



*Actions Have Not Been Taken to Improve  
Amended Tax Return Review Procedures to  
Reduce Erroneous and Fraudulent Refunds*

**July 31, 2019**

**Reference Number: 2019-40-042**

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

**Redaction Legend:**

2 = Law Enforcement Techniques/ Procedures and Guidelines for Law Enforcement Investigations or Prosecutions

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# HIGHLIGHTS

## ACTIONS HAVE NOT BEEN TAKEN TO IMPROVE AMENDED TAX RETURN REVIEW PROCEDURES TO REDUCE ERRONEOUS AND FRAUDULENT REFUNDS

### Highlights

Final Report issued on July 31, 2019

Highlights of Reference Number: 2019-40-042 to the Commissioner of Internal Revenue.

#### IMPACT ON TAXPAYERS

When taxpayers make an error on the originally filed Form 1040, U.S. Individual Tax Return, they can file an amended tax return. Taxpayers can also file an amended tax return to change amounts previously adjusted by the IRS, make a claim for a carryback due to a loss or unused credit, and make certain elections after the prescribed deadline. Taxpayers generally must file an amended tax return within three years from the time the original tax return was filed or two years from the time the tax was paid, whichever is later.

#### WHY TIGTA DID THE AUDIT

This audit was initiated to follow up on TIGTA's previous audit recommendations and to evaluate the IRS's efforts to detect and prevent erroneous or fraudulent claims on amended tax returns.

#### WHAT TIGTA FOUND

TIGTA's analysis of current amended tax return processes and procedures found that the IRS has not implemented a platform. While the IRS updated its internal guidelines, the improvements made to the guidelines. Furthermore, the lack of management action to enable electronic filing of amended tax returns continues to result in taxpayer burden and higher processing costs. TIGTA estimates that the IRS will spend \$79.4 million in additional

processing costs over five years because taxpayers are unable to electronically file their amended tax return. Although IRS management agreed with our recommendation to expand electronic filing to include amended tax returns, the initiative has not been funded due to competing priorities in the IRS.

Finally, the IRS's processes are inadequate because. \*\*\*\*.

#### WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS review the questionable amended tax returns identified and implement adequate processes to identify and correct employee errors to reduce erroneous refunds issued. In addition, the IRS should ensure that a business case is completed and funding is requested to expand electronic filing for the 2020 Filing Season. TIGTA also recommended that the IRS update its internal processes to identify and review amended tax returns with claims for refundable credits that were denied during the original tax return processing; and modify the Form 1040X, Amended U.S. Individual Tax Return, to enable individuals to use the Identity Protection Personal Identification Number when filing an amended tax return.

IRS management agreed with five of the seven recommendations. IRS management disagreed with the need to hold amended tax returns for processing until the taxpayer confirms his or her identity when they are a victim of identity theft. The IRS believes its current verification processes provide sufficient account protections.

IRS management partially agreed to evaluate amended tax returns for potential identity theft. IRS management plans to conduct a study to assess the feasibility of using an Identity Protection Personal Identification Number on amended returns and develop processes accordingly.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

July 31, 2019

**MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE**

**FROM:** Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Actions Have Not Been Taken to Improve Amended Tax Return Review Procedures to Reduce Erroneous and Fraudulent Refunds (Audit # 201840026)

This report presents the results of our review to evaluate the effectiveness of the Internal Revenue Service's efforts to detect and prevent erroneous or fraudulent claims on amended tax returns. This audit was included in our Fiscal Year 2018 Annual Audit Plan and addresses the major management challenge of Reducing Fraudulent Claims and Improper Payments.

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

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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## *Abbreviations*

ACTC	Additional Child Tax Credit
CSR	Customer Service Representative
e-file(d), e-filing	Electronically File(d), Electronic Filing
EITC	Earned Income Tax Credit
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number



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## *Background*

When taxpayers make an error on their originally filed Form 1040, *U.S. Individual Income Tax Return*, they can file an amended tax return. Taxpayers use Form 1040X, *Amended U.S. Individual Income Tax Return*, to amend their original tax return. Form 1040X is used to add, delete, update, or change income, exclusions, deductions, credits, filing status, *etc.*, reported on an original tax return. Taxpayers can also file an amended return to change amounts previously adjusted by the Internal Revenue Service (IRS), make a claim for a carryback due to a loss or unused credit, and/or make certain elections after the prescribed deadline. Taxpayers generally must file an amended tax return within three years from the time their original tax return was filed or two years from the time their tax was paid, whichever is later.

### **Comparison of original tax return and amended tax return filing, refund issuance, and verification processes**

The IRS requires amended tax returns to be paper-filed. When an amended tax return is received at an IRS tax processing site, it is routed for manual processing to either the IRS's Submission Processing function or the Accounts Management function depending on the specific items being amended on the return. Once received in one of these functions, IRS tax examiners or customer service representatives (CSR) review the amended tax returns to verify math computations, ensure that required documentation is included, verify eligibility for deductions or credits claimed, *etc.* Once the tax examiner or the CSR completes all the required research and verification, the tax examiner or the CSR inputs accepted adjustments to the taxpayer's tax account. Once the adjustments are input, the IRS sends the taxpayer a letter notifying him or her of the adjustment, the reason the adjustment was made, and the amount adjusted. If a refund results from the processing of the amended tax return, a paper refund check is sent to the address listed on the amended tax return. The IRS does not allow refunds associated with amended tax return filings to be direct deposited.

In comparison, original tax returns can be electronically filed (e-filed) or paper-filed, and the taxpayer can elect to have their refund sent via paper check or direct deposited. When original tax returns are processed, extensive systemic verifications are performed in an effort to ensure the accuracy of tax refunds claimed. The systemic checks verify basic requirements on the tax return, such as ensuring that math computations are correct, claims for tax credits and deductions meet required income limits, and required tax forms and/or schedules are provided. In addition to the systemic checks, tax returns are also sent through the IRS's fraud detection filters,



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*i.e.*, Return Review Program<sup>1</sup> and the Dependent Database,<sup>2</sup> in an effort to identify and select tax returns as potentially fraudulent including those involving potential identity theft. Figure 1 provides a comparison of processes used to verify the accuracy of tax refunds claimed on an original paper-filed tax return with those used for an amended tax return.

**Figure 1: Comparison of Processes Used to Verify the Accuracy of Tax Refunds Claimed on an Original Paper Tax Return to an Amended Tax Return**

Original Tax Return Verification Process	Amended Tax Return Verification Process
Taxpayer completes and mails Form 1040 to the IRS.	Taxpayer completes and mails Form 1040X to the IRS.
The IRS assigns the Form 1040 a control number used to identify and locate the return and then sends the return to the IRS's Document Perfection function to prepare the return for processing.	The Form 1040X is sent to either the IRS Submission Processing function or the Accounts Management function for manual processing.
Tax examiner reviews the Form 1040 to ensure that the taxpayer signed the tax return and that all required supporting schedules are attached.	Tax examiners or the CSRs review the Form 1040X to ensure that the taxpayer signed the tax return and that all required supporting schedules are attached.
Data transcriber enters selected information from the Form 1040 into IRS tax return processing systems.	*****2***** *****2*****.
Systemic verifications are performed to ensure accuracy of the refund claimed. If errors are identified, the return is sent to the IRS's Error Resolution System function for further review.	*****2***** *****2***** *****2***** *****2***** *****2***** *****2***** *****3 *****2*****. However, the tax examiner or the CSR does not ensure the accuracy of the refund claimed.
Systemic mathematical verifications are performed on the Form 1040. Once verification is completed with no errors identified, the tax return is posted to the Master File. <sup>4</sup>	The tax examiner or the CSR mathematically verifies the Form 1040X and inputs accepted adjustments into the taxpayer's tax account for posting to the Master File.
If the processing of the return results in a tax refund, the tax refund is sent to the taxpayer as a paper check or direct deposited into the taxpayer's bank account.	If the adjustment results in a tax refund, the tax refund is sent to the individual as a paper check.

*Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of IRS tax return processing procedures and instructions.*

<sup>1</sup> The IRS's primary individual tax refund fraud selection system with real-time filtering capabilities and is designed to improve the IRS's ability to detect, resolve, and prevent fraud.

<sup>2</sup> A risk-based audit selection tool the IRS uses to identify tax returns for audit.

<sup>3</sup> IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

<sup>4</sup> The IRS database that stores various types of taxpayer account information. This database contains individual, business, and employee plans and exempt organizations data.





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**Prior TIGTA reports identified concerns with IRS processes for verifying tax refunds claimed on amended tax returns**

Since Calendar Year 2011, TIGTA has issued four reports citing concerns with the manual processing of amended tax returns resulting in taxpayers receiving potentially erroneous tax benefits.<sup>5</sup> In our most recent report dated April 2014, we reported that our review of a statistically valid sample of 259 of the more than 1.1 million amended tax returns that claimed a tax refund of \$500 or more in Fiscal Year<sup>6</sup> 2012 identified 44 (17 percent) tax returns for which the IRS issued potentially erroneous tax refunds totaling \$103,270. Based on the sample results, we estimated that the IRS potentially issued more than \$439 million in potentially erroneous tax refunds claimed on 187,421 amended returns in Fiscal Year 2012 and potentially more than \$2.1 billion in potentially erroneous tax refunds claimed on amended tax returns over the next five years. In addition, we reported that 126 (49 percent) of the 259 amended returns we reviewed included a revised Form 1040 with the amended tax return. These taxpayers submitted the revised Form 1040 with their amended tax return because the taxpayer used the Form 1040 to work through the detailed computations required on an original tax return to recompute the tax benefits to be entered on the Form 1040X.

We recommended that the IRS revise Form 1040 to enable taxpayers to amend their original tax return using this form. In addition, we recommended that the IRS expand electronic filing (e-filing) to include amended tax returns. We estimated that the IRS could potentially save more than \$17 million in processing costs during Fiscal Year 2012 if it had allowed taxpayers to e-file their amended tax return. The IRS disagreed with this recommendation. However, the IRS stated that it would consider the format and the appearance of the Form 1040X to include more specific information related to changes to income in conjunction with the implementation of e-filing of amended returns.

This review was conducted in the Submission Processing centers in Fresno, California, and Kansas City, Missouri, and with information obtained from the Wage and Investment Division, Submission Processing offices in Fresno, California; Cincinnati, Ohio; and Kansas City, Missouri, during the period December 2017 through November 2018. 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

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<sup>5</sup> TIGTA, Ref. No. 2011-41-057, *Control Weaknesses Over Amended Returns Allowed Some Inappropriate Claims for the First-Time Homebuyer Credit to Be Allowed* (June 2011); TIGTA, Ref. No. 2012-40-065, *Processes to Address Erroneous Adoption Credits Result in Increased Taxpayer Burden and Credits Allowed to Nonqualifying Individuals* (June 2012); TIGTA, Ref. No. 2012-40-103, *Additional Controls Are Necessary When Processing Employees' Amended Tax Returns* (Aug. 2012); TIGTA, Ref. No. 2014-40-028, *Amended Tax Return Filing and Processing Needs to Be Modernized to Reduce Erroneous Refunds, Processing Costs, and Taxpayer Burden* (Apr. 2014).

<sup>6</sup> 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.



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audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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## *Results of Review*

### **Employee Processing Errors Continue to Result in Erroneous Refunds**

Our review of a statistically valid sample<sup>7</sup> of 235 of the more than 1.1 million amended tax returns processed during Processing Year<sup>8</sup> 2017 identified 33 (14 percent) questionable amended returns with refunds totaling \$74,974. Based on the result of our sample, we estimate that the IRS issued nearly \$359.9 million in potentially erroneous tax refunds claimed on 158,397 amended tax returns during Processing Year 2017. We forecast the IRS could issue nearly \$1.8 billion over the next five years.

Of the 33 returns we identified as questionable, 23 resulted from employee processing errors totaling \$58,204 in potentially erroneous tax refunds. Based on the results of our sample, we estimate that the IRS issued nearly \$279.4 million<sup>9</sup> in potentially erroneous tax refunds claimed on 110,398 amended tax returns during Processing Year 2017. We forecast that the IRS could issue nearly \$1.4 billion in potentially erroneous tax refunds claimed on amended tax returns over the next five years.<sup>10</sup> For the 23, errors included:

- Tax examiners or the CSRs erroneously allowed adjustments when the taxpayer did not include the required form with the amended return. These included returns in which tax examiners or the CSRs processed claims to change the taxpayer's standard deduction to itemized deductions. However, the taxpayer failed to attach the required Schedule A, *Itemized Deductions*, to the amended return. Internal guidelines require that Schedule A be attached to the amended tax return to allow a change from standard to itemized deduction.
- Tax examiners or the CSRs erroneously allowed deductions to which taxpayers were not entitled. These included returns in which tax examiners or the CSRs allowed deductions

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<sup>7</sup> To select our statistically valid sample, we used an expected error rate of 17 percent, a precision rate of  $\pm 10$  percent, and a confidence interval of 95 percent.

<sup>8</sup> The calendar year in which the tax return or document is processed by the IRS.

<sup>9</sup> When projecting the results of our statistical sample, we are 95 percent confident that the actual total amount is between \$116.6 million and \$672.7 million (where the \$116.6 million and \$672.7 million represent the lower and upper range, respectively).

<sup>10</sup> See Appendix IV. The five-year forecast for potential revenue protection is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change. The actual amount of revenue protected is contingent upon the IRS implementing an effective process to identify questionable amended tax returns and on the extent that taxpayers can adequately substantiate their claims once contacted by the IRS.



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for student loan interest when taxpayers claimed the deduction for a nondependent student. Student loan interest deductions are only available for individuals legally obligated to pay the loan, *i.e.*, parents or other relatives cannot claim a student loan interest deduction if they are not legally obligated to make loan payments.

- The CSRs did not forward amended returns to the Examination function when required. These included returns with claims for a reduction in Net Investment Income Tax that was over the specified threshold. Internal guidelines state that when claims meet specific criteria, they must be routed to the Examination function for review.
- Tax examiners or the CSRs erroneously adjusted credits on associated taxpayer tax accounts. These included returns in which the tax examiner or the CSR incorrectly adjusted a refundable tax credit that the taxpayer neither requested nor was entitled.

