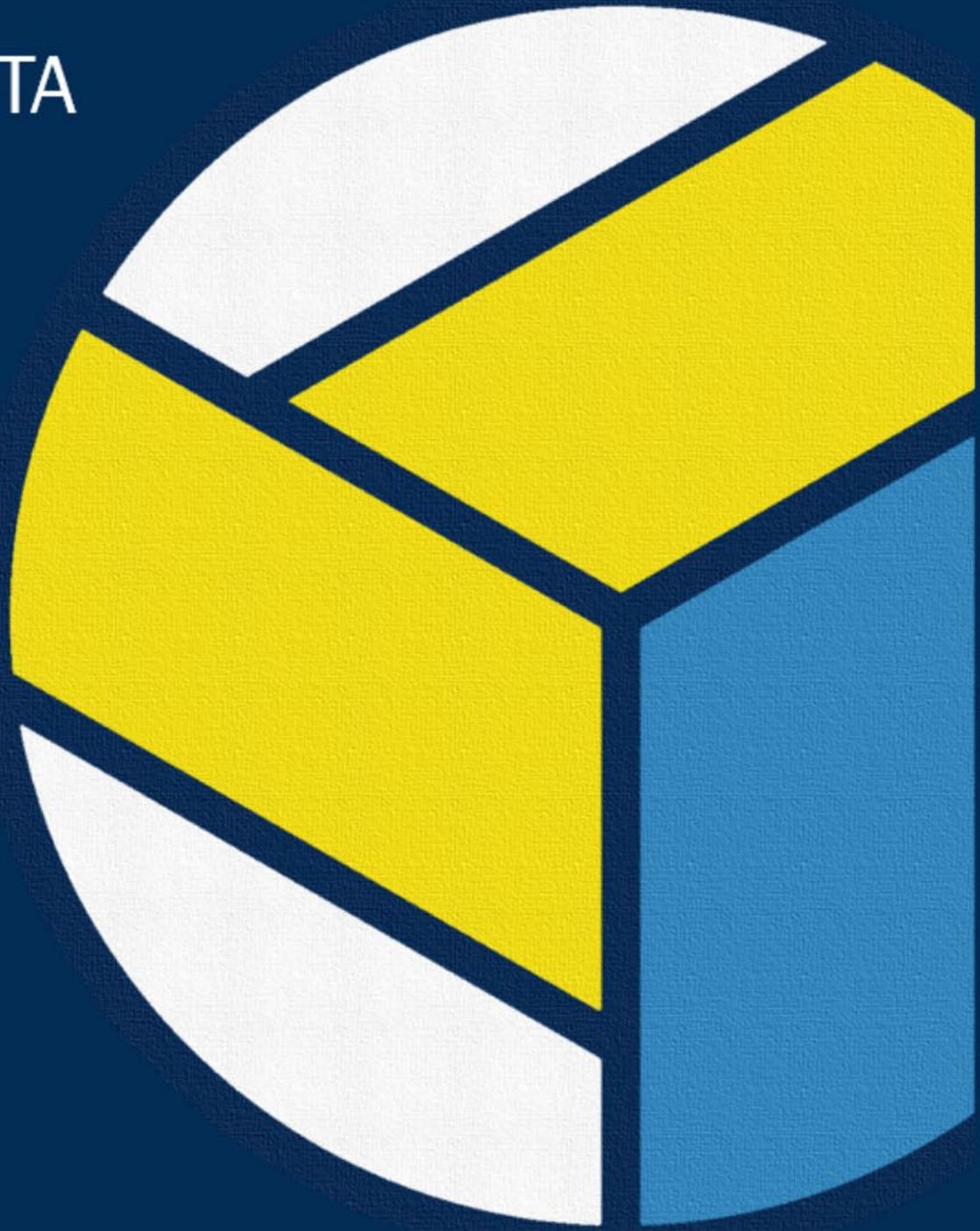




TIGTA



Major Management and Performance Challenges Facing the IRS

Fiscal Year 2023 | October 13, 2022

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

October 13, 2022

MEMORANDUM FOR SECRETARY YELLEN

FROM: J. Russell George 
Inspector General

SUBJECT: Management and Performance Challenges Facing the
Internal Revenue Service for Fiscal Year 2023

The Reports Consolidation Act of 2000¹ requires that the Treasury Inspector General for Tax Administration (TIGTA) summarize, for inclusion in the annual *Department of the Treasury Agency Financial Report*, its perspective on the most serious management and performance challenges confronting the Internal Revenue Service (IRS).

