
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

May 26, 2020

Reference Number: 2020-40-029

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

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HIGHLIGHTS

IMPROVEMENTS ARE NEEDED TO ENSURE THAT MEMBERS OF THE MILITARY RECEIVE TAX BENEFITS TO WHICH THEY ARE ENTITLED

Highlights

Final Report issued on May 26, 2020

Highlights of Reference Number: 2020-40-029 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

Currently more than 2.8 million individuals serve in some capacity for the U.S. military, including more than 2.1 million service members and more than 700,000 civilians. In recognition of the dangers that members of the military face and the sacrifices they make on behalf of the United States, special Federal income tax benefits have been extended to members of the military since the inception of modern taxation.

WHY TIGTA DID THE AUDIT

This audit was initiated to evaluate the IRS's assistance to current and former members of the military who are serving currently or have served in a combat zone and/or received a combat-related disability severance payment.

WHAT TIGTA FOUND

The IRS has taken a number of actions to address prior recommendations to improve the identification of individuals serving in a combat zone. However, the IRS still does not have processes and procedures to resolve unpostable records received from the Department of Defense (DOD).

Our analysis of DOD data with an unpostable condition as of October 3, 2019, determined that 3,047 individuals never had a Combat Zone Indicator placed on their tax account. Although the IRS established processes to maintain the unpostable records in a database, it cannot confirm that manual review processes were implemented.

In addition, due to programming and tax examiner errors, some tax accounts with aged

Combat Zone Indicators were not accurately updated. Our analysis identified 358 individuals with a Combat Zone Indicator with an entry date that was more than two years old and with a balance due to the IRS totaling more than \$2.5 million for which collection activity was suspended.

Further, additional steps can be taken to notify some veterans of their right to claim a disability severance payment refund. Actions should be taken to assist veterans whose letters were returned as undeliverable or the IRS did not have a current address. In addition, the IRS did not protect the right to file a refund claim for 419 veterans who did not receive a letter because the IRS did not have a valid address.

Finally, the Combat-Injured Veterans Tax Fairness Act of 2016, in providing for the retroactive refund of these improperly withheld taxes, did not include veterans from the Coast Guard. The National Taxpayer Advocate 2020 Purple Book includes a legislative recommendation to modify the Act to include Coast Guard veterans who had Federal income tax improperly withheld from their disability severance payments.

WHAT TIGTA RECOMMENDED

TIGTA made eight recommendations to improve the IRS's assistance to current and former members of the military. TIGTA recommended that the IRS develop processes to resolve unpostable records and ensure that all Combat Zone Indicators more than two years old are identified and reviewed. In addition, the IRS should ensure that eligible veterans for whom it has an address are notified of their right to file a refund claim and the right to file a claim is protected for the 419 veterans for which the IRS does not have a valid address.

The IRS agreed or partially agreed with six recommendations. The IRS disagreed with TIGTA's recommendations to update its systemic program to prioritize the assignment of aged Combat Zone Indicators or to place an indicator on the 419 tax accounts of the veterans the DOD identified but did not receive a letter from the IRS.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

May 26, 2020

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM:

Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Improvements Are Needed to Ensure That
Members of the Military Receive Tax Benefits to Which They Are
Entitled (Audit # 201840042)

This report presents the results of our review to evaluate the Internal Revenue Service's assistance to current and former members of the military who are serving or have served in a combat zone and/or received a combat-related disability severance payment. This review was included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Providing Quality Taxpayer Service and Protecting Taxpayer Rights.

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

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).



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

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***Improvements Are Needed to Ensure That Members of the
Military Receive Tax Benefits to Which They Are Entitled***

Abbreviations

| | |
|--------|---|
| DOD | Department of Defense |
| I.R.C. | Internal Revenue Code |
| IRS | Internal Revenue Service |
| TIGTA | Treasury Inspector General for Tax Administration |



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

Background

Currently more than 2.8 million individuals serve in some capacity for the United States (U.S.) military, including more than 2.1 million service members and more than 700,000 civilians. In recognition of the dangers that members of the military face and the sacrifices they make on behalf of the U.S., special Federal income tax benefits have been extended to members of the military since the inception of modern taxation. For example, Section (§) 112 of the Internal Revenue Code (I.R.C.)¹ excludes from gross income compensation paid to noncommissioned U.S. Armed Forces personnel serving in a combat zone and excludes a portion of the compensation paid to commissioned officers of the U.S. Armed Forces.

Civilian contractors and other civilian employees working in a combat zone are not eligible for the combat zone pay exclusion provided by I.R.C. § 112. While civilian employees' pay is taxable, I.R.C. § 7508² postpones certain tax-related acts for individuals serving in the U.S. Armed Forces or serving in support of the U.S. Armed Forces in a combat zone. These benefits are generally extended for the period of time the individual is in a combat zone and are further extended for other reasons including periods of hospitalization due to injury received while in a combat zone.

Military tax benefits for those serving in a combat zone include exclusion of combat zone wages from taxation and postponement of filing tax returns, paying taxes, filing claims for refunds, enforcement activities,³ and other actions. Civilians who support the U.S. Armed Forces, such as Red Cross employees, industrial technicians, accredited correspondents, and Federal Government specialists, can qualify for some combat zone tax benefits. This includes extensions of time to file tax returns, pay taxes, and claim refunds; suspension of enforcement activities; and suppression of notices. The main difference between military and civilian benefits is that ***civilians are not entitled to the combat zone military pay exclusion.***⁴ The income exclusion is reflected in the taxable wages reported on Form W-2, *Wage and Tax Statement*. Figure 1 provides a comparison of benefits to which military members and civilians working in a combat zone are entitled.

¹ I.R.C. § 112 (2019).

² I.R.C. § 7508 (2020).

³ Enforcement activities include examinations and actions to collect outstanding taxes.

⁴ Civilians are not entitled to the combat zone military pay income tax exclusion, but still may be able to exclude income under the Foreign Earned Income Exclusion if they meet the requirements. Civilian employees of the U.S. Government are not entitled to exclude foreign income.



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Figure 1: Comparison of Combat Zone Tax Relief Benefits Afforded to Military Service Members and Civilians

| COMBAT ZONE BENEFITS | MILITARY SERVICE MEMBER | | CIVILIAN |
|--|------------------------------|------------------------|---------------------|
| | Enlisted Member ⁵ | Commissioned Officer | |
| Exclusion of military pay for service in a combat zone | YES | YES (partial wages) | NO |
| Extension of filing deadlines for service in a combat zone | YES | YES | YES |
| Include nontaxable combat zone pay to qualify for Earned Income Tax Credit | YES | YES | NO |
| Forgiveness of decedent's tax liability due to combat zone activity | YES | YES | NO (Non-Federal) |

Source: Internal Revenue Service (IRS) Publication 3, *Armed Forces' Tax Guide*; Internal Revenue Manual 5.19.10.6.2.1; and IRS website (IRS.gov).