In April 2014, we reported that one-half of the potentially erroneous refunds we identified resulted from errors made by employees processing of amended returns. The errors we identified included mathematical errors by both taxpayers as well as IRS employees processing the amended tax return, deductions and credit claims made without the required tax form attached to the tax return, and claims for deductions and/or credits for which the IRS did not receive third-party information substantiating the validity of the deduction/credit claimed.

In response to our April 2014 report, management noted they updated their internal review guidelines as well as continuing to update the programming of its research tool to assist its employees with consistent processing. The research tool interacts with the Integrated Data Retrieval System to automate casework. For example, the tool researches taxpayer accounts for potential issues and checks for mathematical errors on adjustments made by the employee while processing the amended return. However, these actions are still not adequate to address the erroneous refund losses associated with employee error and the lack of systemic verifications that are used for original tax returns (see below).

**Efforts to improve error detection and reduce taxpayer burden have not progressed**

To improve its detection of errors on amended tax returns, in April 2014 we recommended that the IRS enable taxpayers to e-file amended tax returns. In response, the IRS stated it would consider the format and appearance of Form 1040X in conjunction with the implementation of e-filing of amended returns. In response to our prior recommendation to expand e-filing, IRS management stated that the ability to e-file amended tax returns has been a long-term goal of the IRS. However, developing a process that allows for e-filing and processing of an amended tax return is costly and labor intensive. IRS management stated that they submitted funding requests for an additional \$4.1 million in both Fiscal Years 2016 and 2017 to update the systems to enable taxpayers to e-file amended returns through the Modernized e-File system. However, due to the high cost of this initiative and competing priorities, these requests have not been funded.



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In its previous response, the IRS also indicated that the business vision and high-level requirements for the process were being developed and would be provided to the Information Technology organization for a feasibility study and cost estimate by the end of the 2014 Filing Season. As of the date of this report, over five years have passed since we first made this recommendation and the requirements have still yet to be developed. IRS management indicated that once all programming needs for the Tax Cuts and Jobs Act<sup>11</sup> implementation are complete, they plan to resume the process of developing a business case to accept e-filed amended returns. IRS management stated that they will base a proposed business case on factors such as a cost-benefit analysis, viable customer adoption rate, and software industry feedback.

**Questionable amended returns would have been rejected by current e-file rules**

The remaining 10 of the 33 questionable returns that we identified did not involve an employee error. These questionable amended tax returns resulted in \$16,770 in potentially erroneous tax refunds. Based on the results of our sample, we estimate that the IRS issued nearly \$80.5 million<sup>12</sup> in potentially erroneous tax refunds claimed on 47,999 amended tax returns during Processing Year 2017. We forecast that the IRS could issue nearly \$402.5 million in potentially erroneous tax refunds claimed on amended tax returns over the next five years.<sup>13</sup>

The errors we identified relative to these 10 returns would have been identified and the return rejected if processed electronically. \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*. The IRS’s e-file controls would reject tax returns if:

- \*\*\*\*\*2\*\*\*\*\*.
- \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*.
- \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*.

<sup>11</sup> Pub L. 115-97, 131 Stat. 2054.

<sup>12</sup> When projecting the results of our statistical sample, we are 95 percent confident that the actual total amount is between \$36.7 million and \$153.3 million (where the \$36.7 million and \$153.3 million represent the lower and upper range, respectively).

<sup>13</sup> See Appendix IV. The five-year forecast for potential revenue protection is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change. The actual amount of revenue protected is contingent upon the IRS implementing an effective process to identify questionable amended tax returns and on the extent that taxpayers can adequately substantiate their claims once contacted by the IRS.



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**Modifying Form 1040 for use in submitting an amended return would be beneficial given that an increasing number of taxpayers submit a completed Form 1040 with their amended return**

In response to our April 2014 report, management disagreed with our recommendation to modify the Form 1040 to allow taxpayers to use this form when amending an original return. However, in our discussions during this review, management stated that they would consider a checkbox format via the use of the Form 1040. Our testing identified that the taxpayer included a revised Form 1040 with the amended tax return in 134 (57 percent) of the 235 amended tax returns in our sample. Our review of the Forms 1040 submitted with these amended returns identified that the taxpayers submitted the revised Form 1040 with their amended tax return because the taxpayer used the Form 1040 to work through the detailed computations required to recompute the tax benefits to be entered on the Form 1040X. The 134 taxpayers that included a revised Form 1040 represents a 16.3 percent increase<sup>14</sup> from the 49 percent we reported in our last review.

**There would be a substantial cost benefit associated with expansion of e-file and modification of Form 1040 because these would reduce processing costs and erroneous refunds**

The IRS's estimated \$4.1 million to enable e-filing of amended returns is a small fraction of the \$63.5 million in additional processing costs we estimate that the IRS expended between Fiscal Years 2013 and 2016 by not implementing our recommended changes. Moreover, we estimate that there are billions of dollars in erroneous refunds issued \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*.<sup>15</sup> Furthermore, we forecast that the IRS will expend more than \$79.4 million in additional processing costs over the next five years because taxpayers are unable to e-file their amended tax return.<sup>16</sup>

As previously stated, the IRS sends original tax returns through extensive systemic verifications in an attempt to ensure the accuracy of tax refunds claimed. \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*.

<sup>14</sup> In our prior review, we reported that 126 (49 percent) of the 259 amended returns we reviewed included a revised Form 1040 with the amended tax return.

<sup>15</sup> Based on the results of our sample analysis, we forecast the IRS could potentially issue \$1,871,649,975 in erroneous refunds over the next five years (\$374,329,995 x 5).

<sup>16</sup> See Appendix IV. The five-year forecast of potential cost savings is based on multiplying the average cost estimate computed for Fiscal Years 2013 through 2016 by five and assumes, among other considerations, that economic conditions and tax laws do not change. The actual amount of potential cost savings is contingent upon the IRS implementing processes to allow taxpayers to e-file their amended tax return.



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## ***Recommendations***

The Commissioner, Wage and Investment Division, should:

**Recommendation 1:** Review the 23 questionable amended tax returns we identified and take the actions needed to ensure that taxpayers receive only the benefits to which they are entitled.

**Management's Response:** The IRS agreed with this recommendation and plans to review the questionable returns and take appropriate corrective actions when warranted.

**Recommendation 2:** Implement adequate processes and procedures to identify and correct employee errors to reduce erroneous refunds issued.

**Management's Response:** The IRS agreed with this recommendation and plans to evaluate training material and procedural guidance and revise them, as necessary, to address errors identified in amended return processing.

**Recommendation 3:** Complete a business case and request funding for expansion of e-filing to amended returns in the 2020 Filing Season in an effort to reduce unnecessary processing costs and erroneous refunds resulting from amended returns \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*.

**Management's Response:** The IRS agreed with this recommendation and submitted a request on March 29, 2019, for \$5.6 million of Fiscal Year 2020 funding to enhance the Modernized e-File system with the capability of accepting e-filed amended personal income tax returns. If approved as a Fiscal Year 2020 expenditure, programming and related system modifications are expected to be in place to permit acceptance of e-filed amended personal income tax returns upon the start of the 2021 Filing Season. The completion of this work is contingent on both the timely passage of the IRS's Fiscal Year 2020 funding appropriations and the availability of limited information technology resources, which are subject to competing priorities.