Each year, TIGTA evaluates IRS programs, operations, and management functions to identify the most vulnerable areas in the Nation's tax system. For Fiscal Year (FY) 2023, the passage of the Inflation Reduction Act of 2022² (IRA) will provide the IRS with approximately \$79 billion in funding that will remain available through the end of FY 2031. This funding supplements the IRS's annual appropriations. In addition, the IRA contains numerous tax provisions. It will be a significant challenge for the IRS to administer these provisions and effectively use the additional funding to address the challenges of improving taxpayer service, modernizing outdated technological infrastructure, and increasing equity in the tax system through added enforcement actions.

As in years past, the IRS must balance its tax compliance activities against the rights of taxpayers to receive fair and equitable treatment. Protecting taxpayer rights, such as the right to be informed, the right to quality service, the right to challenge the IRS's position and be heard, and the right to privacy and confidentiality, are interconnected with the management and performance challenges outlined in this memorandum. In addition, as required by the IRS Restructuring and Reform Act of 1998,³ TIGTA performs audits of certain taxpayer rights

¹ 31 U.S.C. § 3516(d) (2006).

² Pub. L. No. 117-169.

³ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of Titles 2, 5, 16, 19, 22, 23, 26, 31, 38, and 49 U.S.C.).

provisions and reports whether the IRS complied with those provisions. However, we are mindful of the IRS's need to protect the rights of taxpayers in all of our oversight work.

For FY 2023, we have identified the IRS's top management and performance challenges as:

- Improving Taxpayer Service;
- Protecting Taxpayer Data and IRS Resources;
- Modernizing IRS Operations;
- Administering Tax Law Changes;
- Increasing Domestic and International Tax Compliance and Enforcement; and
- Reducing Tax Fraud and Improper Payments.

Although not listed separately, human capital is also a significant concern and it affects the IRS's ability to address the above challenges. It remains a serious, underlying issue with wide-ranging implications for both the IRS and taxpayers. At a time when the IRS is taking on new challenges, such as implementation of the IRA, the recruitment of new employees and retention of existing employees are critical to ensuring the maintenance of a quality workforce capable of meeting the needs of the American public.

The following information detailing the management and performance challenges is provided to promote the economy, efficiency, and effectiveness of the IRS's administration of the Nation's tax laws.

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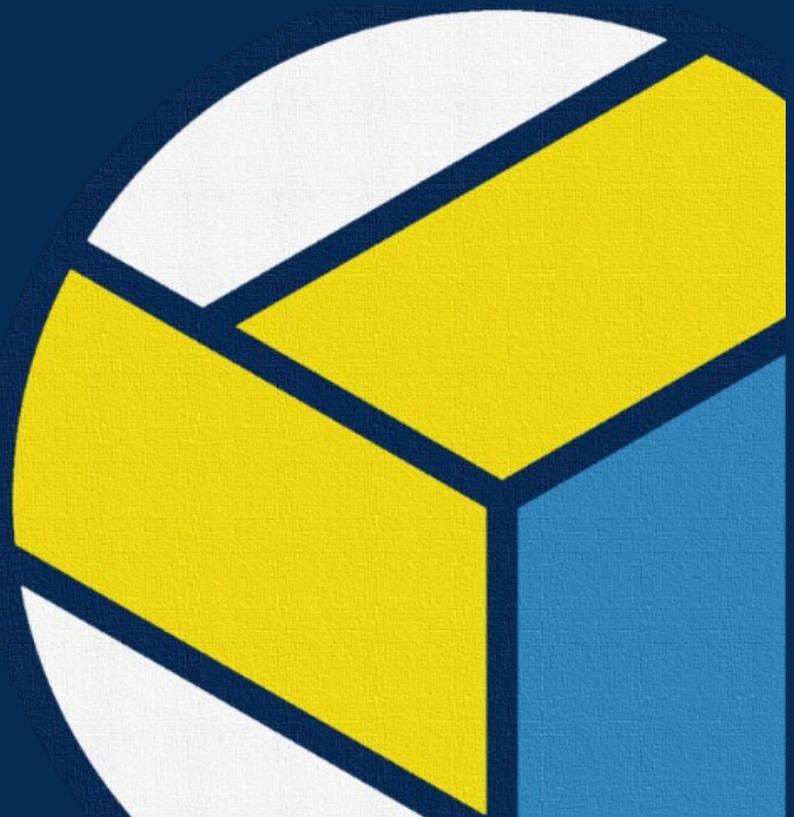
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As the IRS prepares for the 2023 Filing Season, it continues to struggle with eliminating the backlog of unprocessed tax returns and other types of tax account work from prior filing seasons. The pandemic, pandemic-related tax law changes, and significant staffing shortages hampered the IRS's efforts to address the backlog inventories, resulting in millions of tax returns not being timely processed, refunds not being timely issued, the Federal Government paying interest on delayed refunds, and taxpayers not timely receiving assistance with their tax account issues. As of August 12, 2022, the IRS had more than 14 million individual and business paper returns waiting to be processed.

