



*Revising Tax Debt Identification
Programming and Correcting
Procedural Errors Could Improve
the Tax Refund Offset Program*

March 31, 2016

Reference Number: 2016-40-028

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

Redaction Legend:

- 1 = Tax Return/Return Information
- 2 = Risk Circumvention of Agency Regulation or Statute

Phone Number / 202-622-6500

E-mail Address / TIGTACommunications@tigta.treas.gov

Website / <http://www.treasury.gov/tigta>



To report fraud, waste, or abuse, call our toll-free hotline at:

1-800-366-4484

By Web:

www.treasury.gov/tigta/

Or Write:

Treasury Inspector General for Tax Administration

P.O. Box 589

Ben Franklin Station

Washington, D.C. 20044-0589

Information you provide is confidential and you may remain anonymous.



HIGHLIGHTS

REVISING TAX DEBT IDENTIFICATION PROGRAMMING AND CORRECTING PROCEDURAL ERRORS COULD IMPROVE THE TAX REFUND OFFSET PROGRAM

Highlights

Final Report issued on March 31, 2016

Highlights of Reference Number: 2016-40-028 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement and the Chief Technology Officer.

IMPACT ON TAXPAYERS

The IRS maintains a file that contains information about Federal debts owed by taxpayers. In Tax Year 2013, more than \$6.8 billion in individual tax refunds were offset to pay outstanding individual and business tax debts.

WHY TIGTA DID THE AUDIT

The Internal Revenue Code requires a taxpayer's refund to be offset to pay outstanding tax debt. Refunds must be offset to an outstanding Federal tax debt before it may be offset to nontax debts or applied as a credit to a future tax period. The overall objective was to determine whether the IRS's processes and controls ensure that overpayments are properly and accurately applied to offset Federal tax liabilities.

WHAT TIGTA FOUND

TIGTA identified that data maintained by the IRS could be used to increase its identification of individuals with business tax debt. The IRS's current process does not effectively identify sole proprietors with business tax debt. Using information the IRS captures and maintains from Form SS-4, *Application for Employer Identification Number*, TIGTA identified 53,672 individual taxpayers who received approximately \$74.5 million in tax refunds in Tax Year 2013 in which the IRS could have offset the refunds to outstanding tax debt on the taxpayer's associated business tax account.

In addition, the IRS needs to consistently apply tax account freezes to ensure that refunds are offset to pay associated tax liability on the IRS's Non-Master File (NMF) system. TIGTA identified 487 individual and 29 business taxpayers that received more than \$2.9 million in tax refunds for Tax Year 2013 that should have been offset to pay an outstanding NMF tax debt.

Finally, the IRS incorrectly offset individual tax refunds to tax debt of Limited Liability Companies (LLC). TIGTA identified 502 Tax Year 2013 individual tax refunds totaling approximately \$780,474 that were incorrectly applied to outstanding tax debts on their LLC business tax accounts. The IRS stated that its current computer programming did not incorporate criteria to identify these cases.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS revise its processes to identify individual tax returns to offset to business tax debt, develop a systemic process to ensure that freezes are not erroneously reversed, ensure that a manual freeze is input on a primary taxpayer's account when the secondary taxpayer's account has an outstanding tax debt, and develop a process to ensure that offset freezes are placed on all individual and business tax accounts when there is an outstanding debt on the NMF account. TIGTA also recommended that the IRS revise computer programming to ensure that credit elects are offset to any associated tax debt on the NMF, and to use the LLC indicator on the business tax account to ensure that individual tax refunds are not offset to the associated LLC's business tax debt. Finally, TIGTA recommended that the IRS identify and transfer the incorrect offsets totaling \$780,474 from the 502 LLC accounts back to the individual taxpayer accounts.

The IRS agreed with TIGTA's recommendations. For three of TIGTA's recommendations, the IRS stated that implementation of the requisite programming changes to accomplish the objectives are subject to budgetary constraints, limited resources, and competing priorities.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 31, 2016

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT
CHIEF TECHNOLOGY OFFICER

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Revising Tax Debt Identification Programming
and Correcting Procedural Errors Could Improve the Tax Refund
Offset Program (Audit # 201540007)

This report presents the results of our review to determine whether the Internal Revenue Service's (IRS) processes and controls ensure that overpayments are properly and accurately applied to offset Federal tax liabilities. This audit is included in our Fiscal Year 2016 Annual Audit Plan and addresses the major management challenge of Fraudulent Claims and Improper Payments.

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

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



*Revising Tax Debt Identification Programming and Correcting
Procedural Errors Could Improve the Tax Refund Offset Program*

Table of Contents

Background	Page 1
Results of Review	Page 5
Data Maintained by the IRS Could Be Used to Increase Its Identification of Individuals With Business Tax Debt	Page 5
<u>Recommendation 1:</u>	Page 5
Due to Programming and Procedural Errors, Some Overpayments Were Not Applied to Non–Master File Tax Debt.....	Page 6
<u>Recommendations 2 and 3:</u>	Page 7
<u>Recommendations 4 and 5:</u>	Page 8
Individual Tax Refunds Were Incorrectly Offset to the Tax Debt of Limited Liability Companies.....	Page 8
<u>Recommendations 6 and 7:</u>	Page 9
Appendices	
Appendix I – Detailed Objective, Scope, and Methodology	Page 10
Appendix II – Major Contributors to This Report	Page 14
Appendix III – Report Distribution List	Page 15
Appendix IV – Outcome Measures.....	Page 16
Appendix V – Form 1040 Schedule C, <i>Profit or Loss From Business</i> , (Tax Year 2014).....	Page 19
Appendix VI – Form 1040 Schedule F, <i>Profit or Loss From Farming</i> , (Tax Year 2014).....	Page 20
Appendix VII – Management’s Response to the Draft Report.....	Page 21