Process to notify the IRS of an individual's service in a combat zone and to add the Combat Zone Indicator⁶ on a tax account

The IRS is notified of individuals serving in a combat zone from:

- **Department of Defense (DOD)** – The DOD sends monthly electronic extracts to notify the IRS when a member of the military enters or leaves a combat zone.⁷ As of October 3, 2019, the IRS received 252,300 records identifying members of the military who entered or exited a combat zone between January and August 2019.
- **Self-identification** – There are three ways an individual may self-identify.
 - Individuals can write “Combat Zone” on their paper tax return or enter “Combat Zone” in a special field on the electronically filed tax return. When the IRS receives the tax return, a transaction code is entered on the individual's account to update the Combat Zone Indicator ensuring that the individual receives combat zone tax relief

⁵ Includes warrant officers and commissioned warrant officers.

⁶ An indicator is placed on the taxpayer's account to alert IRS employees the taxpayer is or has been in a combat zone.

⁷ The IRS did not receive accurate monthly updates from the DOD beginning March 2018 through October 2019. The IRS received a cumulative dataset on October 3, 2019, containing all deployment records from April 2018 through August 2019.



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benefits. The IRS does not track the number of individuals who self-identify as serving in a combat zone.

- Individuals can call the IRS toll-free telephone number used specifically for combat zone calls. The toll-free telephone line provides individuals with answers to combat zone tax questions and account-related inquiries. During Fiscal Year 2019, the IRS received 6,021 calls on this toll-free telephone number.
- Individuals can send notification using a unique e-mail address of combatzone@irs.gov. During Calendar Year 2018, the IRS received 3,773 e-mails to the combat zone inbox. Similar to the service provided by the toll-free telephone line, individuals can receive answers to combat zone general tax questions.

Once the IRS receives notification that an individual is in a combat zone, a Combat Zone Indicator is placed on the individual's account extending the due dates for filing tax returns and paying taxes, *etc.* The indicator stays active on the individual's account until the IRS receives notification the individual is no longer in a combat zone, at which time the indicator is deactivated and normal processing of the account resumes.

Combat-Injured Veterans Tax Fairness Act of 2016⁸

Congress enacted the Combat-Injured Veterans Tax Fairness Act of 2016 (hereinafter referred to as "the Act"), which extended the amount of time veterans can claim a refund of taxes that were improperly withheld from disability severance payments they received. Veterans discharged from military service due to a medical disability may receive a one-time lump sum severance payment. These payments are not subject to Federal income taxes if the veteran had a combat-related injury or is entitled to receive disability compensation from the Department of Veterans Affairs. However, the DOD identified 130,497 potentially eligible veterans with nearly \$3 billion in severance payments made between Calendar Years 1991 and 2017⁹ for which Federal income taxes were withheld. The Act requires the DOD to identify the amount of severance payments paid to veterans with combat-related injuries after January 17, 1991, from which it incorrectly withheld Federal income tax.

The Act requires the DOD to notify each veteran who received a payment from which Federal income tax was withheld improperly. The DOD provides the veteran with the amount of the severance payment, instructions for filing amended tax returns to recover the amounts withheld improperly, and any other information the Secretary of the Treasury determined to be necessary to implement this legislation. Once notified, veterans can then submit an amended tax return to claim a refund of tax withheld improperly from a disability severance payment.

⁸ Pub. L. No. 114-292.

⁹ The DOD identified one veteran who received disability severance pay in Calendar Year 1988 from which it incorrectly withheld Federal income tax.



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In May 2018, the IRS and the DOD signed a Memorandum of Agreement to facilitate data sharing, detail the process to send letters to inform veterans of their potential benefits, and identify IRS administrative costs related to the assistance provided to the DOD. Specifics of the Memorandum of Agreement include the DOD partnering with the IRS to have the IRS identify the last known address of these former service members and mail the letter on behalf of the DOD.¹⁰ The IRS agreed to print and mail letters to the veterans identified by the Defense Finance and Accounting Services. Under the Memorandum of Agreement, the DOD will reimburse the IRS through an Interagency Agreement for the costs associated with producing, printing, and mailing the letters and the associated labor costs. The DOD identified and the IRS mailed letters to more than 137,000 affected veterans between July 2018 and July 2019.

The IRS created standard refund amounts to assist veterans claiming a refund of taxes that were improperly withheld from a disability severance payment

To assist veterans or their estates that lack sufficient documentation to claim the actual benefit amount, the IRS created safe harbor amounts, referred to as standard refund amounts. Claiming the standard refund amount does not require the taxpayer to find his or her original tax return or ask the IRS for information from the tax return. For example, if a veteran received a severance payment in Calendar Year 1991 but did not have all of his or her tax return documentation, he or she can take the standard refund amount. The letters mailed to the potentially eligible veterans informed them of the option to claim the standard refund amount based on the year the disability severance payment was received. The IRS calculated the standard refund amounts by estimating the amount of taxes paid on the severance payments by the impacted veterans and identifying refund amounts that would benefit the majority of veterans claiming standard refund amounts while limiting potential overpayments. The IRS calculated the following three standard refund amounts:

- \$1,750 for Tax Years 1991 through 2005.
- \$2,400 for Tax Years 2006 through 2010.
- \$3,200 for Tax Years 2011 through 2016.

A prior Treasury Inspector General for Tax Administration (TIGTA) review identified a lack of sufficient processes to ensure the accuracy of Combat Zone Indicators

In September 2009,¹¹ we reported that despite the IRS implementing a number of actions to help ensure the accuracy of Combat Zone Indicators, there were still significant problems with inaccurate indicators. Our review identified that Combat Zone Indicators were inaccurate

¹⁰ Appendix V provides an example of the Letter that was mailed to impacted veterans.

¹¹ TIGTA, Ref. No. 2009-40-138, *Combat Zone Indicators on Taxpayer Accounts Are Frequently Inaccurate* (Sept. 2009).



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because the IRS was incorrectly updating Combat Zone Indicators to active status when a military member self-identified on the tax return that they served in a combat zone. In addition, Combat Zone Indicators the IRS used did not distinguish between military and civilian individuals. Further, unpostable conditions were not resolved accurately when there was a problem posting the entry/exit dates provided by the DOD. Although the IRS had the ability to identify these unpostable records, it had not established a process to resolve them. Finally, actions were not taken at the time an individual self-identified to validate combat zone service.

The IRS agreed to take action on nine of our 10 recommendations. These actions included working with the Information Technology organization to improve the existing process that identifies individuals in a combat zone and ensuring accurate reversal of Combat Zone Indicators. Other IRS actions included developing solutions to address the incorrect reactivation of Combat Zone Indicators, developing a process to capture dropped records, and establishing resolution procedures when records do not post. The IRS disagreed with our recommendation to develop a process to distinguish military individuals from civilian individuals. The IRS stated that it already has a means to distinguish between military and civilian individuals, and the creation of an additional process to distinguish military individuals from civilian individuals would not assist it in determining the benefits to which the individual may be entitled.