Figure 1: Status of Paper Returns Waiting to Be Processed as of August 12, 2022

Category	Returns			
	Individual	Business	Unspecified	Total
Received in Calendar Year 2021	0	135,240	0	135,240
Received in Calendar Year 2022	7,560,022	6,531,163	259,754	14,350,939
Totals	7,560,022	6,666,403	259,754	14,486,179

Source: IRS Submission Processing Weekly Inventory Report, as of August 12, 2022.

The IRS Accounts Management function, which is responsible for assisting individual and business taxpayers with tax law and tax account inquiries, including making adjustments to taxpayer accounts, is also dealing with correspondence backlogs. The IRS requires taxpayers to use written correspondence as the primary method when responding to an IRS notice or letter; however, TIGTA reported that the IRS has not taken any significant actions to address the continued lack of quality customer service it offers taxpayers corresponding with the IRS.⁴

In addition to the processing delays, during the 2022 Filing Season, the IRS saw the number of calls answered and Level of Service (*i.e.*, how many of those who call are able to speak to a Customer Service Representative) for its toll-free telephone lines decline, and wait times increase. Figure 2 shows a comparison for Calendar Years 2021 and 2022.

⁴ TIGTA, Report No. 2022-46-027, *Program and Organizational Changes Are Needed to Address the Continued Inadequate Tax Account Assistance Provided to Taxpayers* (Mar. 2022).

Figure 2: Toll-Free Performance Statistics for Calendar Years 2021 and 2022

Performance Statistics	Calendar Year	
	2021	2022
Assistor Calls Answered	15,400,000	7,783,000
Level of Service	16.4%	14.1%
Average Speed of Answer (Minutes)	20	30
Level of Access ⁵	23.8%	28.0%

Source: IRS management information reports (as of August 14, 2021, for Calendar Year 2021 and as of August 13, 2022, for Calendar Year 2022).

Significant staffing shortages have hampered the IRS's efforts to address the backlog inventories and provide the level of customer service expected by taxpayers. Demand for IRS toll-free telephone assistance has increased each year since November 2018, which directly correlates with the increase in tax law changes in recent years, including the tax law changes related to the pandemic. However, TIGTA reported that many Accounts Management employees split their time between working Accounts Management cases and answering IRS toll-free telephone calls.⁶

To address the backlogs and staffing shortages, the IRS announced its *Get Healthy Plan* on March 10, 2022. The *Get Healthy Plan* is an effort to return the IRS to pre-pandemic inventory levels by the end of Calendar Year 2022. As shown in Figure 1, as of August 12, 2022, the IRS had processed all of the individual paper tax returns received in 2021. While this is a step in the right direction, the IRS still has a significant backlog of returns received during the 2022 Filing Season that needs to be worked. Additionally, as the IRS develops and deploys more automated tools for taxpayers, it will need to ensure that the tools are operating as intended and improving the quality of its customer service.

In the IRS's *Strategic Plan FY 2022-2026*,⁷ providing quality and accessible services to enhance the taxpayer experience is the IRS's top strategic goal. The IRS notes in its plan that it will continue to be challenged to meet this goal due to insufficient funding, a shrinking workforce, hiring difficulties, and reliance on paper processes. The passage of the IRA will provide the IRS with an additional \$3.2 billion through FY 2031 to improve customer service, representing a 9 percent increase over current budget projections.⁸

⁵ A TIGTA calculated telephone measure determined by taking the sum of all assistor and automated calls answered divided by the total number of call attempts made while the various toll-free help lines are open. The hours each toll-free help line are open vary by line.

⁶ TIGTA, Report No. 2022-46-027, *Program and Organizational Changes Are Needed to Address the Continued Inadequate Tax Account Assistance Provided to Taxpayers* (Mar. 2022).

⁷ *Strategic Plan FY 2022-2026*, IRS Pub. 3744 (Rev. 7-2022).

⁸ Congressional Research Service, *IRS-Related Funding in the Inflation Reduction Act* (Updated August 9, 2022).



