billion to potentially ineligible individuals as of July 16, 2020.[17] This included payments made to deceased individuals, potentially nonqualified dependents, nonresidents, individuals in U.S. Territories who already received payments from the Territories, and individuals with filing status changes. In fact, the IRS updated its Frequently Asked Questions directing taxpayers to return the erroneous payments it had issued for deceased taxpayers.

[15] Tax Year 2019 returns selected through July 30, 2020, due to the IRS extending the filing season to July 15, 2020.

[16] Tax Year 2020 returns selected through August 5, 2021, due to the IRS extending the filing season to May 17, 2021.

[17] TIGTA, Report No. 2021-46-034, *Implementation of Economic Impact Payments* (May 2021).

Inaccurate risk ratings allow the IRS to avoid the reporting of required information to the Treasury Department for inclusion in the annual AFR. Such information would include the rate and amount of improper payments, the causes of improper payments, the IRS's plans to address them, reduction targets, and limitations to the IRS's ability to reduce improper payments (including legislative limitations).

IRS management subsequently indicated that they agreed two risk factors should be changed and agreed that the EIP program should be rated as susceptible to significant improper payments based upon the qualitative risk assessment criteria. The IRS updated and resubmitted its qualitative risk assessment to the Treasury Department in March 2022.

IRS management also stated that temporary programs, such as the EIP, that provide emergency stimulus relief are not ongoing programs. Management stated that, by the time improper payment estimates, root cause analysis, and correction action plans could be developed for such programs, the programs will have expired. For example, the IRS's methodology for quantifying improper payments uses three years of National Research Program data. Management states that these data for the EIP would not be available until FY 2024.

The Use of Additional Self-Employment Data From the Social Security Administration Could Reduce Improper Payments

In March 2016, we reported that Social Security Administration (SSA) information provided to the IRS relating to misreported self-employment (SE) income was not being effectively used by the IRS to recover fraudulent or erroneously claimed refundable credits.[18] In response to a prior TIGTA recommendation, steps were taken to begin receiving the SE income transcripts[19] from the SSA in a digital manner in July 2019. However, IRS management states that the SSA does not provide signed statements to the IRS for individuals who admitted to fraudulently reporting SE income for purposes of claiming the EITC as the SSA believes sharing this information violates the Privacy Act.[20] This information would assist the IRS in developing fraudulent intent and applying a 10-year ban on the individual claiming the EITC, thus reducing improper payments of the EITC. According to the IRS, it has been working with the SSA since April 2019 to obtain this information in a manner that the SSA believes would be consistent with its interpretation of the relevant laws. Figure 3 provides an overview of our recommendations from March 2016 and the status of these recommendations.

[18] TIGTA, Report No. 2016-40-027, *Social Security Administration Information on Misreported Self-Employment Income Is Not Effectively Used to Recover Fraudulent or Erroneously Claimed Refundable Credits* (Mar. 2016).

[19] Transcripts notify the IRS of the tax year for which the individual stated the SE income was not earned and the amount of income that was deleted from his or her SSA earnings record.

[20] Privacy Act of 1974, 5 U.S.C. § 552a (2018).

Figure 3: Prior Audit Recommendations and Current Status

Recommendation	Response	Current Status
Ensure that all transcripts received from the SSA identifying individuals that overreport SE income and receive the EITC are reviewed as part of the IRS strategy to recover and reduce improper EITC payments.	Agreed	Implemented – The IRS considers all SE transcripts a referral, when there is sufficient time before the statute of limitations expires.[21]
Establish processes to ensure that all SE transcript cases for which the SSA indicates the individual attested to falsely reporting SE income for the purpose of claiming the EITC are screened for the EITC bans. These processes should include obtaining Form SSA-795, *Statement of Claimant or Other Person*, to assist with the application of the bans.	Agreed	Condition still present – The IRS has tried working with the SSA to get Forms SSA-795, but the SSA says it does not have the authority.
Work with the SSA to establish a method to transfer SE transcript information to the IRS in an electronic format.	Agreed	Implemented – The IRS began receiving weekly, electronic transfers in June 2019.
Once SE transcripts are received by the IRS electronically, establish processes to systemically monitor transcripts to ensure that those with impending statute expirations are worked first.	Disagreed	Condition still present – The IRS receives data weekly but only typically delivers cases to be worked twice per year.
Develop measures to effectively evaluate the performance of the SSA SE Income Transcript program, including developing a method to determine the program's return on investment or equivalent measure. These measures should be used to ensure that sufficient resources are allocated to the SSA SE Income Transcript program to maximize the program's outcome.	Agreed	Implemented – The IRS provided TIGTA with FY 2021 performance metrics such as the no-change rate and return on investment.