This review was conducted in the Submission Processing Centers in Kansas City, Missouri, and Austin, Texas, and with information obtained from the Wage and Investment Division, Accounts Management function in Kansas City, Missouri, and the Small Business/Self-Employed Division, Compliance Service Collection Operations function in Atlanta, Georgia, during the period August 2018 through December 2019. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

The IRS has taken a number of actions to address prior recommendations to improve the identification of individuals serving in a combat zone. For example, the IRS established processes to identify which of the individuals filing a joint tax return is serving in a combat zone. The IRS also established processes to require individuals who self-identify to provide documentation to verify their service in a combat zone. For example, for those individuals who self-identify, the IRS will set the Combat Zone Indicator on the individual's account and send the individual a letter requesting the entry and exit dates. The notice requests supporting military documentation such as a copy of military orders that show deployment dates and the location(s) of the combat zone serving or served in, qualified hazardous duty area, or contingency operation. Once the IRS has received documentation supporting the individual's entry or exit into a combat zone, the Combat Zone Indicator is updated to show the entry or exit date. If the IRS does not receive the requested information within 70 calendar days, it will reverse the Combat Zone Indicator on the individual's account.

In addition, in coordination with the DOD, the IRS developed notification letters to send to the veterans the DOD identified. Between July 2018 and July 2019, the IRS notified more than 137,000 veterans of their right to claim a refund or credit for Federal income tax improperly withheld from their lump-sum disability severance payments in accordance with the Act. As of May 23, 2019, the IRS processed 24,164 amended returns and issued \$104 million in refunds to 18,271 veterans. However, an estimated 1,116 veterans of the Coast Guard were not included in the more than 137,000 individuals who received a notification letter. As reported in the *National Taxpayer Advocate 2020 Purple Book*,¹² the Act did not direct the Secretary of Homeland Security to identify affected Coast Guard veterans and the amounts of disability severance payments they received from which taxes were improperly withheld. A legislative change would be needed to allow Coast Guard veterans to file claims for credit or refund for taxes improperly withheld from disability severance payments.

Unpostable Department of Defense Combat Zone Data Records Are Still Not Resolved

Similar to the problem we reported in September 2009, the IRS still does not have processes and procedures to ensure that Combat Zone Indicators are placed on an individual's tax account with an unpostable condition, once identified by the IRS. An unpostable DOD record is one in which the identifying information, *e.g.*, name and Social Security Number, the DOD provided does not

¹² IRS Publication 5286, *National Taxpayer Advocate Purple Book: Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration*, issued December 31, 2019.



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match the information in the IRS's databases; as such, the IRS is unable to post the information to the associated tax account to set or update the Combat Zone Indicator.

In September 2009, we reported that the IRS did not have a process to maintain and resolve records that had an unpostable condition. This prevented the IRS from being able to add a Combat Zone Indicator to an associated tax account. We recommended that the IRS establish processes to identify and resolve these unpostable records. The IRS agreed with our recommendation. However, our analysis of DOD data with an unpostable condition as of October 3, 2019, determined that 3,047 individuals never had a Combat Zone Indicator placed on their tax account.

In response to our prior recommendation, the IRS established processes to identify DOD records in which the Social Security Number or name provided does not match IRS records. These records are placed in a database to be resolved manually by a tax examiner. In addition, IRS management stated that they had developed processes to work the unpostable records. However, IRS management could not confirm whether the processes to review the unpostable records manually were ever implemented. As a result, individuals currently serving in a combat zone may not receive the benefits to which they are entitled, and individuals who are no longer serving in a combat zone may receive benefits they are no longer entitled to receive.

During this review, the IRS has taken steps to resolve the unpostable condition using both systemic and manual processes. As of December 2019, the IRS has completed the corrections on a majority of the cases and continues to work with stakeholders to resolve the unpostable conditions on the remaining tax accounts.

Actions taken by IRS management did not timely resolve a lack of DOD data needed for identification of tax benefits

Our review identified that the DOD ceased providing the IRS with monthly DOD notification files in July 2018 citing concerns about providing classified information (the deployment location) to the IRS. In August 2018, the IRS began discussions with its DOD counterparts and internal stakeholders to identify potential solutions. However, the IRS did not resume receiving data from the DOD until October 2019.

On January 29, 2019, we became aware that the IRS did not receive DOD data needed to update Combat Zone Indicators systemically, and we met with IRS management to determine what actions they were taking to resolve this issue. IRS management stated that they were working with the DOD to identify relevant data fields and obtain all historical and future data.

On May 9, 2019, we again notified IRS management of our concern regarding the data that were not received from the DOD. The IRS's website and publications inform members of the military that the IRS receives data from the DOD systemically regarding their service in a combat zone. As such, members of the military would assume that no actions were needed on their part to ensure that the IRS knew of their service in a combat zone. We recommended that this information be updated. IRS management disagreed with our recommendation, stating they were



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close to reaching an interim solution on a systemic workaround and communicating self-identification instructions would confuse individuals and cause undue burden.

On September 20, 2019, we again alerted the IRS of our concerns with the extended delay in receiving DOD data. We recommended that the IRS cease collection activities on individuals with nontaxable combat pay reported in Calendar Year 2018. We also again recommended that the IRS update its public website and publications to provide clear information to members of the military and military families that they need to self-identify if they are currently serving or previously served in an active combat zone after April 1, 2018. Management once again disagreed with our recommendation to update the information provided to the military and military families, and stated that they were working with the DOD to obtain usable data as soon as possible. In October 2019, the IRS finally began receiving monthly DOD data needed to update Combat Zone Indicators systemically.

Recommendations

The Commissioner, Small Business/Self-Employed Division, should:

Recommendation 1: Ensure that processes are developed and implemented to resolve unpostable DOD records.

Management's Response: The IRS agreed with this recommendation and plans to develop and implement procedures to timely resolve unpostable DOD records.

Recommendation 2: Review the 10,827 unpostable DOD records we identified and ensure that actions are taken to resolve the unpostable condition to set or update the Combat Zone Indicator on the individual's tax account. For those individuals who the IRS determines are currently serving in a combat zone, the IRS should immediately cease any collection activities being taken and abate all penalties and interest that were assessed incorrectly because the IRS did not work the mismatched DOD records timely.

Management's Response: The IRS agreed with this recommendation and has already reviewed and resolved 91 percent of the unpostable fallout of records and will resolve the remaining records where appropriate. IRS management also plans to cease any collection activities for those individuals they determine are currently serving in a combat zone. Penalties and interest are automatically adjusted on these accounts when the Combat Zone Indicator is input.

Office of Audit Comment: The IRS disagreed with our outcome measure related to the 3,047 individuals whose taxpayer rights and entitlements were not protected. IRS management stated that they are unable to agree with our outcome because the Control D report we used contains duplicates and accounts that may not require a Combat Zone Indicator. Notwithstanding management's disagreement, the Control D report is the same report that management uses to identify accounts with unpostable conditions that



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need to be reviewed. As such, the IRS will need to review the unpostable record for each of the 3,047 individuals we identified on their Control D report before it can determine whether the individual's tax account should have a Combat Zone Indicator.