The trillions of dollars that flow through the IRS each year make it an attractive target for criminals who want to exploit the tax system for personal gain. The proliferation of stolen Personally Identifiable Information poses a significant threat to tax administration by making it difficult for the IRS to distinguish legitimate taxpayers from fraudsters. Tax-related scams, and the methods used to perpetrate them, are continually changing and require constant monitoring by the IRS. The IRS's ability to continuously monitor and improve its approach to taxpayer authentication is a critical step in defending the agency against evolving cyber threats and fraud schemes and in protecting trillions of taxpayer dollars. According to the Commissioner of Internal Revenue, the IRS was experiencing just over 1 million cyberattacks per day in 2017. Currently, the IRS sustains more than 1.5 billion attacks each year.⁹

Security controls provide a range of safeguards and countermeasures for organizations and information systems to protect information during processing, while in storage, and during transmission. However, TIGTA reported that the IRS's mainframe computer platforms did not satisfy the minimum mainframe security requirements in several key areas, which can have serious adverse effects on tax administration and the protection of taxpayer data.¹⁰ The failure to timely remediate high-risk and medium-risk security vulnerabilities could compromise the security posture of the mainframe platform and could lead to unauthorized accesses, increased vulnerability to attacks, and unauthorized data sharing, all of which compromise the integrity, confidentiality, and availability of the platform.

In addition, the failure to resolve or track existing computer vulnerabilities compromises the security posture of an organization, potentially exposing taxpayer data and information to unnecessary risks. Vulnerability scanners are commonly used in organizations to identify known vulnerabilities on hosts and networks and on commonly used operating systems and applications. Scanning tools can proactively identify vulnerabilities, provide a fast and easy way to measure exposure, identify out-of-date software versions, validate compliance with an organizational security policy, and generate alerts and reports about identified vulnerabilities. In December 2021, TIGTA reported that the IRS does not effectively oversee vulnerability remediation across the enterprise.¹¹ For example, the IRS did not verify or monitor the remediation efforts for all vulnerabilities or consistently track and report vulnerability remediation metrics.

⁹ Testimony of Charles P. Rettig, Commissioner of Internal Revenue, *On the Filing Season and the IRS Budget*, House Appropriations Committee, Subcommittee on Financial Services and General Government (May 18, 2022).

¹⁰ TIGTA, Report No. 2022-20-050, *Mainframe Platform Configuration Compliance Controls Need Improvement* (Sept. 2022).

¹¹ TIGTA, Report No. 2022-20-006, *Vulnerability Scanning and Remediation Processes Need Improvement* (Dec. 2021).

The protection of taxpayer data will continue to be a top priority for the IRS as it tries to leverage technology to be responsive to taxpayers' needs for its services, while minimizing the risks from cyberattacks and insider threats. For the 2022 Filing Season, the IRS initially required taxpayers to use a third-party service, ID.me, to help authenticate individuals creating online accounts by using facial recognition to verify their identity. The IRS adopted the technology as a way to enhance the security of taxpayer information. However, in response to privacy concerns related to taxpayers providing biometric data to a private company, the IRS announced in February 2022 that taxpayers could sign up for IRS online accounts with ID.me without the use of any biometric data. In addition, the IRS stated that it would shift from ID.me to the General Services Administration's Login.gov identity authentication service after the current tax filing season.

IRS systems are often prime targets that are exploited both internally and externally in an effort to steal taxpayer data. Individuals constantly attempt to corrupt or impede tax administration through the manipulation and the unauthorized access of IRS systems. The IRS continually works with application developers and third-party contractors who assist in the taxpayer identity verification process known as the Secure Access Digital Identity initiative. This program is an effort to be compliant with new Federal mandates and regulations governing the protection of Personally Identifiable Information.

In addition to safeguarding taxpayer data, the IRS also faces the daunting task of protecting its employees and facilities. Recent incidents involving taxpayers who threatened or assaulted IRS employees underscore the dangers that these employees face. As reported by the IRS, threat-related reports have rapidly increased. TIGTA attributes this to the increased presence of IRS personnel returning to the office, as well as recent legislation that directly impacts the IRS. After passage of the IRA, threats directed at the IRS and its employees increased. As a result, the Commissioner of Internal Revenue announced efforts to perform a comprehensive review of existing IRS safety and security measures. Threats and assaults directed at IRS employees, facilities, and infrastructure impede the effective and safe administration of the Federal tax system and the IRS's ability to collect tax revenue.

Funding provided to the IRS by the IRA is expected to significantly increase IRS staffing levels over the course of the next 10 years. As a result, the IRS should anticipate the potential for increased employee misconduct allegations. The IRA also includes funding for the IRS to study the cost and feasibility of creating a free direct e-file program, which would expand the overall scope and control of the current IRS Free File Program. The implementation of such a system will create additional avenues for malicious actors looking to exploit the IRS network and its online portals.