*Revising Tax Debt Identification Programming and Correcting
Procedural Errors Could Improve the Tax Refund Offset Program*

Abbreviations

ANMF	Automated Non–Master File
BMF	Business Master File
DMF	Debtor Master File
EIN	Employer Identification Number
IMF	Individual Master File
IRS	Internal Revenue Service
LLC	Limited Liability Company
NMF	Non–Master File
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year



*Revising Tax Debt Identification Programming and Correcting
Procedural Errors Could Improve the Tax Refund Offset Program*

Background

Tax refund offset is the process of offsetting tax overpayments (which would otherwise result in a refund) to outstanding Government debt. The Internal Revenue Code¹ requires a taxpayer's refund to be offset to any outstanding tax debt, nontax child support, or nontax Federal agency obligations, *i.e.*, Federal student loans, State income tax obligations, or Unemployment Compensation debts, prior to crediting a refund to a future tax or issuing the refund. A refund must be offset to an outstanding Federal tax debt before it may be offset to non-Federal tax Government debts or applied as a credit to a future tax period.² In Tax Year (TY)³ 2013, more than \$6.8 billion in individual tax refunds were offset to pay outstanding individual and business tax debts.

Tax refunds are first offset by the Internal Revenue Service (IRS) to any current Federal tax debts. For example, if a taxpayer has any outstanding tax debt on the IRS's Individual Master File (IMF),⁴ Business Master File (BMF),⁵ or Automated Non-Master File (ANMF),⁶ a refund will offset to the Federal tax debt. Generally, the overpayment will apply to the oldest outstanding tax liability first. After the tax overpayments have been offset to existing individual tax debts, any amount remaining can then be offset to business tax account liabilities.

If the taxpayer has no outstanding Federal tax debt, then verifications are performed to determine if the taxpayer has other types of government debts. The verifications are performed by the U.S. Department of the Treasury's Bureau of the Fiscal Service through the Treasury Offset Program. If this verification identifies other types of government debt, the refund will be offset up to the lesser of the amount of the debt or the amount of the refund.

Process to offset refunds to pay off individual tax debts

The IRS maintains the Debtor Master File (DMF), which contains information about Federal tax debts owed by taxpayers. The DMF contains different files that are used for many of the IRS's processes. When an individual taxpayer files a tax return resulting in a refund, the IRS performs a systemic verification to determine if the taxpayer has any outstanding individual tax liabilities.

¹ I.R.C. §§ 6402(a), (c), (d), (e), and (f).

² Refers to each tax return filed by the taxpayer for a specific period (year or quarter) during a calendar year for each type of tax.

³ The 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.

⁴ IRS database that maintains transactions or records of individual tax accounts.

⁵ IRS database of Federal tax-related transactions and accounts for businesses that includes employment taxes, income taxes on businesses, and excise taxes.

⁶ IRS database of individual and business tax transactions and accounts that cannot be maintained on either the IMF or the BMF.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

If the taxpayer has an amount owed, the refund will be offset to settle those liabilities. If the individual taxpayer files a joint return, the systemic process identifies whether the taxpayer's Social Security Number (SSN) or spouse's SSN are on the DMF. If the spouse's SSN is on the DMF, the individual tax refund is automatically offset to pay the amount owed on the spouse's other tax period. A notice is systemically generated and sent to the taxpayer informing him or her of the refund offset, including to which tax period(s) the refund was offset. Figure 1 provides the volumes of refund offsets associated with an individual tax return filing to pay off individual tax debts for TYs 2011 through 2013.

Figure 1: Volume of Refund Offsets From Individual Tax Accounts to Pay Off Individual Tax Debt – TYs 2011 Through 2013

TY	Volume of Refund Offsets ⁷	Amount of Refunds Offset to Individual Tax Debt
2011	6,760,783	\$7,767,559,716
2012	6,127,132	\$7,303,280,914
2013	5,661,140	\$6,804,059,104

Source: Treasury Inspector General for Tax Administration (TIGTA) Data Center Warehouse IMF Transactions Table as of January 1, 2015.

Process to offset refunds to pay off business tax debts

When offsetting to business tax accounts, the offset process allows for refunds associated with an individual tax account that belongs to a sole proprietor to be offset to the associated business tax account to pay off outstanding tax balances on the business tax account. A sole proprietorship is an unincorporated business that is owned by one individual. The business has no existence apart from the owner. Its liabilities are all personal liabilities, and the owner undertakes the risks of the business for all assets owned, whether or not used in the business. As such, the individual, *i.e.*, sole proprietor, is responsible for any of the business' tax liabilities.

When an individual tax return is filed resulting in a refund that includes an Employer Identification Number (EIN)⁸ on a Form 1040, *U.S. Individual Income Tax Return*, Schedule C, *Profit or Loss From Business (Sole Proprietorship)*,⁹ or Form 1040 Schedule F, *Profit or Loss From Farming*,¹⁰ the IRS uses the EIN to perform a systemic verification to determine if the business account, *i.e.*, the sole proprietor, has liabilities on the DMF. If the EIN is present on the DMF, the individual tax refund is automatically sent to offset the outstanding tax debt on the

⁷ Manual offsets were not considered but were determined to be minimal.

⁸ A unique nine-digit number used to identify a taxpayer's business account.

⁹ See Appendix V.

¹⁰ See Appendix VI.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

business' tax account. Figure 2 provides the volumes of refund offsets associated with an individual tax return filing to pay off business tax debts for TYs 2011 through 2013.

Figure 2: Volume of Refund Offsets From Individual Tax Accounts to Pay Off Business Tax Debt – TYs 2011 Through 2013

TY	Volume of Refund Offsets	Amount of Refunds Offset to Business Tax Debt
2011	15,519	\$16,788,364
2012	11,498	\$11,716,378
2013	7,798	\$7,787,488

Source: TIGTA Data Center Warehouse BMF Transactions Table as of January 1, 2015.