## **Procedures Do Not Include Adequate Verification Steps to Identify Questionable Refundable Credit Claims**

Of the 33 questionable amended returns we identified in our sample review, three included potentially erroneous refundable credit claims totaling \$4,288. These three claims involved the taxpayer \*\*\*\*\*2\*\*\*\*\* to claim the EITC and/or the ACTC. Based on the results from our sample case review, we expanded our analysis to assess all 228,979 amended tax returns processed during Processing Year 2017 that included a claim for the EITC and/or the ACTC. These taxpayers received more than \$296.4 million in the EITC and/or the ACTC. Our assessment of these returns identified additional characteristics that warrant management expedited action to expand and improve tax examiner processes and procedures when reviewing amended returns with refundable credit claims to ensure the validity of the claims. For example:



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- 65,899 (28.8 percent) returns were for the EITC and/or the ACTC that was not claimed on their original tax return. These taxpayers received more than \$76.3 million in the EITC and/or the ACTC. These returns included:
o 20,778 (31.5 percent) returns processed
o 146 (0.2 percent) Tax Year 2016 returns were received and processed
o 23,512 (10.3 percent) returns in which taxpayers changed
o 21,345 (9.3 percent) returns in which taxpayers adjusted
o 11,328 (4.9 percent) returns in which the refundable credit claimed on the originally filed return was

As we reported earlier, the IRS has taken limited action to update internal guidelines to identify questionable refundable credit filings. For example,

17 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.

18 Pub. L. No. 114-113, 129 Stat. 2242 (2015).





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However, also as we reported earlier, the improvements made by the IRS would not identify questionable refundable credit filings similar to what the systemic verifications would identify. Figure 2 provides examples of criteria used to systemically verify refundable credit claims, at the time original tax returns are processed.

Figure 2: Systemic Checks to Detect and Prevent Potentially Fraudulent Refunds From

Table with 5 rows, each containing a line of asterisks and a number 2, representing systemic checks.

Source: TIGTA analysis of IRS Processing Year 2017

In Fiscal Year 2017, the IRS estimates \$16.2 billion in EITC payments were issued improperly, and we estimate \$7.4 billion in improper ACTC payments for the same time period. The lack of adequate processes and procedures to ensure the validity of refundable credit claims on amended returns does not reflect management's commitment to reduce the more than \$23 billion in estimated improper payments. In addition, the continued manual processing of amended returns, as in other types of tax fraud, which is exactly what the current amended return process allows.

19 TIGTA, Ref. No. 2018-40-032, The Internal Revenue Service Is Not in Compliance With Improper Payment Requirements (Apr. 2018).

20 In September 2017, the IRS completed its compliance studies of the ACTC and estimated that \$8.7 billion annually was claimed in error.



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Recommendation

Recommendation 4: The Commissioner, Wage and Investment Division, should update tax examiner and CSR review guidelines to incorporate additional verification steps to be taken similar to those systemically performed when verifying a refundable claim on an original tax return. In particular, revised processes and procedures should require an extensive review of amended tax returns with claims for refundable credits \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*\*.

Management's Response: The IRS agreed with this recommendation. However, IRS management noted that an audit of the taxpayer would be required to resolve some questionable items presented on the amended returns, and the IRS's examination resources are limited and require discretion in workload selection to ensure they are used as effectively and efficiently as possible. IRS management also noted that the average refund at stake in the population of amended returns analyzed amounted to approximately \$82, which is significantly less than the cost of conducting a limited examination. However, the IRS plans to review its processes and determine additional steps that can be taken with its limited resources to identify and address these issues.

Procedures Do Not Include \*\*\*\*\*2\*\*\*\*\* of Filers Submitting Amended Tax Returns \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*\*

Despite the IRS's recognition that \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*. Our review identified 205,679 amended tax returns processed during Processing Year 2017 that included 193,755 Taxpayer Identification Numbers (TIN)<sup>21</sup> \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*.

Amended return internal review guidelines \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*\* As a result, none of these amended tax returns received additional screening to \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*. These 205,679 amended returns had more than \$16.9 million in associated refunds issued. The 205,679<sup>22</sup> amended tax returns included:

21 A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN is either an Employer Identification Number, a Social Security Number, or an Individual TIN. 22 A TIN could have an \*\*\*\*\*2\*\*\*\*\* As such, the sum of the two populations are greater than the TINs identified and the number of amended tax returns identified.



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- 181,206 TINs with an IRS
35,376 TINs that were on the IRS's

Tax examiners and the CSRs use the xClaim Tool to process amended tax returns

The xClaim Tool is an automated user-friendly interface that allows tax examiners and the CSRs to research tax records when reviewing amended tax returns. For those tax accounts, the tool will generate an alert to the tax examiner or the CSR. Amended tax returns identified are required to be forwarded to the Accounts Management function for processing. Once received in the Accounts Management function, the CSRs follow the general claim processing procedures used for all amended tax returns that do not include any

When we brought our concerns to management's attention regarding when reviewing amended returns, management confirmed that there are no special procedures in place for processing these types of amended returns. Management indicated that all Accounts Management function CSRs receive training that provides them with a general awareness of when working the telephone lines or paper cases. As part of the general claims processing procedures, the CSRs compare. According to IRS management, this serves as a form of income verification. Although management cites the performance of a comparison we identified 6,555 amended tax returns with refunds totaling more than \$2 million in which



Actions Have Not Been Taken to Improve Amended Tax Return Review Procedures to Reduce Erroneous and Fraudulent Refunds

For 1,930 of these returns, we also identified ... This may be indicative of ...

When we notified the IRS of our concerns, management indicated that some taxpayers could have a reasonable explanation ... For example, the taxpayer ... The IRS reviewed a sample of 40 of the 1,930 amended returns and identified ... for 33 out of the 40 amended returns reviewed. Management did note that for five of the cases they reviewed, ... For two of 40 amended returns reviewed, management indicated that they could not review the refund check or the amended return because there was no electronic version of the documents to review.

Repeated accesses to the IRS.gov Where's My Amended Return application could indicate that a fraudster is monitoring a fraudulent refund claim

Our analysis of the 6.4 million attempted log-ins to the IRS.gov Where's My Amended Return application between January and December 2017 identified 39,246 TINs belonging to ... Our analysis of these 39,246<sup>23</sup> TINs found that:

- An average of 12 attempts<sup>24</sup> were made to check the status of an amended tax return for 30,097 TINs ...
An average of nine attempts were made to check the status of an amended tax return for 12,728 TINs ...

When compared to the accesses relative to the TINs that ..., the average number of accesses to check the status of the amended tax return filing was seven. ...

23 A taxpayer's TIN could be in both the population of identity theft indicators and known breach victims. As such, the sum of TINs from the bullets below are greater than 39,246.

24 Amended tax returns using a TIN with an identity theft indicator are forwarded to the Accounts Management function. As such, the processing time could be increased allowing a longer window for a taxpayer to access the Where's My Amended Return application.

25 ...