Source: TIGTA's review of recommendations in TIGTA, Report No. 2016-40-027, Social Security Administration Information on Misreported Self-Employment Income Is Not Effectively Used to Recover Fraudulent or Erroneously Claimed Refundable Credits (Mar. 2016).

More timely review of transcripts could increase the value to identify potential improper payments

The IRS receives SE transcripts weekly from the SSA; however, the transcripts are only reviewed monthly or sometimes quarterly. In addition, transcript cases to be worked by tax examiners are only sent two or three times per year. If the IRS reviewed the transcripts more often and

[21] A statute of limitations is a time period established by law to review, analyze, and resolve taxpayer and IRS tax-related issues.

prioritized more frequent delivery of short-statute transcripts, it could potentially work additional cases and reduce improper payments of the EITC.[22]

According to IRS management, cases are only sent two or three times per year because that is what is established in the Campus Exam Workplan for these cases. The workplan is established before the IRS knows how many transcripts it will receive from the SSA and how many will be workable. Management states that the number of deliveries in a year does not impact its ability to deliver all the cases that meet its criteria. As such, it should not be a problem for management to deliver cases more frequently so that it does not continue to filter out and not work short-statute transcript cases. In addition, management has not provided us with information substantiating why it could not deliver cases more frequently, as it does for other Campus Examination programs.

Recommendation 1: The Commissioner, Small Business/Self-Employed Division, should review transcripts more frequently in an effort to prioritize sending transcripts with short statutes to tax examiners more frequently so that additional transcript cases can be worked.

Management's Response: The IRS disagreed with this recommendation. IRS management stated that this audit report includes an assumption that, the day it receives data from the SSA, the IRS can determine if the case is workable and start the audit process immediately. However, as shared during the audit, there are numerous steps to be completed before an SSA referral can be audited. The IRS is currently working all short-statute cases that meet the filter criteria. As noted in TIGTA's review, the cases identified would likely not have been selected for other reasons. IRS management also stated that their existing process is effective, and changing it, as recommended, would not increase the volume of additional transcripts to be worked. Management believes expending additional resources to review the data more frequently and make additional deliveries would not be an effective use of resources.

Office of Audit Comment: In their response, management does not address our concern that transcripts should be sent for work by tax examiners more frequently than the two or three times a year they are presently sent to tax examiners. In addition, management mischaracterizes information presented in our review. Specifically, in their response, management noted that our review found that cases identified by reviewing transcripts more frequently likely would not have been selected for other reasons. In our report, we acknowledge that there are other exclusion criteria that *may* impact case selection. However, reviewing transcripts more frequently could reduce the number of transcripts categorized as short-statute cases and as such could reduce the number of transcripts that do not meet filter criteria from being removed from workable inventory.

[22] The IRS has other exclusion criteria that it considers after looking at the statute expiration date. As such, cases may subsequently be excluded for other reasons and not worked.

The SSA continues to work with the OMB to make form revisions to provide the IRS with information associated with individuals that fraudulently report self-employment income to claim the EITC

As of January 2022, the IRS states that it has not applied any 10-year bans to taxpayer accounts based upon SE transcripts. According to the IRS, the signed statements of fraud, which are needed to apply the 10-year ban, are still not provided by the SSA. On March 2016, we recommended that the IRS obtain copies of Form SSA-795 or other available SSA information to assist the IRS with applying the EITC ban when individuals attest to falsely reporting SE income for purposes of claiming the EITC.[23] As we reported, when an individual notifies the SSA that they intentionally claimed SE income that was not earned for the purpose of claiming the EITC, the SSA requires the individual to sign a Form SSA-795 affidavit. The signed statements help reduce the burden on determining if fraud occurred, which allows the IRS to apply the 10-year ban on claiming the EITC. IRS management agreed to work with the SSA to obtain this information.