Process to offset refunds to pay off Non–Master File (NMF) tax debts

Due to system limitations, the IRS's current Master File system cannot process certain tax accounts. For example, the account balance is too large for the Master File or the account has too many transactions for the Master File to process. Instead, it processes these accounts, known as NMF accounts, through the ANMF system. Any NMF account with an existing balance is considered an open account. As of January 2015, there were approximately 11,000 open NMF accounts. As previously mentioned, the priority for offsetting to an NMF account with an outstanding tax debt occurs after verification and offset to individual and business Master File liabilities.

For those individual accounts on the NMF with an outstanding tax debt, a systemic process places a refund freeze on the corresponding primary taxpayer's individual tax accounts on the Master File. This freeze prevents a refund from being issued. If the NMF is a secondary taxpayer individual account or business account, the setting of this refund freeze is a manual process. The process involves:

- An employee in the IRS's Submission Processing Center in Covington, Kentucky, prepares a Form 3177, *Notice of Action for Entry on Master File*, requesting that a freeze be input.
- Once the request is received, an employee in the IRS's Compliance Services Collection Operation in Atlanta, Georgia, or Philadelphia, Pennsylvania, places the freeze on the associated Master File account.
- The employee in the Compliance Services Collection Operation then prepares a Form 2424, *Account Adjustment Voucher*, to request refunds from the Master File account be manually transferred to the NMF account to offset tax liabilities.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

Refund freezes will be manually reversed by IRS employees in the Compliance Services Collection Operation in Memphis, Tennessee, when the NMF account no longer has any outstanding tax debt, *i.e.*, the account reaches a zero balance.

This review was performed with information obtained from the Wage and Investment Division in Atlanta, Georgia; the Small Business/Self-Employed Division in Washington, D.C.; and the Chief Technology Officer in Washington, D.C., during the period April through December 2015. 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.



Results of Review

Data Maintained by the IRS Could Be Used to Increase Its Identification of Individuals With Business Tax Debt

The IRS's current process does not effectively identify sole proprietors with business tax debt. Using information the IRS captures and maintains from Form SS-4, *Application for Employer Identification Number*, we identified 53,672 individual taxpayers who received approximately \$74.5 million in tax refunds¹¹ in TY 2013. The IRS could have offset these refunds to outstanding tax debt on the taxpayer's associated business tax account. The Form SS-4 is the application used to obtain an EIN from the IRS and includes identifying information, *i.e.*, name and SSN, relating to sole proprietors' assigned EINs. This information can be used to better identify individual taxpayers with business tax debts. Currently, the identification process is limited to only offsetting a refund from an individual account to a business account when the *****2***** is present on these forms.

When we brought this to IRS management's attention, they stated that the process used to offset refunds from an individual's account to a related business tax account was created more than three decades ago. IRS management could not explain why the current verification process only uses *****2*****.

Recommendation

Recommendation 1: The Deputy Commissioner for Services and Enforcement should revise identification processes to include sole proprietor information from Form SS-4 to identify individual tax refunds to offset to business tax debt.

Management's Response: The IRS agreed with this recommendation. Although the IRS agreed with this recommendation, it stated that the implementation of requisite programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS cannot provide an implementation date at this time.

¹¹ This includes overpayments credited to the taxpayer's next year's tax liability.



Due to Programming and Procedural Errors, Some Overpayments Were Not Applied to Non-Master File Tax Debt

Our review identified 487 individual taxpayers and 29 business taxpayers who received more than \$2.9 million in refunds or credit elects¹² for TY 2013 that should have been applied to an associated outstanding tax debt on the IRS's NMF. These overpayments were not applied to outstanding tax debt for the following reasons:

- 350 cases (343 individual and seven business) with more than \$2,303,157 in overpayments were not offset because a refund freeze was erroneously reversed from the tax account and never reestablished. IRS guidelines state that a freeze should remain on the taxpayer's account as long as there is an outstanding tax debt on the NMF account. IRS management stated that their review of a sample of 30 of these cases indicated that the reversal transactions were processed in error.
- 96 individual cases with \$372,737 in overpayments were not offset because the spouse had an outstanding tax liability, but the primary taxpayer's account was not frozen to prevent the refund from being issued. IRS guidelines state that when there is an outstanding tax debt on the spouse's account, a freeze is manually placed on the primary taxpayer's account. IRS management indicated that this resulted from employee processing errors.
- 69 cases (48 individual and 21 business) with \$170,372 in overpayments that were not offset because either the required systemic refund freeze or manual refund freeze was never placed on these accounts.
 - 48 were individual taxpayer accounts. IRS guidelines state that a systemic freeze is placed on an individual taxpayer's account when an NMF account is established. IRS management indicated that they are reviewing these tax accounts to identify if these errors occurred because of a programming issue or if the cases we identified were due to procedural errors (or a combination of both).
 - 21 were business taxpayer accounts. IRS guidelines state that when there is an outstanding tax debt on a business tax NMF account, a freeze is manually placed on the account. IRS management stated that the 21 business accounts did not have a freeze input because the Form 3177 was routed to the wrong IRS location for processing. IRS internal guidelines were not clear on where Forms 3177 are to be routed for processing. The IRS updated internal guidance on November 23, 2015, to provide the correct location for routing Forms 3177.
- *****1*****. IRS guidelines state that a tax

¹² The taxpayer electing to transfer all or part of an overpayment to the next year's tax period.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

overpayment must offset to an outstanding tax debt before being applied as a credit toward a future tax debt. The IRS indicated that this occurred because the current computer programming only addresses overpayments due to a refund and does not identify cases for which the taxpayer elects to apply the credit to a future tax debt.

There is also a significant potential for future improper refunds for other accounts. We analyzed all NMF accounts¹³ with an outstanding tax debt and identified an additional 616 individual taxpayers and 697 business taxpayers for which required freezes were not on the associated Master File tax account. These accounts¹⁴ have outstanding tax debts totaling more than \$1.4 billion.