Some Tax Accounts With Aged Combat Zone Indicators Were Not Accurately Updated

Our analysis of tax accounts with a Combat Zone Indicator as of October 24, 2019, identified 5,336 tax accounts for which the entry date into a combat zone was more than two years old and there is no exit date. However, 1,780 (33.4 percent) of the 5,336 tax accounts were not listed on the IRS's *Combat Zone Clean-Up Transcript* list. As such, individuals could be receiving benefits to which they are no longer entitled. For example, our review of the 1,780 individuals who were not on the IRS's *Combat Zone Clean-Up Transcript* list found that the IRS has suspended collection actions for 358 (20.1 percent) individuals with a balance due to the IRS totaling more than \$2.5 million.

The IRS has implemented a systemic program that identifies tax accounts with a Combat Zone Indicator for which the entry date into a combat zone was more than two years old and there is no exit date. These tax accounts are then added to the *Combat Zone Clean-Up Transcript* list that is generated each month and provided to tax examiners in the IRS Compliance Services Collection Operations and Accounts Management functions. Once generated, the transcripts are assigned to the respective function in the Account Management Services system¹³ and assigned to the inventory of IRS employees in those functions. Tax examiners are required to research available IRS information in an attempt to confirm whether the individual has left the combat zone and if so, when.

If no exit date is found, the IRS employee will mail a Letter 2761C, *Request for Combat Zone Service Dates*, requesting information from the individual to confirm the entry and exit dates. The Letter 2761C requests members of the military provide a copy of their military orders that show the deployment dates and location of the combat zone, qualified hazardous duty area, or contingency operation. Civilians working in support of a combat zone are requested to provide a copy of their Letter of Authorization. If a copy of military orders or an authorization letter are not available, the IRS requests a written statement from the individual's military department or employer that shows the deployment dates and the location of the designated combat zone area, qualified hazardous duty area, or contingency operation.

As of December 4, 2019, IRS management indicated that they elevated TIGTA's concern to its Information Technology organization specialists to determine why the individuals with an aged Combat Zone Indicator were not listed on the IRS's *Combat Zone Clean-Up Transcript* list. According to IRS management, the tax accounts we identified did not appear on the *Combat*

¹³ Account Management Services is a web-based system that emphasizes the sharing of key business data and provides a consolidated and synchronized view of taxpayer data and contact information from various IRS systems.



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Zone Clean-up Transcript list because at the time we pulled the list, these accounts had not been assigned to the responsible IRS function for resolution.

Due to tax examiner errors, some tax accounts with aged Combat Zone Indicators were not updated accurately

Our review of a judgmental sample¹⁴ of 66 of the 654 responses received from individuals in response to Letter 2761C between February and May 2019 found that IRS employees incorrectly updated the Combat Zone Indicator for 33 (50 percent) of the 66 tax accounts. Tax examiners input the entry or exit dates shown in supporting documentation incorrectly. As a result, individuals can be incorrectly denied benefits, such as the extension of time to file a return or suspension of collection activity, to which they are entitled. Tax examiners' errors can also incorrectly extend benefits for individuals who are no longer entitled to receive them.

On July 17, 2019, we shared our concerns with IRS management. IRS management confirmed that tax examiners input the entry or exit dates incorrectly for 28 (84.8 percent) of the 33 tax accounts we identified. For the remaining five tax accounts, one individual re-entered a combat zone. Management indicated that for the remaining four cases, the Accounts Management Services system incorrectly showed that a response to Letter 2761C was not received when in fact a response was received. As such, these tax accounts were also not updated correctly.

Recommendations

Recommendation 3: The Chief Information Officer should update the systemic program to prioritize the assignment of aged Combat Zone Indicators for which the entry date into a combat zone is more than two years old and there is no exit date to ensure that the oldest aged Combat Zone Indicators are placed in the Account Management Services system for assignment first.

Management's Response: The IRS disagreed with this recommendation. IRS management believes the systemic programming for which the entry date into a combat zone is more than two years old is working as intended. The cases are distributed over a 12-month period on a monthly cleanup list. This is done for workload considerations and allows the list to be worked throughout the year.

Office of Audit Comment: We agree that systemic programming identifies accounts with an entry date more than two years old. However, the concern we raised, which was not addressed, is that once these cases are identified, there is no prioritization to ensure that the oldest cases are worked first. IRS management also disagreed with our outcome measure of \$2.5 million in potential additional revenue, citing that the increased revenue figure assumes these liabilities would be collected in full. We agree that the actual

¹⁴ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population. We reviewed a judgmental sample because the total population of responses to the Letter 2761C is unknown. We reviewed a judgmental sample of 10 percent of the 654 responses provided by the IRS.



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amount of increased revenue is contingent upon IRS working the case and each taxpayer's individual situation and ability to satisfy the balance due.

Recommendation 4: The Commissioner, Small Business/Self-Employed Division, should develop processes and procedures to ensure that Combat Zone Indicators are updated accurately based on individuals' responses to Letter 2761C.

Management's Response: The IRS agreed with this recommendation and plans to collaborate with its stakeholders to develop processes and procedures to ensure that Combat Zone Indicators are updated accurately based on individuals' responses to Letter 2761C.

Additional Steps Can Be Taken to Notify Some Veterans of Their Right to Claim a Disability Severance Payment Refund

Our review identified that in July 2018, the IRS sent 130,078 letters to veterans. Our analysis of the 130,078 letters mailed found 139 veterans were mailed an incorrect version of the letter. This included:

- 61 veterans who were mailed a Letter 6060-A when there was a deceased indicator on their tax account. The IRS mails a Letter 6060-A to the current mailing address for veterans who are still alive. The IRS should have sent a Letter 6060-D to the last known address used on a deceased veteran's tax return and included filing instructions for the estate, *i.e.*, a Form 1310, *Statement of Person Claiming Refund Due a Deceased Taxpayer*, stuffer. Form 1310 provides the surviving spouse or court-appointed representative an opportunity to file a claim for a refund on the deceased veteran's behalf.
- 78 veterans who were mailed a Letter 6060-D because the IRS database erroneously identified the veteran as deceased. These veterans should have been sent a Letter 6060-A.

We notified the IRS of our concerns during our review. The IRS agreed that the 78 veterans were erroneously identified as deceased due to a programming issue in the tool used to pull date of death information. The IRS also agreed that the 61 veterans TIGTA identified as deceased were mailed the incorrect letter because of the programming error or because the IRS's database was not updated with the date of death information for the veteran at the time the letters were issued. The IRS implemented programming changes to correct the programming errors. We reviewed the 5,774 letters mailed to potentially eligible veterans in the second letter mailing campaign in July 2019 and confirmed that the programming errors were resolved. We found that the IRS correctly identified living and deceased veterans to determine which letter to send.