Actions Have Not Been Taken to Improve Amended Tax Return Review Procedures to Reduce Erroneous and Fraudulent Refunds

The Where's My Amended Return portal allows taxpayers to check the status of amended tax return processing using a TIN, date of birth, and zip code. Unscrupulous individuals who file fraudulent amended returns \*\*\*\*\*2\*\*\*\*\* can use the application to monitor the status of the fraudulent refund. We notified IRS management of our concerns with higher than average accesses of the Where's My Amended Return application. IRS management indicated that they are currently working on processes to identify and monitor suspicious activity for the Where's My Amended Return application and plan to implement these processes before the 2019 Filing Season.<sup>26</sup>

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 5: Modify the Form 1040X to allow individuals \*\*\*\*\*2\*\*\*\*\* when filing an amended tax return. Once modified, update processing procedures to verify the accuracy of \*\*\*\*\*2\*\*\*\*\* and, \*\*\*\*\*2\*\*\*\*\* \*\*\*\*2\*\*\*\*, continue processing the amended return.

Management's Response: The IRS agreed with this recommendation. However, IRS management believes a deeper analysis of the issue should be completed before including it as a requirement for amended returns. The IRS's previous analyses of fraud potential on amended returns indicated a low risk \*\*\*\*\*2\*\*\*\*\*. Nonetheless, IRS management plans to perform additional \*\*\*\*\*2\*\*\*\*\* checks on a sample population of amended returns by taxpayers \*\*\*\*\*2\*\*\*\*\*. Based on the results of this study, management will determine if Form 1040X should be modified to include the Identity \*\*\*\*\*2\*\*\*\*\*.

Recommendation 6: Update processing procedures to hold the amended tax return from further processing when the taxpayer's tax account \*\*\*\*\*2\*\*\*\*\* Consistent with original tax return processes, \*\*\*\*\*2\*\*\*\*\* \*\*\*\*2\*\*\*\*.

Management's Response: The IRS disagreed with this recommendation. IRS management stated that verification processes are already in place to ensure that the amended return matches the original tax return. Taxpayers who \*\*\*\*\*2\*\*\*\*\* are not precluded from having a need to amend or correct their original tax return. The analysis of 205,679 amended returns made correlations to the taxpayers \*\*\*\*\*2\*\*\*\*\*.

<sup>26</sup> The period from January through mid-April when most individual income tax returns are filed.



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\*\*\*\*\*2\*\*\*\*\*.  
However, none of those amended returns were found \*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\*. IRS management believes the verification processes provide sufficient  
account protections without imposing the additional burden on taxpayers that may be  
necessary during original return processing.

**Office of Audit Comment:** Notwithstanding the fact that the IRS compares  
information from the amended tax return to the original return, there is still a risk of  
fraud, especially for the accounts we identified \*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\* similar to those used on original returns \*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\* should be considered.

**Recommendation 7:** Establish processes to evaluate amended tax returns for \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*. Processes should include identifying amended tax returns filed \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* tax returns that were filed before and after the amended tax return.

**Management's Response:** The IRS partially agreed with this recommendation. As  
stated previously, none of the 205,679 amended returns that were analyzed \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*. IRS management reviewed 40 amended  
returns from the subset of 1,930 \*\*\*\*\*2\*\*\*\*\*  
amended returns. For 33 of the 40 accounts, the IRS found clear linkages between \*\*2\*\*  
\*\*\*\*\*2\*\*\*\*\*.  
\*\*\*\*\*2\*\*\*\*\*. Under existing processes, \*\*\*\*\*2\*\*\*\*\* is not feasible; however, IRS  
management stated that they will include amended returns filed \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* in their sample population discussed in the corrective action for  
Recommendation 5. Presumably, this approach will leverage the \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* used on original returns \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*,  
\*\*\*\*\*2\*\*\*\*\*, the amended return will be subject to inclusion in the sample population. If  
\*\*\*\*\*2\*\*\*\*\*,  
\*\*\*\*\*2\*\*\*\*\*, there is reasonable assurance that the original return passed  
the \*\*\*\*\*2\*\*\*\*\* and the \*\*\*\*\*2\*\*\*\*\* of the amended return is low.

The potential corrective action for this recommendation is dependent on the outcome of  
the study the IRS will conduct to assess the feasibility of using an \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* on amended returns. If it is determined processes should  
be developed, the IRS will identify the actions to be taken and determine when they can  
be implemented.



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*Actions Have Not Been Taken to Improve  
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**Office of Audit Comment:** Whether IRS management's planned actions will adequately address our concerns is dependent upon the scope of their analysis. For example, IRS management stated that they would include returns \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*\* in their analysis of additional \*\*\*\*\*2\*\*\*\*\* checks. However, IRS management did not indicate whether they would also evaluate the risk associated with individuals on the \*\*\*\*\*2\*\*\*\*\*. We will continue to monitor the IRS's efforts to evaluate and implement additional processes to address the risk \*\*\*\*\*2\*\*\*\*\* on amended tax returns.



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**Appendix I**

*Detailed Objective, Scope, and Methodology*

Our overall objective was to evaluate the effectiveness of the IRS's efforts to detect and prevent erroneous or fraudulent claims on amended tax returns. To accomplish our objective, we:

- I. Evaluated the IRS's efforts to identify and prevent refund fraud on amended tax returns.
  - A. Determined if the IRS implemented our prior recommendations to expand e-filing to include amended tax returns and to revise the Form 1040, *U.S. Individual Tax Return*, to enable taxpayers to amend their original tax return using this form.
    1. Identified whether actions have been taken to design and implement a workable electronic Form 1040X, *Amended U.S. Individual Tax Return*.
    2. Determined the potential cost to the IRS and taxpayers of the IRS not implementing our prior recommendations, *e.g.*, inefficient use of IRS resources and impact on taxpayer burden.
  - B. Evaluated amended tax returns filed in Processing Year<sup>1</sup> 2017 (as of November 30, 2017) which resulted in benefit to the taxpayer for potential refund fraud.
    1. \*\*\*\*\*2\*\*\*\*\*.
    2. Evaluated amended tax returns claiming the EITC or the ACTC for potential refund fraud.
    3. Selected and reviewed a statistically valid sample of 235 tax returns from the 1,127,982 amended tax returns processed during Processing Year 2017 that resulted in a tax benefit to the taxpayer. This sample was based on an expected error rate of 17 percent, a precision rate of  $\pm 10$  percent, and a confidence interval of 95 percent. The contracted statistician assisted with developing sampling plans and projections.
- II. Evaluated the IRS's efforts to identify \*\*\*\*\*2\*\*\*\*\* on amended tax returns.
  - A. Identified amended tax returns \*\*\*\*\*2\*\*\*\*\* for additional review and met with IRS officials to determine how these amended tax returns are treated.

<sup>1</sup> The calendar year in which the tax return or document is processed by the IRS.





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- B. Identified amended tax returns \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*.
  
- C. Reviewed the *Where's My Amended Return* application access logs to identify the number of access attempts \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*.