Successful modernization of systems and the development and implementation of new information technology applications are critical to meeting the IRS's evolving business needs and enhancing services provided to taxpayers. The IRS uses different legacy case management systems that vary widely in complexity, size, and customization to support tax administration. Modernization is necessary to deliver efficient taxpayer services and enforcement with enhanced user experiences. Modernizing the IRS's computer systems has been a persistent challenge for many years and will likely remain a challenge for the foreseeable future.¹²

According to the Commissioner of Internal Revenue, delays in updating the IRS's information technology system have resulted in the IRS's continued use of certain paper-based processes.¹³ These paper processes can result in significant delays, contributing to IRS backlogs and limiting taxpayers' ability to know the status of their cases. The Commissioner testified that this will continue to present challenges because the IRS has not sustained sufficient multi-year investment for information technology modernization. As part of the IRA, the IRS will receive an additional \$4.7 billion for modernization efforts through FY 2031, representing a 153 percent increase over current budget projections.

One of the most complex modernization programs in the Federal Government is the IRS's Customer Account Data Engine 2 (CADE 2) Program, which involves major changes to core IRS tax processing systems. One of the goals of CADE 2 is to reengineer core components of the Individual Master File. The IRS currently has a project that is converting lines of legacy code to a modern software language. The code conversion is a major milestone towards retiring the Individual Master File. TIGTA reported that the IRS has taken steps to improve the process for estimating the development time required to convert the lines of code and that the IRS's methodology is consistent with industry best practices.¹⁴ However, due to completing an extensive analysis to account for the project's complexity and capturing all required work, the IRS determined in September 2019 that the development end date for the project should be moved from August 2021 to September 2022. In August 2020, the IRS extended the development end date again from September 2022 to April 2023.

TIGTA reported that more effective program management would help the IRS coordinate information technology investments in a cost-effective and efficient manner. Specifically, the Next Generation Infrastructure program is part of the *IRS Integrated Modernization Business Plan* that emphasizes modernizing core tax administration systems, operations, and

¹² TIGTA, Report No. 2022-20-005, *Annual Assessment of the IRS's Information Technology Program for Fiscal Year 2021* (Dec. 2021).

¹³ Written testimony of Charles P. Rettig, Commissioner of Internal Revenue, *On the Filing Season and IRS Operations*, House Oversight and Reform Committee, Subcommittee on Government Operations (April 21, 2022).

¹⁴ TIGTA, Report No. 2022-25-029, *The Individual Tax Processing Engine Project's Estimation Methodology Aligns with Best Practices and the Project Addressed the Independent Verification and Validation Recommendations* (Mar. 2022).

cybersecurity to improve the taxpayer experience. The Plan is a road map for achieving necessary modernization of systems and taxpayer services in two three-year phases that are comprised of a series of discrete projects and programs. Although TIGTA determined the IRS implemented several capabilities of the Next Generation Infrastructure program in Calendar Years 2019 and 2020, no clear or comprehensive program management structure was established. This decentralized approach makes it difficult to determine ultimate responsibility and accountability over the Next Generation Infrastructure program.¹⁵

Successful modernization of systems and the development and implementation of new information technology applications will continue to be a critical challenge for the IRS to meet its evolving business needs and enhance services provided to taxpayers.

Administering Tax Law Changes



One of the continuing challenges the IRS faces each year in processing tax returns is the implementation of new tax law changes as well as changes resulting from expired tax provisions. Legislative actions generating the changes often occur late in the year, shortly before the filing season begins. The recently passed IRA includes numerous tax provisions, including the creation of a corporate alternative minimum tax and tax incentives for companies and consumers who make cleaner energy choices. This will require the IRS to act quickly to assess the change and determine the necessary actions to ensure that all legislative requirements are satisfied. These actions may require revisions to various tax forms, instructions, and publications, as well as reprogramming computer systems to ensure that tax returns are accurately processed based on the changes. Errors in the IRS's tax return processing systems may delay tax refunds, affect the accuracy of taxpayer accounts, or result in incorrect taxpayer notices.

The primary legislation affecting the 2022 Filing Season was the American Rescue Plan Act of 2021 (ARPA),¹⁶ signed into law on March 11, 2021, which included approximately \$1.9 trillion in economic relief and stimulus to address the continuing impact of the pandemic on the economy, public health, State and local governments, individuals, and businesses. It also contained numerous tax-related provisions intended to provide relief to individuals and

¹⁵ TIGTA, Report No. 2022-20-001, *Some Next Generation Information Technology Infrastructure Capabilities Were Implemented, but Program Management Improvements Are Needed* (Nov. 2021).

¹⁶ Pub. L. No. 117-2, 135 Stat 4 (codified in scattered sections of Titles 7, 12, 15, 19, 20, 26, 29, 42, and 45 U.S.C.).

businesses. The ARPA modified several credits, including the Child and Dependent Care Credit (CDCC) and Child Tax Credit (CTC), as well as creating a third Recovery Rebate Credit.