We subsequently reported in February 2020 that the SSA determined that it could not provide Form SSA-795 to the IRS under the Privacy Act Statement in § 205a of the Social Security Act (42 U.S.C. § 405a).[24] However, SSA management agreed to continue to work with the IRS to modify Form SSA-7008, *Request for Correction of Earnings Record*, to include the information the IRS needs to determine whether a 10-year ban should be applied.

During this review, IRS management stated that they continue to coordinate with the SSA on obtaining Forms SSA-7008. IRS management noted that the delay results from the SSA working through revisions to Form SSA-7008 with the OMB. As of February 2022, the SSA provided information to the SSA Office of Inspector General which states that the SSA submitted a form renewal request to the OMB in January 2020 for Form SSA-7008 and has not yet heard back from the OMB. The SSA does not plan to request a revision to the form, to meet the IRS's need, until the OMB approves the renewal request. As such, there is no planned date for the SSA to provide this critical information to the IRS. According to the SSA Office of Inspector General, it is reviewing the SSA's responses about its lack of authority for providing the Form SSA-795 to the IRS for legal sufficiency. Because this is outside of the IRS's control and we have shared our concerns with the SSA Office of Inspector General, we are making no recommendations at this time.

Prioritization of SE transcripts with impending statute expirations is needed

During FY 2021, the IRS received 8,948 SE transcripts[25] from the SSA, and the statute had already expired by the time the IRS received the transcript for 5,620 (63 percent) of those transcripts. For another 1,173 (13 percent) of the transcripts,[26] the statute had not yet expired, but IRS management decided that there was not enough time left to work the case before the statute

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[23] TIGTA, Report No. 2016-40-027, *Social Security Administration Information on Misreported Self-Employment Income Is Not Effectively Used to Recover Fraudulent or Erroneously Claimed Refundable Credits* (Mar. 2016).

[24] TIGTA, Report No. 2020-40-008, *Authorities Provided by the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims* (Feb. 2020).

[25] The IRS received 9,027 records. However, we consider a transcript a unique taxpayer and tax year. Some taxpayers can have multiple SE changes for the same tax year and we counted this as one transcript.

[26] The IRS subsequently informed us that it was still reviewing 84 Tax Year 2018 cases as of October 2020.

expired. We disagree. In fact, our review found that all of these transcripts had more than six months remaining on the statute from the day the transcript was received by the IRS from the SSA. In addition, 830 (71 percent) transcripts had more than nine months remaining, and 557 (47 percent) had more than one year remaining on the statute. The largest number of days remaining on any Tax Year 2018 statute was 529 days.[27]

We previously recommended that the IRS prioritize the transcripts with impending statute expirations. However, IRS management disagreed with our recommendation and stated that the IRS's processes for sorting and prioritizing were sufficient. IRS management stated that the IRS does have procedures in place to consider the same issue on the current audit year when the referral year would be excluded due to a short statute (*i.e.,* if Tax Year 2018 is excluded due to a short statute, Tax Year 2019 will be considered for the same issue).

We continue to find that the IRS processes for prioritizing statute expiration transcripts are insufficient. IRS management states that numerous steps must take place before an audit can be opened, such as converting the transcripts into easily filterable data and collecting additional tax information for filtering purposes. However, we disagree that the time required to complete these tasks is insufficient given the number of days remaining on the statute for the cases we reviewed (*i.e.,* as much as 529 days). Figure 4 shows a summary of SE transcripts that the IRS identified as workable or unworkable for FY 2021.