**Validity and reliability of data from computer-based systems**

During this review, we relied on data extracted from the TIGTA Data Center Warehouse<sup>2</sup> of the IRS's Individual Master File<sup>3</sup> for Processing Years 2017 and 2018, the Individual Return Transaction File<sup>4</sup> for Processing Years 2013 through 2018, the *Where's My Amended Return* application logs for Processing Year 2017, and the Form W-2, *Wage and Tax Statement*, File<sup>5</sup> for Tax Years<sup>6</sup> 2016 and 2017. Before relying on the data, we ensured that each file contained the specific data elements we requested. In addition, we reviewed judgmental samples of the data extracted and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System.<sup>7</sup> These tests demonstrated that the data were sufficiently reliable and could be used to meet the objectives of this audit.

**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 IRS's amended tax return processes and procedures. We evaluated these controls by interviewing IRS employees and management, analyzing data and reviewing tax returns we systemically identified, and reviewing policies and procedures.

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<sup>2</sup> A collection of IRS databases containing various types of taxpayer account information that TIGTA maintains for analyzing data for ongoing audits.

<sup>3</sup> The IRS database that maintains transactions or records of individual tax accounts.

<sup>4</sup> This file contains data transcribed from the initial input of original individual tax returns during return processing.

<sup>5</sup> TIGTA creates the Form W-2 database using IRS information reported on Forms W-2 for each tax year.

<sup>6</sup> 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.

<sup>7</sup> IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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**Appendix II**

*Major Contributors to This Report*

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)  
Deann L. Baiza, Director  
Sharla J. Robinson, Acting Director  
Linna K. Hung, Audit Manager  
Mark Willoughby, Lead Auditor  
Jeffrey Cullum, Senior Auditor  
Shaymoria Baldwin, Auditor  
Nathan Cabello, Auditor  
Brieane Hamaoka, Auditor



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**Appendix III**

*Report Distribution List*

Deputy Commissioner for Services and Enforcement  
Commissioner, Wage and Investment Division  
Director, Accounts Management, Wage and Investment Division  
Director, E-File Services, Wage and Investment Division  
Director, Refundable Credits Policy and Program Management, Wage and Investment Division  
Director, Submission Processing, Wage and Investment Division  
Director, Office of Audit Coordination



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## Appendix IV

### *Outcome Measures*

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

#### **Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$279,372,438 (\$1,396,862,190 over five years)<sup>1</sup> of erroneous refunds on 110,398 questionable amended returns because of human error (see page 5).

#### **Methodology Used to Measure the Reported Benefit:**

We conducted computer analysis of the Individual Master File<sup>2</sup> and identified 1,127,982 amended returns that resulted in a benefit to the taxpayer during Processing Year 2017. We selected a statistically valid sample of 235 of the 1,127,982 amended returns. Our sample was selected using a 95 percent confidence level, a  $\pm 10$  percent precision, and an error rate of 17 percent. Our analysis of the 235 amended returns identified 23 amended tax returns for which all or part of the adjustments or refunds issued were potentially erroneous; however, our outcome is based on the full refund amount from 23 questionable amended tax returns.

The projected total number of amended returns with potentially erroneous tax refunds is 110,398. To make this projection, our contract statistician divided the 23 exceptions identified by the sample size of 235. The result was then multiplied by the overall population of 1,127,982:  $\left(\frac{23}{235}\right) (1,127,982)$ . The 95 percent confidence interval for the percentage of amended returns with potentially erroneous tax refunds is 6.31 percent to 14.32 percent. The resulting precision is approximately  $\pm (14.32 \text{ percent} - 6.31 \text{ percent})/2$  or  $\pm 4.01$  percent.

The projected potentially erroneous tax refunds claimed during Processing Year 2017 is \$279,372,438. The calculations for this amount were the total potential refund amounts for the 23 returns with exceptions in the sample of 235 (\$58,203.52) divided by 235 and then multiplied

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<sup>1</sup> The five-year forecast for potential revenue protection is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change. The actual amount of revenue protected is contingent upon the IRS implementing an effective process to identify questionable amended tax returns and on the extent that taxpayers can adequately substantiate their claims once contacted by the IRS.

<sup>2</sup> The IRS database that stores various types of taxpayer account information. This database contains individual, business, and employee plans and exempt organizations data.



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by 1,127,982:  $\left(\frac{\$58,203.52}{235}\right) (1,127,982)$ . The resulting 95 percent confidence interval for the potentially erroneous tax refund claimed during Processing Year 2017 is \$116,589,505 to \$672,663,001. We forecast<sup>3</sup> the IRS could potentially issue \$1,396,862,190 in erroneous refunds over the next five years (\$279,372,438 x 5). We provided the IRS each of our 23 exception cases for review.

**Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$80,495,387 (\$402,476,935 over five years)<sup>4</sup> of erroneous refunds on 47,999 questionable amended returns because taxpayers are unable to e-file their amended tax return (see page 5).

**Methodology Used to Measure the Reported Benefit:**

We selected a statistically valid sample of 235 of the 1,127,982 amended returns. Our sample was selected using a 95 percent confidence level, a  $\pm 10$  percent precision, and an error rate of 17 percent. Our analysis of the 235 amended returns identified 10 amended tax returns for which the refund issued was potentially erroneous because the amended tax return was not e-filed. These 10 questionable amended tax returns \*\*\*\*\*2\*\*\*\*\*.

The projected total number of amended returns with potentially erroneous tax refunds is 47,999. To make this projection, our contract statistician divided the 10 exceptions identified by the sample size of 235. The result was then multiplied by the overall population of 1,127,982:  $\left(\frac{10}{235}\right) (1,127,982)$ . The 95 percent confidence interval for the percentage of amended returns with potentially erroneous tax refunds is 2.06 percent to 7.69 percent. The resulting precision is approximately  $\pm (7.69 \text{ percent} - 2.06 \text{ percent})/2$  or  $\pm 2.82$  percent.

The projected potentially erroneous tax refunds claimed during Processing Year 2017 is \$80,495,387. The calculations for this amount were the total potential refund amounts for the 10 returns with exceptions in the sample of 235 (\$16,770.14) divided by 235 and then multiplied by 1,127,982:  $\left(\frac{\$16,770.14}{235}\right) (1,127,982)$ . The resulting 95 percent confidence interval for the potentially erroneous tax refund claimed during Processing Year 2017 is \$36,749,809 to

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<sup>3</sup> The five-year forecast for potential revenue protection is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change. The actual amount of revenue protected is contingent upon the IRS implementing an effective process to identify questionable amended tax returns and on the extent that taxpayers can adequately substantiate their claims once contacted by the IRS.

<sup>4</sup> The five-year forecast for potential revenue protection is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change. The actual amount of revenue protected is contingent upon the IRS implementing an effective process to identify questionable amended tax returns and on the extent that taxpayers can adequately substantiate their claims once contacted by the IRS.



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*Actions Have Not Been Taken to Improve  
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\$153,333,661. We forecast<sup>5</sup> the IRS could potentially issue \$402,476,935 in erroneous refunds over the next five years (\$80,495,387 x 5). We provided the IRS each of our 10 exception cases for review.

**Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$79,413,315 in additional processing costs forecast<sup>6</sup> over five years because taxpayers are unable to e-file their amended tax return (see page 5).

**Methodology Used to Measure the Reported Benefit:**

We used the IRS's cost estimates and percentage of e-filed and paper-filed tax returns to estimate the cost savings the IRS could have potentially realized by systemically processing amended tax returns during Fiscal Years 2013 through 2016.