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

Actions should be taken to assist veterans whose letters were returned undeliverable or the IRS did not have a current address

For 10,734 of the veterans to whom the IRS sent a letter, the letter was returned undeliverable or the IRS did not have a good address for the veteran. To identify addresses for use in mailing the notification letter, the IRS matched the veteran's identifying information the DOD provided to the veteran's tax account. The IRS used the most current address on the tax account, the address of record, to mail the letter. The 10,734 veterans included:

- 10,315 (96.1 percent) veterans for whom the U.S. Post Office returned their letters to the IRS as undeliverable. Our review of tax returns filed during Processing Year 2019 identified an updated address for 2,860 (27.7 percent) of these veterans. The IRS resent the notification letters to these 2,860 veterans at the updated address on November 20, 2019. However, IRS management stated that they do not have the resources to continuously monitor the remaining veterans' tax accounts as returns are filed to identify an updated address.
- 419 (3.9 percent) veterans for whom the IRS did not have a good address in its databases. For example, the IRS's address of record for these veterans was either missing, invalid, or that of an IRS tax processing center indicating the veteran was a victim of identity theft. As a result, the IRS could not mail letters to these potentially eligible veterans. However, our analysis of the 419 veterans' tax accounts identified tax returns and/or information returns the IRS received that contained an address for 292 (69.7 percent) veterans (161 from tax returns and 131 from information documents) which the IRS could use to attempt a mailing.

When we discussed this issue with IRS management, they indicated that they do not plan to send a letter to these 292 veterans. IRS management indicated that it is the IRS's policy not to use addresses found on an information return for mailing communications to individuals. However, the I.R.C.¹⁵ does authorize the IRS to use return information to send notices and other correspondence. Return information includes information returns.

Processes were implemented to protect veterans' right to file a refund claim when a valid address could not be identified

The Act grants eligible veterans one year from the date they receive the required notification to file a claim for refund. To ensure that this period is protected for veterans for whom the letter was returned undeliverable, the IRS places an indicator on the associated veteran's tax account identifying them as an eligible veteran. The indicator notifies IRS employees that the veteran has not received the required notification and, as such, still has one year from the time the veteran contacts the IRS and is re-mailed the letter to file a claim. Our review of the 10,315 veterans whose letter was returned to the IRS as undeliverable found that all tax accounts

¹⁵ I.R.C. § 6103.



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

for those veterans who have not yet filed a claim contained the indicator to protect the one-year claim period.

However, the IRS did not place an indicator on the tax account of the 419 veterans who did not receive a letter because the IRS did not have a valid address. IRS management stated that they cannot place an indicator on these tax accounts because the IRS never attempted to mail a letter to these veterans. We agree that the IRS should not place an undeliverable indicator on the 419 veterans' tax accounts we identified. However, the IRS could set an indicator on these veterans' tax accounts to show that the veteran was identified by the DOD but was not notified of their right to file a claim for improperly withheld tax because of the lack of a valid address. For example, the current indicator can be modified to show a "1" for veterans whose letter was returned as undeliverable and a "2" for veterans for whom the IRS does not have a valid address.

Coast Guard veterans were not covered by the law that provides for the refund of these improperly withheld taxes

The Act did not direct the Secretary of Homeland Security¹⁶ to identify affected Coast Guard veterans and the amounts of disability severance payments they received from which taxes were withheld improperly. As such, an estimated 1,116 Coast Guard veterans are not entitled to additional time to file claims for credit or refund for taxes improperly withheld from disability severance payments.

The *National Taxpayer Advocate 2020 Purple Book*, which details legislative recommendations designed to strengthen taxpayer rights and improve tax administration, includes a recommendation to remedy the exclusion of Coast Guard veterans from claiming a credit or refund for tax that was withheld from disability severance payments improperly. Specifically, the Taxpayer Advocate Service recommends amending Section 3(a) of the Act to include severance payments paid by the Secretary of Homeland Security and to require the Secretary of Homeland Security to notify Coast Guard veterans about disability severance payments from which taxes were withheld.

¹⁶ 14 U.S.C. Section 1. The Coast Guard as established January 28, 1915, shall be a military service and a branch of the armed forces of the United States at all times. The Coast Guard shall be a service in the Department of Homeland Security, except when operating as a service in the Navy.



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 5: Send notification letters to the 292 veterans for whom we identified a more current address on a prior year tax return or information return.

Management's Response: The IRS partially agreed with this recommendation and has already issued the notification to 70 of the veterans based on new address information from a subsequently filed tax return. The remaining letters will not be sent using third-party addresses due to the potential for unauthorized disclosure of confidential information that could lead to the information being used for identity theft-related activities.

Recommendation 6: Place an indicator on the 419 tax accounts of the veterans who the DOD identified but did not receive a letter to identify them as a potential claimant.

Management's Response: The IRS disagreed with this recommendation stating that there is no existing indicator available to mark the accounts of these veterans. IRS management noted that letters were subsequently issued to some of these veterans based on new address information. The majority of the veterans have identity theft issues or have no existing account on which to place any indicators. Alternatively, the IRS has existing guidance to direct these veterans to the DOD. The DOD has information available via e-mail, websites, and toll-free calls to provide the veterans with all necessary steps to file a claim if eligible.

Office of Audit Comment: We agree that for individuals without an active tax account, the IRS is unable to notate that the individual is a veteran identified by the DOD and was not issued a letter. However, as noted previously, we identified an address for 161 individuals using tax return information. As such, the IRS has a tax account for these individuals and should mark these accounts, similar to the manner in which it marks a veteran's account when the letter is returned as undeliverable, to protect the veteran's right to file a claim without first having to go to the DOD.

Due to Inaccurate Cost Calculations, an Estimated \$83,142 Was Not Reimbursed From the Department of Defense

The IRS and the DOD entered into two Interagency Agreements, one in June 2018 and the other in June 2019, which include the IRS's agreement to print and mail letters to the veterans the DOD identified. In response, the DOD agreed to reimburse the IRS up to \$151,819 for the costs associated with producing, printing, and mailing the letters and the associated labor costs. As of August 15, 2019, the IRS billed the DOD \$84,697 for the costs to print and mail the letters. However, the IRS has yet to bill the DOD for reimbursement of the costs associated with the development of the letters used to notify veterans or the indirect labor costs associated with



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

producing, printing, and mailing the letters. As such, the IRS has not pursued reimbursement for an estimated \$83,142.¹⁷

As part of the Agreements with the DOD, the IRS developed six letters to notify veterans of their right to claim a disability severance payment refund. The IRS mailed 130,078 letters to veterans in July 2018 and 7,084 letters during June and July 2019. The IRS notified the DOD that it cost \$84,697 to produce and mail these letters, which the DOD reimbursed to the IRS. However, IRS management stated that the amount they provided to the DOD ***did not include the cost for resources used to develop the six letters or the indirect labor costs, i.e. overhead costs, associated with providing oversight of the production, printing, and mailing of the letters.*** The incorrect billing resulted from IRS management using an outdated and incomplete cost calculation model. The IRS's Corporate Budget Office could not provide information to support its decision to approve the use of historical Correspondence Production Services data during contract negotiations instead of previous Interagency Agreements to develop cost estimates.