Recommendations

The Deputy Commissioner for Services and Enforcement should:

Recommendation 2: Develop a systemic process to ensure that freezes are not erroneously reversed if an outstanding tax debt remains on an NMF account.

Management's Response: The IRS agreed with this recommendation. In January 2016, the IRS developed a process to address this issue. The IRS will reconcile ANMF accounts with the IMF and the BMF to identify accounts without the requisite refund freeze, and will take appropriate corrective action on any accounts not having an active freeze in place.

Recommendation 3: Ensure that a manual freeze is input on a primary taxpayer's account when the secondary taxpayer's account has an outstanding tax debt.

Management's Response: The IRS agreed with this recommendation. Internal Revenue Manual sections 5.1.12.21.3.2, *Offset an IMF Refund*, and 5.19.10.3.3, *Input of TC 130 on IMF*, will be updated to add the requirement to input a manual freeze on a primary taxpayer's account when the secondary taxpayer's account has an outstanding tax debt. Internal Revenue Manual sections 5.16.1.2.1, *Unable to Locate and Unable to Contact*, 5.16.1.2.9, *Hardship*, and 5.19.1-15, *BMF TC 130 Procedures*, will be updated to refer to Internal Revenue Manual section 5.1.12.21.3.2 for guidance when a refund offset is required.

¹³ Our analysis of the NMF accounts for individual taxpayers was as of May 2015. However, freeze data for the same time period were not readily available for the business tax accounts. Therefore, those accounts were manually reviewed as of October 2015.

¹⁴ These 1,313 accounts are at risk if a future refund is more than \$25 and if the outstanding tax debt remains more than \$50.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

The Commissioner, Wage and Investment Division, should:

Recommendation 4: Develop a process to ensure that offset freezes are placed on all individual and business accounts when there is outstanding debt on the NMF tax account.

Management's Response: The IRS agreed with this recommendation. The corrective action described in response to Recommendation 2 will also address this recommendation.

Recommendation 5: Revise computer programming to ensure that credit elects are offset to any associated tax debt on the NMF.

Management's Response: The IRS agreed with this recommendation. Although the IRS agreed with this recommendation, it stated that the implementation of requisite programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS cannot provide an implementation date at this time.

Individual Tax Refunds Were Incorrectly Offset to the Tax Debt of Limited Liability Companies

Our review identified 502 TY 2013 individual tax refunds totaling approximately \$780,474 that were incorrectly applied to outstanding tax debts on their Limited Liability Company (LLC) business tax accounts. This occurred because the systemic process used to identify sole proprietors does not consider whether there is an LLC indicator on the tax account.

Treasury Regulation Section (§) 301.7701-2 (*Business entities; definitions*) states that single-member LLCs are to be treated as a corporation with regard to employment taxes paid on or after January 1, 2009, and excise taxes for liabilities imposed in tax periods beginning on or after January 1, 2008. However, these single-member LLC EINs were incorrectly identified as a sole proprietor due to their filing scenario. Single-member LLCs report their Federal business income/loss through Schedules C or F because they do not have filing requirements for Form 1065, *U.S. Return of Partnership Income*, or Form 1120S, *U.S. Income Tax Return for an S Corporation*, like multimember LLCs.

When we brought this to IRS management's attention, they agreed that the refund offsets were not appropriate. Management explained that this occurred because the original computer programming for the systemic offset did not contain any exclusion criteria to prevent an offset between the LLCs and individual tax accounts from occurring on or after the effective dates within Treasury Regulation § 301.7701-2. IRS management submitted a request to change programming to add the appropriate exclusion criteria on December 15, 2015. The IRS stated that it does not expect this to be completed until January 2017 due to Information Technology organization resource limitations and the approval and prioritization process currently in effect; however, an earlier implementation is being explored.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

Recommendations

The Deputy Commissioner for Services and Enforcement should:

Recommendation 6: Revise computer programming to use the LLC indicator on the business tax account to ensure that individual tax refunds are not offset to the associated LLC's business tax debt.

Management's Response: The IRS agreed with this recommendation. The requisite programming changes were requested on December 15, 2015, to add the appropriate exclusion criteria. The implementation of such programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS cannot provide an implementation date at this time.

The Commissioner, Wage and Investment Division, should:

Recommendation 7: Identify and transfer the incorrect offsets totaling \$780,474 from the 502 LLC accounts back to the individual taxpayer accounts. In addition, identify other accounts with incorrect offsets subsequent to the time frame of our TY 2013 analysis until programming is corrected and transfer incorrectly offset refunds back to the individual taxpayer accounts.

Management's Response: The IRS agreed with this recommendation. The IRS will review current procedures and modify as needed to manually reverse the offsets from the LLC accounts. The IRS will also identify other accounts with incorrect offsets for manual reversals until the current programming is corrected. The IRS will send a letter to taxpayers explaining why they are now receiving a refund.



Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether the IRS's processes and controls ensure that overpayments are properly and accurately applied to offset Federal tax liabilities. In order to accomplish our objective, we:

- I. Determined the effectiveness of the IRS's current process of offsetting individual tax refunds to business modules¹ with outstanding tax debt by using*****² *****2*****
*****2*****
filed by the individual taxpayer.
 - A. Reviewed the Internal Revenue Manual, policy, and documentation, *etc.*, to identify the IRS's process for offsetting individual refunds to business modules with outstanding tax debt.
 - B. Interviewed the staff of the IRS Wage and Investment Division and Information Technology organization to determine the IRS's process for offsetting individual refunds to business modules with an outstanding tax debt.
- II. Evaluated the IRS's processes to ensure that individual tax refunds are not incorrectly identified for offset to LLC business tax accounts.
 - A. Reviewed the IRS's current criteria for identifying sole proprietor EINs by filing requirement codes and returns filed.
 - B. Determined if individual to business tax offsets that have been processed were identified correctly.
 1. Obtained an extract of 150,024 Transaction Codes 796³ from the BMF⁴ for tax periods beginning January 1, 2008, and later.