Figure 4: FY 2021 SE Transcripts

Description	Count	Percentage
Total SE transcripts received from the SSA	8,948[28]	100%
Less: Transcripts with expired statutes (TY 2017 and prior)	5,620	63%
Less: Transcripts with short statutes (TY 2018)	1,173	13%
Less: Transcripts with suspended earnings (TYs 2019 and 2020)[29]	429	5%
Less: Transcripts with net tax change below IRS's dollar criteria	270	3%
Less: Transcripts identified as unworkable for other reasons[30]	1,076	12%
Total Workable SE Transcripts Identified by the IRS	**380**	**4%**

Source: IRS Campus Case Selection function information for SE transcripts received from the SSA for FY 2021.

Recommendation 2: The Commissioner, Small Business/Self-Employed Division, should revise processes for filtering short-statute transcripts to not only look at the tax year but also the

[27] While there may be time left on the statute, this does not mean the case will always be worked due to other IRS filters that are subsequently applied.

[28] Transcript counts are defined as unique taxpayers and tax years reported by the SSA. Several SE income changes for multiple tax years may be reported for the same taxpayer as well as multiple SE changes for the same tax year.

[29] Income transferred by the SSA from an individual's earnings record to the SSA's Earnings Suspense File with the expectation that it can eventually be matched to the person that actually earned the income.

[30] Transcripts already selected for examination, those with an amended return filed, and numerous other reasons.

number of days remaining before statute expiration so that additional transcript cases can be worked.

Management's Response: The IRS disagreed with this recommendation. IRS management stated that calculating the number of days remaining before statute expiration would yield the same number of cases worked because of Fiscal Year 2021 referrals. Management also stated they are currently working all short-statute cases that meet the filter criteria. They believe that their existing filtering process is effective and that changing it, as recommended, would not increase the volume of additional transcripts to be worked.

Office of Audit Comment: Using the tax year alone and not calculating the number of days remaining before statute expiration will continue to result in transcripts being incorrectly removed from workable inventory.

The ACTC should be considered when determining whether potential tax changes meet the IRS's dollar criteria for selecting SE transcript cases

As part of its SE transcript case review process, the IRS evaluates how the SE income reported on the SE transcript would change the amount of any EITC and computes a net tax change, *i.e.,* how much the total amount of taxes owed would change. However, the IRS does not include all refundable credits in its computation of net tax change. Specifically, the IRS does not include the potential changes to the ACTC when computing the net tax change for case selection.

Similar to the EITC, the ACTC also requires earned income. The ACTC is also subject to adjusted gross income limits, and the credit is phased out for higher adjusted gross income amounts. An adjustment to SE income could reduce the amount of ACTC a taxpayer is entitled to receive. Therefore, the IRS is not accurately computing the potential net tax change for case selection and potentially excluding transcripts that may yield a higher net tax change if ACTC amounts were also considered. As shown in Figure 4 above, the IRS excluded 270 SE income transcripts in FY 2021 because the potential net tax change was less than the IRS's established dollar criteria for selecting and working the case. Our review found that 97 (36 percent) of the 270 transcripts that the IRS excluded received the ACTC. The net tax change for the 97 cases could have been increased to meet the IRS's dollar criteria by including potential changes to the amount of the ACTC.

Recommendation 3: The Commissioner, Small Business/Self-Employed Division, should revise case selection criteria to include the ACTC when computing the potential tax change on SE transcript income reported by the SSA.

Management's Response: The IRS agreed with this recommendation and has revised the case selection criteria and updated the tax calculation to include the disallowance of the ACTC when computing the potential tax change, when applicable.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective of this audit was to determine whether the IRS complied with the annual improper payment reporting requirements for FY 2021. To accomplish our objective, we:

- Determined the reporting requirements listed in the PIIA and Executive Order 13520 and evaluated whether the IRS complied with the reporting requirements for FY 2021
- Evaluated the adequacy of the IRS's FY 2021 risk assessments for the IRS revenue program funds identified by the Treasury Department, including completion of required risk assessment questionnaires for new and existing programs.
- Reviewed the IRS's methodology to calculate EITC, ACTC, AOTC, and Net PTC improper payment rates for FY 2021.
- Reviewed the IRS's coordination with the Department of Health and Human Services and Centers for Medicare and Medicaid Services for reporting the Net PTC improper payment rates.
- Followed up on prior audit recommendations regarding the IRS's use of SE income transcripts received from the SSA.