We notified the IRS on November 14, 2019, of our concerns with the costs that were not billed to the DOD. IRS management agreed that they did not bill the DOD for the resources used to develop the letters or the indirect costs associated with developing and mailing these letters to veterans. However, IRS management indicated that because the IRS did not include those additional categories of expenses in the agreement and had no way to accurately document the actual hours expended, it is not appropriate to ask the DOD to reimburse the IRS for these additional costs.

It is important that when the IRS provides services to other agencies for reimbursement, the contracted reimbursement amount and the amount actually received properly reflect the resources the IRS expended on the services provided. Resources that are expended to provide services that are not reimbursed properly further reduce the funds the IRS has available for use in other areas of tax administration.

Recommendation

Recommendation 7: The Chief Financial Officer should update the cost calculation models to ensure that all costs, including indirect labor costs, are used to calculate reimbursement amounts in future agreements to perform work for other Federal agencies.

Management's Response: The IRS agreed with this recommendation. IRS management stated the Chief Financial Officer develops a standard overhead cost methodology which all reimbursable agreements are required to use. However, direct cost estimates are developed by program offices (with support from the Chief Financial

¹⁷ These cost estimates only include time recorded for weekly status meetings between the IRS and the DOD. These estimates do not include any time spent meeting with the DOD prior to weekly status meetings to develop the language of the letters, standard refund development, or internal IRS meetings.



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

Officer if necessary) and reviewed by the Chief Financial Officer. IRS management believes it is important that program offices continue to develop the direct cost estimates because they have the best knowledge of the work performed to provide services to customers. The Chief Financial Officer will provide additional guidance to customers on the types of costs that should be included in direct cost calculations and provide additional training.

Due to Programming and Tax Examiner Errors in Computing Interest, Some Veterans Did Not Receive Correct Refunds

Our review of the 24,164 amended return claims processed as of May 23, 2019, found that programming and tax examiner errors resulted in veterans associated with 1,462 claims receiving an estimated \$638,451 in incorrect interest amounts. These included:

- 1,453 claims in which the incorrect interest calculation resulted from programming errors. As a result, we estimate that these veterans' claims included incorrect interest amounts totaling \$595,108. In response to our identification of the systemic interest calculation programming error, the IRS has taken actions to correct the programming deficiencies. In addition, IRS management is reviewing the 1,453 claims and will take the actions needed to ensure that these individuals receive the interest to which they are entitled.
- 9 claims in which tax examiners did not compute interest manually when required. As a result, these veterans did not receive \$43,343 in interest to which they were entitled. Interest calculations are generally computed systemically. However, for some tax accounts, tax examiners are required to compute the interest calculation manually. For these nine claims, internal guidelines did not alert tax examiners that interest must be calculated manually when specific conditions were present on the tax account, e.g., the individual's original tax return was missing information or incomplete,. On December 21, 2018, we notified the IRS of our concerns with the manual computation of interest amounts.

IRS management agreed that the interest associated with these claims was not calculated correctly. They agreed to issue manual refunds for the interest due for these nine claims and issued updated internal guidelines to the teams processing the claims to require a manual refund when certain codes are present on the tax account. In addition, management conducted training on these updated procedures to mitigate this issue.



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

Recommendation

Recommendation 8: The Commissioner, Wage and Investment Division, should evaluate the 1,453 claims we identified and issue refunds of interest due because of the systemic programming error.

Management's Response: The IRS agreed with this recommendation and plans to continue evaluating the claims and adjusting the interest where applicable.



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the IRS's assistance to current and former members of the military who are serving or have served in a combat zone and/or received a combat-related disability severance payment. To accomplish our objective, we:

- I. Evaluated the IRS's actions to implement the Combat-Injured Veterans Fairness Act of 2016.¹
 - A. Determined if the IRS correctly identified and notified individuals if they are still living or if the IRS notified the estate if the individual was deceased.
 - B. Evaluated IRS actions to ensure that all eligible veterans the DOD identified were notified of their potential benefits from the funds that were improperly withheld from their disability severance payments.
 1. Determined whether the IRS sent all applicable veterans a Letter 6060-A or 6060-D.
 2. Evaluated the IRS's undeliverable mail processes.
 - C. Evaluated claims received and processed as a result of Combat-Injured Veterans Fairness Act of 2016 for accuracy.
 - D. Determined whether the cost estimates in the Memorandum of Agreement accurately reflected the actual costs. We evaluated whether the IRS has been reimbursed for work completed pursuant to the Memorandum of Agreement.
- II. Evaluated the IRS's actions to address our prior audit recommendations² related the Combat Zone Indicators and assessed current control weaknesses.
 - A. Determined whether IRS corrective actions to TIGTA's prior recommendations to improve processes ensured that Combat Zone Indicators are reversed when exit dates are received from DOD data.
 - B. Evaluated the impact of the delayed DOD combat zone data.

¹ Pub. L. No. 114-292.

² TIGTA, Ref. No. 2009-40-138, *Combat Zone Indicators on Taxpayer Accounts Are Frequently Inaccurate* (Sept. 2009).



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

- C. Determined whether IRS corrective actions to TIGTA's prior recommendations to improve processes to validate combat zone service at the time an individual self-identifies are effective.
- D. Evaluated the effectiveness and accuracy of the IRS's combat zone transcripts clean-up procedures. We reviewed a judgmental sample of 66 of the 654 responses received from individuals in response to Letter 2761C, *Request for Combat Zone Service Dates*, between April and May 2019.³

Data validation methodology

During this review, we relied on data stored at TIGTA's Data Center Warehouse and performed analysis of data received from the IRS. To assess the reliability of computer-processed data, programmers within the Data Center Warehouse validated the data files we extracted, and we ensured that each data extract contained the specific data elements we requested and that the data elements were accurate. For example, we reviewed judgmental samples of the data extracts and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System⁴ or other systems, if possible. As a result of our testing, we determined that the data used in our review were reliable.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the Internal Revenue Manual, and other policies and procedures followed when processing Combat-Injured Veterans Fairness Act of 2016 claims and Combat Zone Indicator cleanup. We evaluated the controls by reviewing the Internal Revenue Manual, interviewing IRS management, and evaluating applicable documentation and reports.

³ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

⁴ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



***Improvements Are Needed to Ensure That Members of the
Military Receive Tax Benefits to Which They Are Entitled***

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

J. Edmund Carr, Lead Auditor

Kimberly Holloway, Lead Auditor

Van Warmke, Lead Auditor



***Improvements Are Needed to Ensure That Members of the
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Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Commissioner, Small Business/Self-Employed Division
Commissioner, Wage and Investment Division
Director, Accounts Management, Wage and Investment Division
Director, Collection, Small Business/Self-Employed Division
Director, Customer Account Services, Wage and Investment Division
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division
Director, Enterprise Audit Management



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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:

- Taxpayer Rights and Entitlements – Potential; 3,047 individuals on the IRS’s Control D report who did not have a Combat Zone Indicator on their tax account (see page 6).