¹ Refers to each tax return filed by the taxpayer for a specific period (year and quarter) during a calendar year for each type of tax.

² A unique nine-digit number used to identify a taxpayer's business account.

³ Offset of an individual tax refund to a business tax account.

⁴ IRS database of Federal tax-related transactions and accounts for businesses that includes employment taxes, income taxes on businesses, and excise taxes.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

2. Obtained the name of the entity by matching 70,372 EINs that received IMF⁵ offsets to the BMF EIN Entity file.⁶
 3. Analyzed 70,372 entity names to identify potential LLC entities. We obtained LLC indicator information for these 70,372 EINs.
 4. Quantified the dollar amount of tax offsets that were processed but should not have been due to the EINs being identified incorrectly as sole proprietors. There were \$2.1 million in tax offsets that should not have been processed, and \$780,474 of that amount was from TY 2013 refunds.
- III. Assessed the effectiveness of using the BMF EIN Entity file and other data to correctly identify sole proprietors' business tax accounts.
- A. Reviewed the current reference information available for the EINs on the IRS's BMF EIN Entity file.
 - B. Analyzed selected TY 2013 BMF tax module data and TY 2013 individual tax return data to determine if there was an individual tax refund available to be offset to a business module with an outstanding tax debt that was not offset.
 1. Identified and obtained 1,404,999 TY 2013 BMF account modules with an outstanding tax debt.
 2. Determined the responsible party for the BMF modules with an outstanding tax debt by matching the EIN to the IRS BMF EIN Entity file to identify the sole proprietor's SSN. We identified 230,497 BMF account modules with an outstanding tax debt and with a sole proprietor SSN on the BMF EIN Entity file.
 3. Determined there were 75,869 sole proprietors who filed a TY 2013 individual tax return and received a tax refund with no tax offset transaction on the tax account.
 4. Quantified how many refund offsets should have occurred. We identified 53,672 individual taxpayers who received \$74,480,952 in tax refunds that the IRS should have applied to outstanding tax debts on the taxpayers' business accounts.
 5. For those missed refund offsets identified in Step III.B.4, determined the reason why the offset did not take place.

⁵ IRS database that maintains transactions or records of individual tax accounts.

⁶ The EIN Entity file is a data extract containing information obtained from the Form SS-4, *Application for Employer Identification Number*, such as the applicant's identifying information and assigned EIN.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

- IV. Evaluated the effectiveness of the IRS's processes to ensure that NMF tax accounts with outstanding tax debts are receiving offsets.
- A. Evaluated the preliminary analysis by the Applied Research and Technology directorate to identify the analysis process.
 - B. Reviewed the Internal Revenue Manual, policy, and documentation, *etc.*, to identify the IRS's process for offsetting refunds to NMF modules with an outstanding tax debt.
 - C. Identified NMF tax accounts with an outstanding tax debt and determined whether they received offsets when they should have.
 - 1. Identified 5,129 NMF tax accounts with an outstanding tax debt.
 - 2. Identified the responsible party for those NMF tax accounts
 - 3. Determined that 516 tax accounts received tax refunds or credit elects⁷ that were not offset to the associated NMF tax accounts in TY 2013. The total dollar amount available for offset associated with these 516 accounts was more than \$2.9 million.
 - 4. Determined why offsets to the NMF tax accounts did not occur.
 - D. Analyzed all NMF accounts with outstanding tax debts and identified 616 individual taxpayers and 697 business taxpayers for which required freezes were not on the account. We determined that the debt owed by those taxpayers totaled \$1,413,503,758.

Data validation methodology

During this review, we relied on extracts from the IRS's BMF and IMF databases for Processing Years⁸ 2014 and 2015 that were available on the TIGTA's Data Center Warehouse.⁹ We received additional extracts from the BMF from the TIGTA's Office of Investigations' Strategic Data Services. Before relying on those data, we ensured that each file contained the specific data elements we requested. In addition, we selected random samples of each extract and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System.¹⁰ We also performed analysis to ensure the validity and reasonableness of our data, such as ranges of dollar values, transaction dates, and validity fields. Based on the results of our testing, we believe that the data used in our review were reliable. We also relied on extracts from the IRS's ANMF that identified the outstanding tax debts for entities

⁷ The taxpayer electing to transfer all or part of an overpayment to the next year's tax period.

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

⁹ A TIGTA repository of IRS data.

¹⁰ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

on the ANMF and performed analysis to ensure the reasonableness of the data, such as the validity of the Taxpayer Identification Number.¹¹

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: 1) procedures that identify business tax accounts with an outstanding tax debt and ensure that they are receiving credits from their associated individual tax accounts and 2) procedures that ensure that NMF accounts with debt are receiving credits from their associated individual and business tax accounts. We evaluated the controls by reviewing the IRS's Internal Revenue Manuals, interviewing IRS management, and reviewing data files related to the offset of overpayments to Federal tax liabilities.

¹¹ A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the Taxpayer Identification Number is an EIN, an SSN, or an Individual Taxpayer Identification Number.



*Revising Tax Debt Identification Programming and Correcting
Procedural Errors Could Improve the Tax Refund Offset Program*

Appendix II

Major Contributors to This Report

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)
Diana M. Tengesdal, Director
Kathleen Hughes, Audit Manager
Ngan Tang, Lead Auditor
David Robben, Senior Auditor
Alberto Garza, Information Technology Specialist



*Revising Tax Debt Identification Programming and Correcting
Procedural Errors Could Improve the Tax Refund Offset Program*

Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Operations Support
Commissioner, Small Business/Self-Employed Division
Commissioner, Wage and Investment Division
Deputy Commissioner, Small Business/Self-Employed Division
Deputy Commissioner, Operations, Wage and Investment Division
Director, Customer Account Services, Wage and Investment Division
Director, Submission Processing, Wage and Investment Division
Director, Office of Audit Coordination



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

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; approximately \$74.5 million in tax refunds related to 53,672 individual taxpayers that the IRS should have applied to outstanding tax debts on the taxpayers' business tax accounts (see page 5).