One key provision in the ARPA is the expanded CTC. Determining eligibility for and the amount of the CTC is a complex process. As of March 2, 2022, the IRS processed more than 14.9 million tax returns claiming \$82.7 billion in CTCs, of which \$33.7 billion was paid in advance. This required a significant undertaking on the IRS's part as it needed to develop processes and procedures to determine eligibility, compute advance payment amounts, and develop an online portal and nonelectronic assistance options for taxpayers to provide the IRS with updates to key information used to compute the advance payment amounts.

TIGTA reported that the IRS established controls to track advance CTC updates and detect potentially fraudulent tax returns.¹⁷ Although the IRS also developed a process to identify discrepancies between the advance payments reported on the tax return and advance payments recorded on the taxpayer's account, the process did not account for undelivered checks. In these situations, taxpayers do not receive their payments and need to work with the IRS, after filing their tax returns, to recover them. TIGTA recommended that the IRS develop a process to continue to proactively identify and correct accounts with undelivered advance CTCs that post to accounts after the IRS processes the Tax Year 2021 tax return.

In addition to legislative changes, the IRS must frequently issue additional guidance to taxpayers on emerging trends that impact tax administration, such as cryptocurrencies and gig work. Expanding access to information about new or expiring tax legislation is a critical step in improving voluntary compliance. In the IRS's *Strategic Plan FY 2022-2026*, the IRS noted that it needs to engage with more segments of the population, like those with limited English proficiency, that face unique challenges in accessing the information, forms, or services they need.

Increasing Domestic and International Tax Compliance and Enforcement



One of the IRS's key responsibilities is to ensure that taxpayers comply with the tax law. Sustaining and improving taxpayer compliance is important because small declines in compliance cost the Nation billions of dollars in lost revenue and shift the tax burden from those who do not pay their taxes to those who pay their taxes on time every year. If the IRS can increase the rate of voluntary compliance, it can reduce the Tax Gap. The Tax Gap is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a tax year.

¹⁷ TIGTA, Report No. 2022-47-042, *American Rescue Plan Act: Assessment of the Child Tax Credit Update Portal's Capabilities and Related Processes* (July 2022).

However, the IRS has indicated that insufficient funding remains a constraint to address its operations.¹⁸ Specifically, the Commissioner of Internal Revenue indicated the IRS's budget has decreased by more than 15 percent in real dollars over the past decade. Because of this decrease, the IRS indicates its staffing is close to 1974 levels. Over the next six years, the IRS estimates it will need to hire 52,000 employees just to maintain its current staffing levels.¹⁹ As part of the IRA, the IRS will receive an additional \$45.7 billion for enforcement activities through FY 2031, representing a 69 percent increase over current budget projections. Although increased funding will assist the IRS in replacing employees lost through attrition, onboarding, training, and assimilating large numbers of employees will create its own challenges for the IRS.

The IRS's research shows that examinations have a strong positive impact on voluntary compliance.²⁰ Comparing FYs 2016 and 2020, there were 55 percent fewer correspondence examinations and 59 percent fewer field examinations conducted in FY 2020.²¹ The decrease in staffing within the Examination functions has contributed to the decline in examinations. Specifically, the number of Examination staff decreased 9.9 percent from 10,101 in FY 2017 to 9,116 in FY 2020. The trending decline in enforcement activity is likely causing growth in the overall Tax Gap as taxpayers are less likely to be subject to an examination. While examinations have declined over the years, the Secretary of the Treasury has directed that any additional resources not be used to increase the share of small business or households below the \$400,000 threshold that are audited relative to historical levels.

The IRS will continue to be challenged to enforce international tax compliance. U.S. taxpayers, regardless of whether they live in the U.S. or abroad, are required to report and pay applicable taxes on worldwide income to the IRS, including income from offshore accounts and other assets. While taxpayers can hold offshore accounts for a number of legitimate reasons, some taxpayers have used such accounts to hide income and evade taxes, and the IRS has not developed a reliable estimate of the international tax gap. The Tax Gap is estimated using statistics from the IRS's National Research Program data that does not measure international noncompliance.²² Complexity and change in the international tax environment will continue to challenge the IRS in enforcing compliance in this area.

¹⁸ Testimony of Charles P. Rettig, Commissioner of Internal Revenue, *On the Filing Season and the IRS Budget*, Senate Finance Committee (April 7, 2022).

¹⁹ Testimony of Charles P. Rettig, Commissioner of Internal Revenue, *On the Filing Season and the IRS Budget*, House Appropriations Committee, Subcommittee on Financial Services and General Government (May 18, 2022).

²⁰ IRS, *The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results* (Nov. 2002).

²¹ TIGTA, Report No. 2022-30-033, *Trends in Compliance Activities Through Fiscal Year 2020* (May 2022).

²² TIGTA, Report No. 2009-IE-R001, *A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap* (Jan. 2009).