- Estimated cost to process amended tax returns using current amended return processes for Fiscal Years 2013 through 2016: \$77,474,647.
- Based on the Form 1040 paper-filing rates for Fiscal Years 2013 through 2016, we estimate that taxpayers would have filed 2,183,050 paper-amended tax returns. We estimate the cost to systemically process those paper amended tax returns for Fiscal Years 2013 through 2016 would have been \$11,193,651.
- Based on the Form 1040 e-filing rates for Fiscal Years 2013 through 2016, we estimate that taxpayers would have filed 12,934,665 electronic amended tax returns. We estimate the cost to process those electronic amended tax returns systemically for Fiscal Years 2013 through 2016 would have been \$2,750,344.

We used the average cost estimate computed for Fiscal Years 2013 through 2016 and forecast<sup>7</sup> \$79,413,315 in additional processing costs over the next five years ( $\$77,474,647 - \$11,193,651 - \$2,750,344 = \$63,530,652/4$ ) x 5 because taxpayers are unable to e-file their amended tax return.

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<sup>5</sup> The five-year forecast for potential revenue protection is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change. The actual amount of revenue protected is contingent upon the IRS implementing an effective process to identify questionable amended tax returns and on the extent that taxpayers can adequately substantiate their claims once contacted by the IRS.

<sup>6</sup> The five-year forecast of potential cost savings (funds put to better use) is based on multiplying the average cost estimate computed for Fiscal Years 2013 through 2016 by five and assumes, among other considerations, that economic conditions and tax laws do not change. The actual amount of potential cost savings is contingent upon the IRS implementing processes to allow taxpayers to e-file their amended tax return.

<sup>7</sup> The five-year forecast of potential cost savings (funds put to better use) is based on multiplying the average cost estimate computed for Fiscal Years 2013 through 2016 by five and assumes, among other considerations, that economic conditions and tax laws do not change.



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*Actions Have Not Been Taken to Improve  
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**Type and Value of Outcome Measure:**

- Revenue Protection – Potential; 193,755 tax accounts used to file 205,679 potentially fraudulent amended returns filed during Processing Year 2017 with refunds totaling \$16,925,552 \*\*\*\*\*2\*\*\*\*\* (see page 12).

**Methodology Used to Measure the Reported Benefit:**

We matched TINs from our population of 1,127,982 amended tax returns filed in Processing Year 2017 to \*\*\*\*\*2\*\*\*\*\* and identified 35,376 TINs. We also identified 181,206 TINs with amended returns filed \*\*\*\*\*2\*\*\*\*\*. Our analysis identified 193,755<sup>8</sup> \*\*\*\*\*2\*\*\*\*\*. were used to file 205,679<sup>9</sup> amended returns. These 205,679 amended returns had more than \$16,925,552 in associated refunds issued.

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<sup>8</sup> A TIN could \*\*\*\*\*2\*\*\*\*\*. As such, the sum of the two populations are greater than the TINs identified and the number of amended tax returns identified.

<sup>9</sup> The number of amended tax returns is higher than the number of TINs used because an individual can amend more than one year or can submit more than one amended tax return for a tax year.



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**Appendix V**

*Management's Response to the Draft Report*

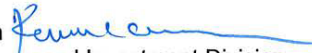


COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

MAY 31 2019

MEMORANDUM FOR MICHAEL E. MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Actions Have Not Been Taken to Improve  
Amended Tax Return Review Procedures to Reduce Erroneous  
and Fraudulent Refunds (Audit # 201840026)

Thank you for the opportunity to review the subject draft audit report and provide comments. We appreciate the acknowledgement that your statistically valid sample reflected that 86 percent of amended tax returns processed were not questionable. As the IRS has incrementally modernized its tax return processing systems over the past decade, we have maintained the goal of introducing amended returns into the electronic processing environment. The first milestone toward accomplishing that goal will be adding the capability of accepting amended individual income tax returns to the Modernized e-File (MeF) system. A Development, Modernization, and Enhancement request for fiscal year 2020 has been submitted for initial funding of \$5.6 million for the first year of the project. Completion of the first phase will provide the systemic capability of detecting potentially fraudulent returns, improving inventory management and processing of amended returns, facilitating downstream processing, and enhancing reporting capabilities.

We disagree with statements in the report to the effect that management action to enable electronic filing of amended tax returns has been lacking. In response to a previous recommendation<sup>1</sup> to expand e-filing to include amended tax returns, we agreed to develop the high-level requirements for the process and provide them to the Information Technology organization for completion of a feasibility study and cost estimate. The business capabilities, rules, and requirements for e-filing amended returns were developed and provided to the Information Technology organization on June 6, 2014. Based on these requirements, costs were estimated in December 2014 for a projected deployment in 2016. Since that time, the legacy e-File system was

<sup>1</sup> TIGTA, Ref. No. 2014-40-028, *Amended Tax Return Filing and Processing Needs to Be Modernized to Reduce Erroneous Refunds, Processing Costs, and Taxpayer Burden* (Apr. 2014).





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*Actions Have Not Been Taken to Improve  
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retired and the requirements for its electronic return intake processes were transitioned to the MeF system, and we provided this documentation to the audit team. The Congressional Justifications for IRS funding for fiscal years 2015 and 2016 each included requests of \$4.1 million to implement electronic submission of amended tax returns. The requested funding was not provided in either year and, without the earmarked funding, competing priorities for limited Information Technology resources delayed progress on the project. Examples of competing priorities include programming to fortify the defenses of our computer systems from unauthorized access and other external threats, improving fraud detection capabilities, and implementing other programming determined to be critical needs by the Treasury Inspector General for Tax Administration, such as obtaining the ability to continuously monitor e-file service providers for reported criminal activity. While resource constraints have delayed progress toward implementing electronic filing of amended tax returns, our commitment and actions toward reaching that goal have not stopped.

In its current state, amended return processing is reliant on manual processes; however, we developed automated tools for our employees to use that replicate, to the greatest extent possible, the systemic checks and validations to which original returns are subjected. As reported under the results of the review, the statistical sample of amended returns processed in 2017, in comparison to the same sampling that was performed on amended returns processed in 2012, shows improvements have been made in reducing potential errors and in the amount of potentially erroneous refunds paid due to those errors. As compared to the 2012 results, the number of amended returns identified as potential errors decreased by three percentage points, from 17 percent in 2012 to 14 percent in 2017. The amount of potentially erroneous refunds associated with the error cases similarly decreased from \$103,270 in 2012 to \$74,974 in 2017. This decrease impacts the projected estimate of losses by decreasing it from \$439 million in 2012 to \$359.9 million in 2017. While work remains to be done in this area, the results of the review do not support the finding that actions have not been taken to improve amended return processing.

The electronic submission of amended tax returns will improve our ability to reduce taxpayer errors detected during the submission process. However, it must be noted that each of the bulleted conditions described in the observations of the expanded analysis of all 228,979 amended returns processed during 2017 would require an examination, or audit, of the taxpayer(s) and their records to conclusively address any questionable items. This puts the amended returns in the arena of other compliance work that competes for the same limited resources. Under the law, taxpayers have the right of judicial review of determinations made by the IRS. If claim disallowances were made without an adequate development of the facts or review of supporting documentation, the IRS would be unable to support its determinations and taxpayers would be needlessly burdened by pursuing their administrative or statutory rights against an undeveloped or under-developed decision.