Methodology Used to Measure the Reported Benefit:

We obtained an extract from the BMF that identified business tax accounts with outstanding tax debts. We matched these data to business entity information the IRS maintains to identify the business tax accounts with an outstanding tax debt that also listed an individual's SSN as a cross-reference number for the business tax account. We accessed the IMF for these cross-reference SSNs and identified the individual tax accounts that either received a tax refund for the TY 2013 tax return or selected the option of having the refund applied to the following year tax period (credit elect). We identified 53,672 tax refunds that the IRS should have applied to satisfy the outstanding tax debts of the businesses.

We calculated the \$74,480,952 measure by comparing the refund amounts to the related business tax account outstanding tax debts. If the refund was greater than the outstanding tax debt, we computed the refund amount that should have been offset as the amount of the outstanding tax debt. If the refund amount was less than the outstanding tax debt, we computed the refund amount that should have been offset as the amount of the refund. We then compared any remaining outstanding tax debt to credit elect¹ amounts. If the remaining outstanding tax debt was greater than the credit elect amount, the credit elect amount was computed as the amount that should have been offset, otherwise the remaining balance was the amount of the credit elect. The outcome measure is the sum of the refunds and credit elections that could have offset the existing business tax debts.

¹ This includes only systemic credit elects.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

Type and Value of Outcome Measure:

- Revenue Protection – Potential; more than \$2.9 million in tax refunds for TY 2013 related to 487 individual taxpayers and 29 business taxpayers who received a refund that instead should have been applied to outstanding tax debts on the IRS's ANMF (see page 6).

Methodology Used to Measure the Reported Benefit:

We obtained an extract of the 5,129 NMF accounts with an outstanding tax debt and matched those accounts to the related individual or business accounts and identified 516 related accounts (487 individual and 29 businesses) that were issued a refund during Calendar Year 2014 even though the related NMF had an existing outstanding tax debt.

We calculated \$2,911,818 in offsets by comparing the refund amounts to the related NMF outstanding tax debts. If the refund amount was greater than the outstanding tax debt, we computed the refund amount that should have been offset as the amount of the outstanding tax debt. If the refund amount was less than the outstanding tax debt, we computed the refund amount that should have been offset as the amount of the refund. We then compared any remaining outstanding tax debt to credit elect amounts. If the remaining outstanding tax debt was greater than the credit elect amount, the credit elect amount was computed as the amount that should have been offset, otherwise the remaining balance was the amount of the credit elect. The outcome measure is the sum of the refunds and credit elections that could have offset the existing NMF debt.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; more than \$1.4 billion related to 1,313 taxpayers that have outstanding tax debts that could receive refunds because there is no freeze present on the accounts (see page 6).

Methodology Used to Measure the Reported Benefit:

We obtained a complete extract of the ANMF system. There were 3,571 individual NMF accounts and 1,214 business NMF accounts. From these accounts, we excluded those with an outstanding tax debt less than \$50. We arrived at 3,422 individual NMF accounts and 1,080 business NMF accounts that met this criterion. We excluded the NMF exception cases reported on in the previous outcome measure.

We also obtained an extract from the IMF that indicated whether the individual accounts associated with NMF accounts currently have a freeze indicator. For BMF accounts related to an NMF account, we manually researched the Integrated Data Retrieval System to determine their freeze status. We were able to identify 616 individual NMF accounts with outstanding debts totaling \$1,049,599,468 that currently do not have a freeze on the associated IMF accounts. We also identified 697 business NMF accounts with outstanding debts totaling \$363,904,290 that do



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

not have a freeze on the associated BMF accounts. The total outstanding tax debt associated with these 1,313 accounts is \$1,413,503,758.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; \$780,474 in individual tax refunds that were offset to outstanding tax debts of the business tax account of 502 LLCs (see page 8).

Methodology Used to Measure the Reported Benefit:

We identified 150,024 systemic offset transactions and 67 manual offset transactions received on the BMF for tax periods starting January 1, 2008. We also identified 1,899 reversing transactions responsible for reversing the systemic and manual offset transactions identified previously.²

We calculated the transaction amounts per Taxpayer Identification Number, tax module³ type, and tax period and arrived at 136,456 records. Of these, there were 1,272 records with a net offset amount of zero, leaving 135,184 records with net offset amounts greater than zero belonging to 70,372 EINs. We matched these EINs to the BMF to obtain the LLC indicator for these accounts. We selected records for which there was an excise tax module for tax periods beginning on or after January 1, 2008, or an employment tax module for tax periods beginning on or after January 1, 2009. We identified 106,257 records meeting this criterion. We identified 742 records with LLC indicators that had TY 2013 refunds offset from the individual tax account to the business tax account. These 742 records belonged to 502 EINs. The amount of tax refunds offset in error totaled \$780,474.

² Manually applied overpayment credits transferred from the IMF to the BMF.