The Foreign Account Tax Compliance Act (FATCA) was intended to reduce tax evasion by creating greater transparency and accountability with respect to offshore accounts and other assets held by U.S. taxpayers.²³ However, TIGTA reported that due to resource limitations, the IRS has significantly departed from its original comprehensive FATCA Compliance Roadmap in favor of a more limited compliance effort.²⁴ Continued emphasis by the IRS will be necessary to address offshore tax noncompliance.

To ensure confidence in the tax system, American taxpayers expect that everyone pays their Federal tax obligations. This includes entities receiving the benefits of contracts and grants from the Federal Government. Starting with the Consolidated and Further Continuing Appropriations Act, 2015,²⁵ Congress now prohibits Federal agencies from using appropriated funds to award a contract or grant to a corporation that owes any amount of delinquent Federal tax, unless suspension or debarment is considered. Congress provided the IRS \$30 million to establish an application through which entities could request from the IRS a certification that the entity did or did not owe seriously delinquent taxes.

However, TIGTA reported that Federal agencies across the Government awarded contracts and grants to entities that owed millions in delinquent Federal taxes.²⁶ Between October 2018 and December 2019, the Federal Government awarded 2.1 million Federal contracts and grants to more than 83,000 awardees. Of these, 3,040 contractors received almost \$10.2 billion in Federal contracts while owing \$621.8 million in delinquent Federal taxes. Figure 3 depicts the amounts of contracts and grants the Federal Government awarded to entities with delinquent taxes between October 2018 and December 2019.

²³ Pub. L. No. 111-147, Subtitle A, 124 Stat 97 (2010) (codified in scattered sections of 26 U.S.C.).

²⁴ TIGTA, Report No. 2022-30-019, *Additional Actions Are Needed to Address Non-Filing and Non-Reporting Compliance Under the Foreign Account Tax Compliance Act* (Apr. 2022).

²⁵ Pub. L. No. 113-235, 128 Stat. 2130 (2014).

²⁶ TIGTA, Report No. 2022-10-066, *Reliance on Self-Certifications Resulted in Federal Agencies Awarding Contracts and Grants to Entities With Delinquent Federal Taxes; However, the IRS Is Making Progress on Establishing the Federal Contractor Tax Check* (Sept. 2022).

Figure 3: Federal Contracts and Grants Awarded to Entities With Delinquent Taxes

	 Contractors	 Grantees
 Entities owing delinquent taxes that received Federal awards between October 2018 and December 2019.	3,040 Entities	938 Entities
 Federal awards that went to entities owing delinquent taxes.	\$10.2 billion	\$22.7 billion
 Delinquent Federal taxes owed.	\$621.8 million	\$269.2 million

Source: TIGTA analysis of entity data from the System for Award Management, contracts data from the Federal Procurement Data System, grants data from USAspending.gov, and tax data from the IRS’s Transaction Category Reports.

Increasing voluntary taxpayer compliance and reducing the Tax Gap will remain a persistent challenge facing the IRS. As such, the IRS will need to stay committed to a strong, visible, and robust tax enforcement presence to support voluntary compliance and protect the integrity of the tax system.

Reducing Tax Fraud and Improper Payments



Identity theft tax refund fraud involves the use of another person’s name and Taxpayer Identification Number²⁷ to file a fraudulent tax return reporting false income and withholding in an effort to receive a fraudulent tax refund. The IRS continues to increase the number of fraudulent tax returns detected and stopped from entering the tax processing system (*i.e.*, rejecting e-filed tax returns and preventing paper tax returns from posting).²⁸ For the 2022 Filing Season, the IRS used 168 filters to identify potential identity theft tax returns and prevent the issuance of fraudulent refunds. In comparison, the IRS used 155 filters for the 2021 Filing Season. These filters incorporate criteria based on characteristics of confirmed identity theft tax

²⁷ A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, it can be an Employer Identification Number, a Social Security Number, or an Individual Taxpayer Identification Number.

²⁸ TIGTA, Report No. 2022-40-035, *Interim Results of the 2022 Filing Season* (May 2022).

returns, including 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.

Identity theft not only affects individuals, it can also affect businesses. The IRS defines business identity theft as creating, using, or attempting to use a business's information without authority to obtain tax benefits. The IRS continues to improve and expand its detection capabilities to include additional types of business tax returns. During Processing Year 2021, the IRS used 84 selection filters to identify business tax returns claiming refunds for potential fraud. These filters identified and selected for review 62,096 business returns as potentially fraudulent.