Performance of This Review

This review was performed with information obtained from the Chief Financial Officer and Small Business/Self-Employed Division offices located in Washington, D.C., and Atlanta, Georgia, respectively, during the period October 2021 through March 2022. 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.

Major contributors to the report were Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services); Linna K. Hung, Director; Jeffrey D. Cullum, Audit Manager; Laura R. Christoffersen, Lead Auditor; and Nathan J. Cabello, Auditor.

Validity and Reliability of Data From Computer-Based Systems

During this review, we relied on data received from the IRS's Individual Master File[1] databases for Processing Year 2021 that were available on TIGTA's Data Center Warehouse.[2] We also obtained extracts of FY 2021 transcript data the IRS receives from the SSA. We evaluated the data by performing electronic testing of required data elements and reviewing existing

[1] The IRS database that maintains transactions or records of individual tax accounts.

[2] A TIGTA repository of IRS data.

information about the data and the systems that produced them. 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: the controls in place to ensure that the IRS met the annual improper payment reporting requirements established in the PIIA and Executive Order 13520. We tested these controls by reviewing and analyzing relevant documents and holding discussions with IRS management and the Treasury Department's Risk and Control Group.

Appendix II

Programs Identified for Improper Payment Risk Assessments for Fiscal Year 2021

The following IRS programs were identified by the Treasury Department for improper payment risk assessments for FY 2021.

IRS Program	Type of Assessment	Total Non-Federal Disbursements
Headquarters Disbursement Earned Income Credit	Quantitative	$57.6 billion
Additional Child Tax Credit	Quantitative	$27.8 billion
American Opportunity Credit	Quantitative	$2.8 billion
Premium Tax Credit[1]	Quantitative	$60.0 billion
Refund – Corporations	Qualitative	$16.1 billion
Informant Reimbursement	Qualitative	$62.8 million
Taxpayer Services	Qualitative	$2.0 billion
Tax Law Enforcement	Qualitative	$3.6 billion
Operations Support	Qualitative	$3.0 billion
Business Systems Modernization	Qualitative	$271.3 million
US Coronavirus Payments	Qualitative	$274.7 billion
US Coronavirus Refundable Credits	Qualitative	$713.8 million
Private Collection Agent Program	Qualitative	$60.2 million
Special Compliance Personnel Program Account	Qualitative	$18.3 million

Source: IRS Office of the Chief Financial Office.

[1] A risk assessment was required; however, the IRS requested an exemption for reporting an estimate for the PTC for FY 2021, as implementing COVID-19 programs was determined to be a priority.

Appendix III

Prior Improper Payment Reports by the Treasury Inspector General for Tax Administration

Issuance Date	Report Number	Report Title
May 2021	2021-40-036	Improper Payment Rates for Refundable Tax Credits Remain High
April 2020	2020-40-025	Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments
May2019	2019-40-039	Some Refundable Credits Are Still Not Classified and Reported Correctly As a High Risk for Improper Payment by the Internal Revenue Service
April 2018	2018-40-032	The Internal Revenue Service Is Not in Compliance With Improper Payment Requirements
April 2017	2017-40-030	Revised Refundable Credit Risk Assessments Still Do Not Provide an Accurate Measure of the Risk of Improper Payments
April 2016	2016-40-036	Without Expanded Error Correction Authority, Billions of Dollars in Identified Potentially Erroneous Earned Income Credit Claims Will Continue to Go Unaddressed Each Year
April 2015	2015-40-044	Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014
March 2014	2014-40-027	The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act
February 2013	2013-40-024	The Internal Revenue Service Was Not in Compliance With All Requirements of the Improper Payments Elimination and Recovery Act for Fiscal Year 2012

Source: www.treasury.gov/tigta/oa_auditreport.