Methodology Used to Measure the Reported Benefit:

We reviewed the IRS’s Control D reports containing 10,827 unpostable records. Our review identified 7,061 individuals for which the Social Security Number or the name of the individual associated with the DOD record did not match IRS records. We matched the Social Security Number from the IRS’s Control D report to the Individual Master File to determine whether a Combat Zone Indicator was ever placed on the tax account. We found that 3,047 of the 7,061 individuals in the unpostable DOD records never had a Combat Zone Indicator on their tax accounts.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; 358 individuals with balances due totaling more than \$2.5 million¹ with suspended collection activities due to aged Combat Zone Indicators (see page 9).

Methodology Used to Measure the Reported Benefit:

We obtained all active Combat Zone Indicators from the Individual Master File and identified 5,336 tax accounts with a Combat Zone Indicator as of October 24, 2019, that were more than two years old and did not have an exit date. We compared the 5,336 tax accounts to the IRS’s *Combat Zone Indicator Clean-Up Transcript* list and found 1,780 individuals who were not on the IRS’s clean-up lists. We matched the Taxpayer Identification Numbers to the Transaction Category Report files and identified 358 individuals who had balances due totaling \$2,544,634. We matched the 1,780 individuals to the Individual Master File Tax Module Freeze Codes files

¹ The actual amount of increased revenue is contingent upon each taxpayer’s individual situation and his or her ability to satisfy the balance due.



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to identify all collection suspense freeze codes. We found that all individuals have a collection suspense freeze code.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; 2,860 taxpayers whose letters were returned undeliverable with an updated address who were resent notifications (see page 11).

Methodology Used to Measure the Reported Benefit:

We used the IRS's list of 10,315 veterans whose letters were returned to the IRS by the U.S. Postal Service as undeliverable. We compared the Taxpayer Identification Numbers on the IRS's list of undeliverable mail to the Returns Transaction File for Processing Year 2019 to determine whether the veteran filed a tax return during Processing Year 2019. We compared the mailing address of the Letter 6060 to the address used on the tax return in Processing Year 2019 to identify an updated address. We identified 2,860 individuals who filed a tax return in Processing Year 2019 with an address that was different from the address to which the IRS mailed the Letter 6060.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 419 veterans for whom the IRS did not have a good address in its databases that did not have an indicator placed on the tax account (see page 11).

Methodology Used to Measure the Reported Benefit:

We used the IRS's list of 419 potentially eligible veterans who were not mailed a letter. We met with IRS management to determine whether any indicators were placed on the tax account that would identify the individual as a potentially eligible veteran under the Combat-Injured Veterans Act of 2016.² According to the IRS, it would not mark the tax accounts for the 419 veterans because a letter was never sent. Further, these veterans would be required to obtain additional documentation from the Defense Finance and Accounting Services before they could file a claim.

² Pub. L. No. 114-292.



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Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; 139 veterans who were erroneously identified as deceased or alive due to a programming error (see page 11).

Methodology Used to Measure the Reported Benefit:

We used the IRS's list of the 130,078 letters that were mailed to potentially eligible veterans in July 2018. We matched the Taxpayer Identification Numbers from the IRS's list to the National Account Profile³ to obtain the date of death information for each veteran in the IRS's list.

- For those veterans who did not have a date of death, we reviewed the IRS's list to confirm that a Letter 6060-A was sent.
- For those veterans with a date of death in the National Account Profile, we reviewed the IRS's list to confirm that a Letter 6060-D was sent.

Type and Value of Outcome Measure:

- Funds Put to Better Use – Potential; \$67,122 of indirect labor costs for time spent in weekly meetings with the DOD (see page 14).

Methodology Used to Measure the Reported Benefit:

We used the IRS's cost estimates used in previous Interagency Agreements to identify the indirect labor costs incurred to conduct weekly status meetings with the DOD during the periods covered during the Agreements.

- For Calendar Year 2018, we estimated labor costs of \$41,229 expended for 576 recorded hours meeting with the DOD.
- For Calendar Year 2019, we estimated labor costs of \$41,912 expended for 576 recorded hours meeting with the DOD.

We estimate the total indirect labor cost is \$83,142.⁴ We limited our outcome to only that portion of the agreed upon reimbursement cost shown in the Memorandum of Agreement. The DOD agreed to reimburse the IRS for \$151,818.78 (\$146,378.78 + \$5,440.00) per the two approved Memorandums of Agreement. According to the IRS, it received \$84,697 from the DOD as of August 15, 2019, for services provided under the Agreements. We calculated the difference between the agreed upon amounts in the Memorandums of Agreement to the amounts actually reimbursed to identify the remaining amounts of contracted dollars

³ A compilation of selected entity data from various Master Files that also includes data from the Social Security Administration.

⁴ Amounts of calendar year estimates do not total the estimated total indirect labor costs due to rounding.



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

(\$151,818.78 – \$84,697.57 = \$67,121.52). The total remaining agreed upon funds that have not been reimbursed is \$67,121.52, rounded to \$67,122.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; \$43,343 in interest payments that were not paid on nine claims that veterans were entitled to receive (see page 16).

Methodology Used to Measure the Reported Benefit:

Using the Individual Master File data, we identified 24,164 amended returns claims processed as of May 23, 2019. We calculated the estimated interest payments for the 24,164 amended tax returns processed and compared it to the amount of interest the IRS paid. We identified differences greater than \$100 in the amount of TIGTA-calculated interest and the amount of interest paid to the individual.

We identified nine claims in which tax examiners did not compute interest manually when required. As a result, these veterans did not received \$43,343 in interest to which they were entitled.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; \$595,108 in estimated interest payments that were incorrect on 1,453 claims that veterans were entitled to receive (see page 16).

Methodology Used to Measure the Reported Benefit:

Using the Individual Master File data, we identified 24,164 amended return claims processed as of May 23, 2019. We calculated the estimated interest payments for the 24,164 amended tax returns processed and compared it to the amount of interest the IRS paid. We identified differences greater than \$100 in the amount of TIGTA-calculated interest and the amount of interest paid to the individual.

We identified 1,453 claims in which computer programming errors resulted in an incorrect interest computation. As a result, these veterans received \$595,108 in incorrect interest.



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

Appendix V

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Appendix VI

Management's Response to the Draft Report




COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

April 27, 2020

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

Digitally signed by Kenneth C. Corbin
Date: 2020.04.27 08:53:21 -04'00'

SUBJECT: Draft Audit Report – Improvements Are Needed to Ensure
Members of the Military Receive Tax Benefits to Which They Are
Entitled (Audit # 201840042)

Thank you for the opportunity to review and provide comments on the subject draft report. We are committed to providing the American taxpayer, including members of the military, with top-quality service, and we share TIGTA's concerns regarding protections to active service members. The Combat-Injured Veterans Tax Fairness Act of 2016 presented a unique opportunity for the Department of Defense (DOD) and the IRS to work together to inform impacted veterans of their potential eligibility to claim a refund of improperly withheld taxes from a disability severance payment.