³ Refers to each tax return filed by the taxpayer for a specific period (year and quarter) during a calendar year for each type of tax.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

Appendix V

Form 1040 Schedule C, Profit or Loss From Business, (Tax Year 2014)

SCHEDULE C (Form 1040)		Profit or Loss From Business (Sole Proprietorship)		OMB No. 1545-0074
Department of the Treasury Internal Revenue Service (99)		▶ Information about Schedule C and its separate instructions is at www.irs.gov/schedulec . ▶ Attach to Form 1040, 1040NR, or 1041; partnerships generally must file Form 1065.		2014 Attachment Sequence No. 09
Name of proprietor			Social security number (SSN)	
A Principal business or profession, including product or service (see instructions)			B Enter code from instructions	
C Business name. If no separate business name, leave blank.			D Employer ID number (EIN) (see instr.)	
E Business address (including suite or room no.) ▶ City, town or post office, state, and ZIP code				
F Accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶				
G Did you "materially participate" in the operation of this business during 2014? If "No," see instructions for limit on losses <input type="checkbox"/> Yes <input type="checkbox"/> No				
H If you started or acquired this business during 2014, check here <input type="checkbox"/> Yes <input type="checkbox"/> No				
I Did you make any payments in 2014 that would require you to file Form(s) 1099? (see instructions) <input type="checkbox"/> Yes <input type="checkbox"/> No				
J If "Yes," did you or will you file required Forms 1099? <input type="checkbox"/> Yes <input type="checkbox"/> No				
Part I Income				
1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked <input type="checkbox"/>		1	
2	Returns and allowances		2	
3	Subtract line 2 from line 1		3	
4	Cost of goods sold (from line 42)		4	
5	Gross profit. Subtract line 4 from line 3		5	
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)		6	
7	Gross income. Add lines 5 and 6		7	
Part II Expenses. Enter expenses for business use of your home only on line 30.				
8	Advertising	18	Office expense (see instructions)	18
9	Car and truck expenses (see instructions)	19	Pension and profit-sharing plans	19
10	Commissions and fees	20	Rent or lease (see instructions):	
11	Contract labor (see instructions)	a	Vehicles, machinery, and equipment	20a
12	Depletion	b	Other business property	20b
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	21	Repairs and maintenance	21
14	Employee benefit programs (other than on line 19)	22	Supplies (not included in Part III)	22
15	Insurance (other than health)	23	Taxes and licenses	23
16	Interest:	24	Travel, meals, and entertainment:	
a	Mortgage (paid to banks, etc.)	a	Travel	24a
b	Other	b	Deductible meals and entertainment (see instructions)	24b
17	Legal and professional services	25	Utilities	25
		26	Wages (less employment credits)	26
		27a	Other expenses (from line 48)	27a
		b	Reserved for future use	27b
28	Total expenses before expenses for business use of home. Add lines 8 through 27a		28	
29	Tentative profit or (loss). Subtract line 28 from line 7		29	
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method (see instructions). Simplified method filers only: enter the total square footage of: (a) your home: _____ and (b) the part of your home used for business: _____ Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30		30	
31	Net profit or (loss). Subtract line 30 from line 29. • If a profit, enter on both Form 1040, line 12 (or Form 1040NR, line 13) and on Schedule SE, line 2. (If you checked the box on line 1, see instructions). Estates and trusts, enter on Form 1041, line 3. • If a loss, you must go to line 32.		31	
32	If you have a loss, check the box that describes your investment in this activity (see instructions). • If you checked 32a, enter the loss on both Form 1040, line 12, (or Form 1040NR, line 13) and on Schedule SE, line 2. (If you checked the box on line 1, see the line 31 instructions). Estates and trusts, enter on Form 1041, line 3. • If you checked 32b, you must attach Form 6198. Your loss may be limited.		32a	<input type="checkbox"/> All investment is at risk.
			32b	<input type="checkbox"/> Some investment is not at risk.
For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11334P Schedule C (Form 1040) 2014				

Source: IRS Form 1040 Schedule C, Profit or Loss From Business, for Tax Year 2014.



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

Appendix VI

Form 1040 Schedule F, Profit or Loss From Farming, (Tax Year 2014)

SCHEDULE F (Form 1040) Profit or Loss From Farming

Department of the Treasury Internal Revenue Service (99) **2014** Attachment Sequence No. **14**

OMB No. 1545-0074

▶ Attach to Form 1040, Form 1040NR, Form 1041, Form 1065, or Form 1065-B. ▶ Information about Schedule F and its separate instructions is at www.irs.gov/schedulef.

Name of proprietor Social security number (SSN)

A Principal crop or activity B Enter code from Part IV C Accounting method: Cash Accrual D Employer ID number (EIN), (see instr)

E Did you "materially participate" in the operation of this business during 2014? If "No," see instructions for limit on passive losses Yes No
 F Did you make any payments in 2014 that would require you to file Form(s) 1099 (see instructions)? Yes No
 G If "Yes," did you or will you file required Forms 1099? Yes No

Part I Farm Income—Cash Method. Complete Parts I and II (Accrual method, Complete Parts II and III, and Part I, line 9.)

1a	Sales of livestock and other resale items (see instructions)	1a	
b	Cost or other basis of livestock or other items reported on line 1a	1b	
c	Subtract line 1b from line 1a	1c	
2	Sales of livestock, produce, grains, and other products you raised	2	
3a	Cooperative distributions (Form(s) 1099-PATR)	3a	
3b	Taxable amount	3b	
4a	Agricultural program payments (see instructions)	4a	
4b	Taxable amount	4b	
5a	Commodity Credit Corporation (CCC) loans reported under election	5a	
b	CCC loans forfeited	5b	
5c	Taxable amount	5c	
6	Crop insurance proceeds and federal crop disaster payments (see instructions)		
a	Amount received in 2014	6a	
b	Taxable amount	6b	
c	If election to defer to 2015 is attached, check here <input type="checkbox"/>		
6d	Amount deferred from 2013	6d	
7	Custom hire (machine work) income	7	
8	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	8	
9	Gross income. Add amounts in the right column (lines 1c, 2, 3b, 4b, 5a, 5c, 6b, 6d, 7, and 8). If you use the accrual method, enter the amount from Part III, line 50 (see instructions).	9	

Part II Farm Expenses—Cash and Accrual Method. Do not include personal or living expenses (see instructions).