Appendix IV

Management's Response to the Draft Report

CHIEF FINANCIAL OFFICER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

April 21, 2022

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Bryan L. Musselman
Deputy Chief Financial Officer

Digitally signed by 0B7CB
Date: 2022.04.21
08:59:34 -04'00'

SUBJECT: Response to Draft Audit Report – Programs Susceptible to Improper Payments Are Not Adequately Assessed and Reported (Audit #202240001)

Thank you for the opportunity to review and comment on your draft audit report entitled *Programs Susceptible to Improper Payments Are Not Adequately Assessed and Reported.* The programs examined in this report are refundable tax credits (RTC) designed to achieve specific economic and social objectives, such as coronavirus pandemic relief, reducing poverty and increasing the affordability of higher education. Even before RTCs were key to the Federal government's response to the national emergency caused by the global worldwide pandemic, programs with RTC presented challenges of administering complex social benefit programs through the tax administration system. These, and other social programs, have been expanded and will continue to require education, oversight, and compliance activities going forward to ensure taxpayers receive the correct benefits.

The IRS believes the tax system is primarily a collection system and not a payment program and RTCs do not meet the definition of payments in the traditional sense. Treating RTCs as payments ignores the interrelated nature of other components of the tax system and provides no additional information that would help the IRS address erroneous RTC claims. Continuing to report RTCs as payments could lead to inefficient and skewed application of limited enforcement resources when the IRS' tax gap program better equips the IRS to analyze and address noncompliance throughout the federal tax system.

As mentioned in the report, starting July of 2019, the Self Employment income transcripts are now received by the IRS digitally. This improvement allows for standardized classification and case selection and is a vast improvement over the paper process. That said, reviewing these referrals more frequently and/or prioritizing by days remaining on the statute will not provide additional workable inventory. As noted in your review, the cases identified would likely have not been selected for other reasons. Reviewing the data more frequently would be an inefficient use of resources given there would not be a significant increase in workable cases.

The IRS agrees with one of three recommendations, and our response to each is attached. We appreciate your office's evaluation of these programs and the IRS' continuing efforts to reduce and eliminate erroneous claims within the structure of the tax administration system. Additional technical comments have been forwarded separately. If you have any questions, please contact me at 202-317-6453, or a member of your staff may contact Charles Messing, Associate Chief Financial Officer for Internal Controls, at 202-803-9762.

Attachment

Attachment

Programs Susceptible to Improper Payments Are Not Adequately Assessed and Reported (TIGTA Audit #202240001)

Corrective Actions for Draft Audit Report

RECOMMENDATION 1
The Commissioner, Small Business/Self Employed Division, should review transcripts more frequently to prioritize sending transcripts with short statutes to tax examiners more frequently so that additional transcript cases can be worked.

CORRECTIVE ACTION:
Disagree. The audit report includes an assumption that the day we receive the data from Social Security Administration (SSA) we can determine if the case is workable and start the audit process immediately. However, as shared during the audit, there are numerous steps to be completed before an SSA referral can be audited. We are currently working all short statute cases that meet the filter criteria. As noted in TIGTA's review, the cases identified would likely not have been selected for other reasons. Our existing process is effective and changing it, as recommended, would not increase the volume of additional transcripts to be worked. Expending additional resources to review the data more frequently and make additional deliveries would not be an effective use of resources.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 2
The Commissioner, Small Business/Self Employed Division, should revise processes for filtering short-statute transcripts to not only look at the tax year, but also the number of days remaining before statute expiration so that additional transcript cases can be worked.

CORRECTIVE ACTION
Disagree. Calculating the number of days remaining before statute expiration, as TIGTA demonstrated, would yield the same number of cases worked because of fiscal year 2021 referrals. We are currently working all short statute cases that meet the filter criteria. Our existing process is effective and changing it, as recommended, would not increase the volume of additional transcripts to be worked.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

2

RECOMMENDATION 3
The Commissioner, Small Business/Self Employed Division, should revise case selection criteria to include the ACTC (Additional Child Tax Credit) when computing the potential tax change on SE (Self Employment) transcript income reported by the Social Security Administration (SSA).

CORRECTIVE ACTION
We have revised the case selection criteria and updated the tax calculation to include the disallowance of ACTC when computing the potential tax change, when applicable.

IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director Exam Case Selection, SB/SE

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

Appendix V

Glossary of Terms

Term	Definition
Additional Child Tax Credit (ACTC)	A credit for individuals who receive less than the full amount of the nonrefundable Child Tax Credit. The ACTC may result in a refund even if no tax is owed.
Advanced Premium Tax Credit (APTC)	A tax credit that is paid in advance to a taxpayer's insurance company to help cover the cost of premiums.
Agency Financial Report (AFR)	Presents the Treasury Department's financial and performance information for the fiscal year, with comparative prior year data where appropriate.
American Opportunity Tax Credit (AOTC)	A credit for qualified education expenses paid for an eligible student for the first four years of higher education. A partially refundable Federal tax credit used to help parents and college students offset the costs of college.
Data Center Warehouse	A TIGTA repository of IRS data.
Earned Income Tax Credit (EITC)	A tax credit used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment.
Excess Advanced Premium Tax Credit	When the APTC is more than the allowed PTC (APTC minus PTC = Excess APTC). This is treated as a tax liability.
Filing Season	The period from January through mid-April when most individual income tax returns are filed.
Fiscal Year (FY)	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.
High-Priority Program	Program identified as susceptible to significant improper payments.
Improper Payment	Any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements (including both overpayments and underpayments).
Improper Payment Rate	Amount in improper payments divided by the amount in program outlays.
Individual Master File	The IRS database that maintains transactions or records of individual tax accounts.
Net Premium Tax Credit	When the PTC exceeds the APTC (PTC minus APTC = Net PTC). Net PTC reduces a taxpayer's tax liability and, if it is more than the tax liability, results in a refundable tax credit.
Outlay	A payment to liquidate an obligation generally equal to cash disbursements (the measure of Government spending).

Term	Definition
Overpayment	A payment in excess of what is due. When an overpayment occurs, the improper amount is the difference between the amount due and the amount that was actually paid. Overpayments are monetary loss IPs.
Payment	Any disbursement or transfer of Federal funds to any non-Federal person, non-Federal entity, or Federal employee that is made by a Federal agency, contractor, grantee, or a governmental or other organization administering a Federal program or activity.
Premium Tax Credit (PTC)	Refundable tax credit that helps eligible individuals and families cover the premiums for their health insurance purchased through the Health Insurance Marketplace.
Processing Year	The calendar year in which the tax return or document is processed by the IRS.
Program	Activities or sets of activities recognized as programs by the public, OMB, or Congress as well as those that entail program management or policy direction.
Qualitative Risk Assessment	A technique used to quantify risk associated with IPs and UPs. For example, a qualitative IP risk assessment methodology prioritizes the identified IP and UP risks using a predefined rating scale. Risks will be scored based on their probability or likelihood of occurring and the impact on IPs and UPs in the program should they occur.
Quantitative Risk Assessment	A review of a sample of disbursements to formulate the overall estimated improper payment rate for the program.
Significant Improper Payment	Annual IPs and UPs (*i.e.*, the sum of monetary loss IPs, non–monetary loss IPs, and UPs) in the program exceeding (1) both 1.5 percent of program outlays and $10,000,000 of all program or activity payments made during the fiscal year reported or (2) $100,000,000 (regardless of the IP percentage of total program outlays).
Tax Gap	The Tax Gap is the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.
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.
Underpayment	A payment that is less than what is due. When an underpayment occurs, the improper amount is the difference between the amount due and the amount that was actually paid. An underpayment is a non–monetary loss IP.

Appendix VI

Abbreviations

ACTC	Additional Child Tax Credit
AFR	Agency Financial Report
AOTC	American Opportunity Tax Credit
APTC	Advanced Premium Tax Credit
COVID-19	Coronavirus Disease 2019
EIP	Economic Impact Payment
EITC	Earned Income Tax Credit
FY	Fiscal Year
IP	Improper Payment
IRS	Internal Revenue Service
OMB	Office of Management and Budget
PIIA	Payment Integrity Information Act
PTC	Premium Tax Credit
SE	Self-Employment
SSA	Social Security Administration
TIGTA	Treasury Inspector General for Tax Administration
UP	Unknown Payment

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Treasury Inspector General for Tax Administration

P.O. Box 589

Ben Franklin Station

Washington, D.C. 20044-0589

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