However, TIGTA's assessment of the IRS's efforts to combat business identity theft and assist these types of victims identified that efforts can be improved if the IRS adopts successful taxpayer detection and assistance options, similar to what it provides to individual taxpayers. These include developing clustering filters for business identity theft detection and expanding Identity Protection Personal Identification Numbers to business taxpayers.²⁹

In addition, TIGTA continues to find that IRS processes and procedures do not ensure that Individual Taxpayer Identification Numbers (ITIN) are issued only to individuals who have a Federal income tax need.³⁰ An ITIN is a tax processing number issued by the IRS for certain resident and nonresident aliens, their spouses, and their dependents who are not eligible to obtain a Social Security Number from the Social Security Administration. Only individuals who have a valid filing requirement, who are filing a return to claim a refund, or who are claiming reduced withholding under an applicable income tax treaty are eligible to receive an ITIN. TIGTA made several recommendations to improve administration of the ITIN program, such as ensuring that the IRS receives complete data extracts for identifying ITIN applications with duplicate entity information or supporting documents, regularly identifying and addressing retroactive claims that were processed incorrectly, and updating programming to systemically identify and deactivate all ITINs when required.

The IRS continues to work diligently to combat various scams designed to steal taxpayers' money or personal information. Compiled annually, the IRS's "Dirty Dozen" lists a variety of common scams that taxpayers may encounter. In 2022, the IRS added pandemic-related scams to its list. These scams involve the theft of a person's money and identity with bogus e-mails, social media posts, and unexpected telephone calls, among other things. The scams can take a variety of forms, including using unemployment information and fake job offers to steal money and information from people. All of these efforts can lead to sensitive personal information being stolen, with scammers using it to try filing a fraudulent tax return as well as harming victims in other ways.

²⁹ TIGTA, Report No. 2022-40-041, *Successful Detection and Assistance Processes Used to Combat Individual Identity Theft Should Be Implemented for Business Identity Theft* (July 2022).

³⁰ TIGTA, Report No. 2022-40-013, *Administration of the Individual Taxpayer Identification Number Program* (Jan. 2022).

Improper payments (*i.e.*, payments that should not have been made, were made in an incorrect amount, or were made to an ineligible recipient) continue to be a challenge facing the IRS. 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.³¹

In addition, the IRS continues not to be in compliance with the goal of reducing the overall improper payment rate for the Earned Income Tax Credit (EITC), the Additional Child Tax Credit (ACTC), and the American Opportunity Tax Credit (AOTC) to less than 10 percent. The IRS estimates it issued approximately \$26.1 billion in potentially improper EITC, ACTC, and AOTC payments in FY 2021. As shown below, this represents a significant loss to the Federal Government:

- EITC – The IRS estimates 28 percent (\$19.0 billion) of the total EITC payments of \$68.3 billion were improper.
- ACTC – The IRS estimates 13 percent (\$5.2 billion) of the total ACTC payments of \$39.4 billion were improper.
- AOTC – The IRS estimates 26 percent (\$1.9 billion) of the total AOTC payments of \$7.1 billion were improper.

Further, the passage of the ARPA temporarily expands the CDCC. Beginning on January 1, 2021, the credit is fully refundable and the amount of the credit and the income phase-out limits have significantly increased. The unintended consequence of refundable credits is that they can result in the issuance of improper payments and can be the targets of unscrupulous individuals.

TIGTA's review of nearly 6.3 million Tax Year 2019 tax returns that received the CDCC identified a number of weaknesses in the controls over the processing of CDCC claims.³² Although IRS management agreed to take actions to address some of these processing weaknesses, the IRS is not taking actions to address all deficiencies identified by TIGTA. This includes not taking the steps needed to ensure that requirements to claim the CDCC are met at the time tax returns are processed. In addition, the IRS is not taking actions to update its filing instructions and publications to provide additional guidance to taxpayers or revising programming and processes to identify potentially erroneous CDCC claims. As a result, the IRS may potentially allow improper payments associated with erroneous CDCC claims.

³¹ TIGTA, Report No. 2022-40-037, *Programs Susceptible to Improper Payments Are Not Adequately Assessed and Reported* (May 2022).

³² TIGTA, Report No. 2022-47-023, *American Rescue Plan Act: Assessment of Processes to Identify and Address Improper Child and Dependent Care Credit Claims* (Mar. 2022).

Conclusion

This memorandum is provided as our annual summary of the most serious major management and performance challenges confronting the IRS in FY 2023. TIGTA's *Fiscal Year 2023 Annual Audit Plan* and *Fiscal Year 2023 Inspections and Evaluations Program Plan* contain our proposed reviews. If you have any questions or wish to discuss our views on the challenges in greater detail, please contact me at (202) 622-6500.

cc: Deputy Secretary of the Treasury
Acting Assistant Secretary for Management
Deputy Chief Financial Officer
Commissioner of Internal Revenue