The processing of these claims presented some additional challenges as claims could be filed for tax years as far back as 1991. Typically, the statute of limitations on claims is only three years from the due date of the return. Due to these older tax years, unanticipated issues were encountered, such as specific adjustment requirements and issues related to interest programming. Despite the challenges, through mid-February 2020, we have processed almost 50,000 of these veterans' claims.

When we received a reclassification notice from the DOD that prohibited systemic data-sharing with IRS, we worked diligently with all stakeholders to identify potential solutions to ensure that Combat Zone Indicators could be input timely and accurately maintained. The reclassification significantly altered the longstanding data-sharing process between IRS and DOD by rendering the data fields incompatible with existing programming. We focused our efforts on pursuing a permanent systemic solution that did not overburden deployed members of the military and their families and were able to successfully reestablish the DOD systemic data-sharing process, bringing all historical records current.



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

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We appreciate your acknowledgment of our recent actions to resolve the unpostable conditions on the combat zone data received from the DOD. We will develop and implement processes to resolve unpostable DOD records, and are working with stakeholders to finalize procedures to resolve them, as appropriate. We are also working with stakeholders to reduce the instance of human errors when updating Combat Zone Indicators.

We believe that the systemic programming for which the entry date into a combat zone is more than two years old is working as intended, as these cases are distributed over a 12-month period on a monthly cleanup list.

We disagree with the taxpayer rights and entitlements and increased revenue outcome measures. The files identified in the Control D report contained duplicates or accounts not in the IRS database that did not require a Combat Zone indicator. The increased revenue figure assumes these liabilities would be collected in full. TIGTA's analysis assumes an ability to pay and does not include a financial analysis of the balance due accounts that have a collection suspense freeze code. It also does not account for the opportunity cost of shifting resources away from working other cases.

We recognize the concerns identified by TIGTA and are working to address those concerns where possible. Please see our responses to the report's recommendations below.

If you have any questions, please contact me, or a member of your staff my contact Dietra Grant, Director, Customer Account Services, Wage and Investment Division, at (470) 639-3504.

Attachment



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

Attachment

RECOMMENDATIONS

The Commissioner, Small Business/Self-Employed Division, should:

RECOMMENDATION 1

Ensure that processes are developed to resolve unpostable DOD records and implemented.

CORRECTIVE ACTION

We will develop procedures that assign functional responsibility for timely resolution of unpostable Department of Defense (DOD) records and provide guidance and timeframes for this process.

IMPLEMENTATION DATE

November 15, 2020

RESPONSIBLE OFFICIAL

Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 2

Review the 10,827 unpostable DOD records we identified and ensure that actions are taken to resolve the unpostable condition to set or update the Combat Zone Indicator on the individual's tax account. For those individuals who the IRS determines are currently serving in a combat zone, the IRS should immediately cease any collection activities being taken and abate all penalties and interest that were assessed incorrectly because the IRS did not work the mismatched DOD records timely.

CORRECTIVE ACTION

We have already reviewed and resolved 91 percent of the unpostable DOD fallout records and will resolve the remaining records where appropriate. For those individuals that we determine are currently serving in a combat zone, we will cease any collection activities. Penalties and interest are automatically adjusted on these accounts when the combat zone indicator is input.

IMPLEMENTATION DATE

November 15, 2020

RESPONSIBLE OFFICIAL

Director, Collection Policy, Small Business/Self-Employed Division



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

2

CORRECTIVE ACTION MONITORING PLAN

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

Recommendations

RECOMMENDATION 3

The Chief Information Officer should update its systemic program to prioritize the assignment of aged Combat Zone Indicators for which the entry date into a combat zone is more than two years old and there is no exit date to ensure that the oldest aged Combat Zone Indicators placed in the Account Management Services system for assignment first.

CORRECTIVE ACTION

The systemic programming for which the entry date into a combat zone is more than two years old is working as intended. The cases are distributed over a 12-month period on a monthly cleanup list. This is done for workload considerations and allows the list to be worked throughout the year.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 4

The Commissioner, Small Business/Self-Employed Division, should develop processes and procedures to ensure that Combat Zone Indicators are updated accurately based on individuals' responses to Letter 2761C.

CORRECTIVE ACTION

We will work collaboratively with our stakeholders to develop processes and procedures to ensure that Combat Zone indicators are updated accurately based on taxpayer responses to Letter 2761C.

IMPLEMENTATION DATE

March 15, 2021

RESPONSIBLE OFFICIAL

Director, Collection Policy, Small Business/Self-Employed Division



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

3

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

Send notification letters to the 292 veterans for whom we identified a more current address on a prior year tax return or information return.

CORRECTIVE ACTION

We have already issued the notification to 70 of the veterans based on new address information from a subsequently filed tax return. The remaining letters will not be sent using third-party addresses due to the potential for unauthorized disclosure of confidential information that could lead to the information being used for identity theft-related activities.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 6

Place an indicator on the 419 tax accounts of the veterans who the DOD identified but did not receive a letter to identify them as a potential claimant.

CORRECTIVE ACTION

There is no existing indicator available to mark accounts of these veterans. Additionally, letters have subsequently been issued to some of these veterans based on new address information while the majority have identity theft issues or have no existing account on which to place any indicators. Alternatively, we currently have existing guidance to direct these veterans to the DOD. The DOD has information available via email, websites, and toll-free calls to provide the veterans with all necessary steps to file a claim if eligible.

IMPLEMENTATION DATE

N/A



Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled

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RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

Recommendations

RECOMMENDATION 7

The Chief Financial Officer, should update the cost calculation models to ensure all costs, including indirect labor costs, are used to calculate reimbursement amounts in future agreements to perform work for other Federal Agencies.

CORRECTIVE ACTION

The Chief Financial Officer (CFO) develops a standard overhead cost methodology, which all reimbursable agreements are required to use. Direct cost estimates are developed by program offices (with support from CFO if necessary) and reviewed by CFO. It is important that program offices continue to develop the direct cost estimates because they have the best knowledge of the work performed to provide services provided to customers. To address the concerns underlying this recommendation, CFO will provide additional guidance to customers on the types of costs that should be included in direct cost calculations and provide additional training.

IMPLEMENTATION DATE

January 15, 2021

RESPONSIBLE OFFICIAL

Associate Chief Financial Officer, Corporate Budget

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 8

The Commissioner, Wage and Investment Division, should evaluate the 1,453 claims we identified and issue refunds of interest due because of the systemic programming error.

CORRECTIVE ACTION

We will continue to evaluate the claims and adjust the interest where applicable.

IMPLEMENTATION DATE

March 15, 2021



***Improvements Are Needed to Ensure That Members of the
Military Receive Tax Benefits to Which They Are Entitled***

5

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.