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We agree with six of the seven recommendations made in the report. We disagree that  
\*\*\*\*\*2\*\*\*\*\*  
\*\*2\*\* would provide significant additional protections beyond the current process. Based  
on the observations, we agree with the stated potential outcome measures.

Attached are our comments and planned corrective actions to your recommendations. If  
you have any questions, please contact me or a member of your staff may contact  
James P. Clifford, Director, Customer Account Services, Wage and Investment Division  
at 470-639-3504.

Attachment



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*Actions Have Not Been Taken to Improve  
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Attachment

**Recommendations**

The Commissioner, Wage and Investment Division, should:

**RECOMMENDATION 1**

Review the 23 questionable amended tax returns we identified and take the actions needed to ensure that taxpayers receive only the benefits to which they are entitled.

**CORRECTIVE ACTION**

We agree with this recommendation. The questionable returns will be reviewed, and appropriate corrective actions will be taken when warranted.

**IMPLEMENTATION DATE**

October 15, 2019

**RESPONSIBLE OFFICIAL**

Director, Customer Account Services, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 2**

Implement adequate processes and procedures to identify and correct employee errors to reduce erroneous refunds issued.

**CORRECTIVE ACTION**

We agree with this recommendation. We will evaluate training material and procedural guidance, and revise it, as necessary, to address errors identified in amended return processing.

**IMPLEMENTATION DATE**

October 15, 2020

**RESPONSIBLE OFFICIAL**

Director, Customer Account Services, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control system.



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**RECOMMENDATION 3**

Complete a business case and request funding for expansion of e-filing to amended returns in the 2020 Filing Season in an effort to reduce unnecessary processing costs and erroneous refunds resulting from amended returns \*\*\*\*\*2\*\*\*\*\*.

**CORRECTIVE ACTION**

We agree with this recommendation. Development, Modernization, and Enhancement request 222643 was submitted on March 29, 2019, requesting \$5.6 million of fiscal year 2020 funding, to enhance the Modernized e-File system with the capability of accepting electronically filed amended personal income tax returns. If approved as a fiscal year 2020 expenditure, it is expected the programming and related system modifications will be in place to permit acceptance of electronically filed amended income tax returns upon the start of the 2021 filing season. The completion of this work is contingent on both the timely passage of the IRS's fiscal year 2020 funding appropriations and the availability of limited Information Technology resources, which are subject to competing priorities. Consequently, we cannot provide an implementation date.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

Director, Customer Account Services, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control system.

**Recommendation**

**RECOMMENDATION 4**

The Commissioner, Wage and Investment Division, should update tax examiner and CSR review guidelines to incorporate additional verification steps to be taken similar to those systemically performed when verifying a refundable claim on an original tax return. In particular, revised processes and procedures should require an extensive review of amended tax returns with claims for refundable credits \*\*\*\*\*2\*\*\*\*\*.

**CORRECTIVE ACTION**

We agree with this recommendation; however, we note that the observations upon which it is based represent issues of fact that require an examination of taxpayer records. In other words, an audit of the taxpayer would be required to resolve questionable items presented on the amended returns. Our examination resources are finite and require discretion in workload selection to ensure they are used as effectively



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and efficiently as possible. We also note that the average refund at stake in the population of amended returns analyzed amounted to approximately \$82, which is significantly less than the cost of conducting even a limited examination. We will, however, review our processes and determine additional steps that can be taken with our limited resources to identify and address these issues.

**IMPLEMENTATION DATE**

October 15, 2020

**RESPONSIBLE OFFICIAL**

Director, Customer Account Services, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control system.

**Recommendations**

The Commissioner, Wage and Investment Division, should:

**RECOMMENDATION 5**

Modify the Form 1040X to allow individuals \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* when filing an amended tax return. Once  
modified, update processing procedures to verify the accuracy of \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* and, \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* , continue processing the amended return.

**CORRECTIVE ACTION**

We agree with this recommendation; however, we believe a deeper analysis of the issue should be completed before including it as a requirement for amended returns. Our previous analyses of fraud potential on amended returns indicates low risk \*\*2\*\* \*\*\*\*\*2\*\*\*\*\* . We will perform additional \*\*\*\*\*2\*\*\*\*\* checks on a sample population of amended returns by taxpayers \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*\* . Based on the results of this study, we will determine if Form 1040-X, Amended U.S. Individual Income Tax Return, should be modified to include \*\*\*\*\*2\*\*\*\*\* .

**IMPLEMENTATION DATE**

October 15, 2020

**RESPONSIBLE OFFICIAL**

Director, Accounts Management, Customer Account Services, Wage and Investment Division



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**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 6**

Update processing procedures to hold the amended tax return from further processing when the taxpayer's tax account \*\*\*\*\*2\*\*\*\*\*. Consistent with original tax return processes, \*\*\*\*\*2\*\*\*\*\*.

**CORRECTIVE ACTION**

We disagree with this recommendation. Verification processes are in place to ensure the amended return matches the original. Taxpayers who \*\*\*\*\*2\*\*\*\*\* are not precluded from having a need to amend or correct their original return. The analysis of the 205,679 amended returns made correlations to the taxpayers \*\*\*\*\*2\*\*\*\*\* however, none of those amended returns were found \*\*\*\*\*2\*\*\*\*. We believe our verification processes provide sufficient account protections without imposing the additional burden on taxpayers that may be necessary during original return processing.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION 7**

Establish processes to evaluate amended tax returns \*\*\*\*\*2\*\*\*\*\* Processes should include identifying amended tax returns filed \*\*\*\*\*2\*\*\*\*\* tax returns that were filed before and after the amended tax return.

**CORRECTIVE ACTION**

We partially agree with this recommendation. As stated previously, none of the 205,679 amended returns that were analyzed \*\*\*\*\*2\*\*\*\*\* We reviewed 40 amended returns from the subset of 1,930 \*\*\*\*\*2\*\*\*\*\* For 33 of the 40 accounts, we



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found clear linkages between the \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*. Under existing processes, \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\* is not feasible; however, we will include amended returns filed \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* in our sample population discussed in the corrective  
action for Recommendation 5. Presumably, this approach will leverage the \*\*\*\*\*2\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* used on original returns as \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*; the amended return will be subject to inclusion in the sample  
population. \*\*\*\*\*2\*\*\*\*\*; there is reasonable assurance that the  
original return passed the \*\*\*\*\*2\*\*\*\*\* and the \*\*\*\*\*2\*\*\*\*\* of the  
amended return is low.

The potential corrective action for this recommendation is dependent on the outcome of  
the study we will conduct to assess the feasibility of using an \*\*\*\*\*2\*\*\*\* on amended  
returns. If it is determined processes should be developed, we will identify the actions to  
be taken and determine when they can be implemented. Consequently, we cannot  
provide an implementation date now.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

Director, Accounts Management, Customer Account Services, Wage and Investment  
Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control  
system.