10	Car and truck expenses (see instructions). Also attach Form 4562	10		23	Pension and profit-sharing plans	23	
11	Chemicals	11		24	Rent or lease (see instructions):		
12	Conservation expenses (see instructions)	12		a	Vehicles, machinery, equipment	24a	
13	Custom hire (machine work)	13		b	Other (land, animals, etc.)	24b	
14	Depreciation and section 179 expense (see instructions)	14		25	Repairs and maintenance	25	
15	Employee benefit programs other than on line 23	15		26	Seeds and plants	26	
16	Feed	16		27	Storage and warehousing	27	
17	Fertilizers and lime	17		28	Supplies	28	
18	Freight and trucking	18		29	Taxes	29	
19	Gasoline, fuel, and oil	19		30	Utilities	30	
20	Insurance (other than health)	20		31	Veterinary, breeding, and medicine	31	
21	Interest:			32	Other expenses (specify):		
a	Mortgage (paid to banks, etc.)	21a		a		32a	
b	Other	21b		b		32b	
22	Labor hired (less employment credits)	22		c		32c	
				d		32d	
				e		32e	
				f		32f	
33	Total expenses. Add lines 10 through 32f. If line 32f is negative, see instructions	33					
34	Net farm profit or (loss). Subtract line 33 from line 9	34					

35 Did you receive an applicable subsidy in 2014? (see instructions) Yes No
 36 Check the box that describes your investment in this activity and see instructions for where to report your loss.
 a All investment is at risk. b Some investment is not at risk.

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11346H Schedule F (Form 1040) 2014

Source: IRS Form 1040 Schedule F, Profit or Loss From Farming, for Tax Year 2014.



*Revising Tax Debt Identification Programming and Correcting
Procedural Errors Could Improve the Tax Refund Offset Program*

Appendix VII

Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

MAR 08 2016

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Revising Tax Debt Identification
Programming and Correcting Procedural Errors Could Improve
the Tax Refund Offset Program (Audit # 201540007)

Thank you for the opportunity to review the subject draft report and provide comments. Refund offsets occur when a taxpayer's overpayment is applied to an outstanding Federal tax debt, child support, Treasury Offset Program debt, state income tax obligation, or unemployment compensation prior to crediting the overpayment to a future tax obligation or issuing a refund. The legacy programming requirements that currently identify potential offset situations were developed over 30 years ago, and the tax processing environment has evolved over this time. Because of this, we recognize the need to evaluate the current process and make changes to improve the recognition of offset conditions that cause individual refunds to offset all eligible tax obligations. Program changes will be requested; however, due to budgetary and resource constraints, and competing priorities, we will also explore low-cost alternative solutions, where possible, to achieve process improvements.

The Automated Non-Master File (ANMF) system is used for accounts that cannot be processed by the Master File; consequently, the two systems do not interact. We recently obtained an ANMF extract of all taxpayer accounts with balances above the threshold and identified those without ANMF-related refund freezes. Refund freezes will be input on those accounts to ensure future overpayments are offset to pay outstanding Non-Master File tax debts. We will repeat this process, periodically, to improve our ability to ensure overpayments are applied to outstanding debt.

In December 2015, we submitted a programming request with the appropriate exclusion criteria to address individual refunds being erroneously offset to Limited Liability Company business tax debts. Additionally, internal procedures are being modified to reverse offsets, identify other impacted accounts, and notify the affected taxpayers.



*Revising Tax Debt Identification Programming and Correcting
Procedural Errors Could Improve the Tax Refund Offset Program*

2

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

Attachment



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

Attachment

Recommendations

RECOMMENDATION 1

The Deputy Commissioner for Services and Enforcement should revise identification processes to include sole proprietor information from Form SS-4 to identify individual tax refunds to offset to business tax debt.

CORRECTIVE ACTION

We agree with this recommendation; however, the implementation of requisite programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS cannot provide an implementation date at this time.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

The Deputy Commissioner for Services and Enforcement should:

RECOMMENDATION 2

Develop a systemic process to ensure freezes are not erroneously reversed if an outstanding tax debt remains on an NMF account.

CORRECTIVE ACTION

We agree with this recommendation. In January 2016, we developed a process to address this issue. We will reconcile Automated Non-Master File accounts with the Individual Master File and Business Master File to identify tax accounts without the requisite refund freeze, and will take appropriate corrective action on any accounts not having an active freeze in place.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division
Director, Collection Policy, Small Business/Self-Employed Division



*Revising Tax Debt Identification Programming and Correcting
Procedural Errors Could Improve the Tax Refund Offset Program*

2

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 3

Ensure that a manual freeze is input on a primary taxpayer's account when the secondary taxpayer's account has an outstanding tax debt.

CORRECTIVE ACTION

We agree with this recommendation. Internal Revenue Manual (IRM) sections 5.1.12.21.3.2, *Offset an IMF Refund*, and 5.19.10.3.3, *Input of TC 130 on IMF*, will be updated to add the requirement to input a manual freeze on a primary taxpayer's account when the secondary taxpayer's account has an outstanding tax debt. Internal Revenue Manual sections 5.16.1.2.1, *Unable to Locate and Unable to Contact*, 5.16.1.2.9, *Hardship*, and 5.19.1-15, *BMF TC 130 Procedures*, will be updated to refer to IRM 5.1.12.21.3.2 for guidance when a refund offset is required.

IMPLEMENTATION DATE

March 15, 2017

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.

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 4

Develop a process to ensure that offset freezes are placed on all individual and business accounts when there is outstanding debt on the NMF tax account.

CORRECTIVE ACTION

We agree with this recommendation. The corrective action described in response to Recommendation 2 will also address this recommendation.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

N/A



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

3

RECOMMENDATION 5

Revise computer programming to ensure that credit elects are offset to any associated tax debt on the NMF.

CORRECTIVE ACTION

We agree with this recommendation; however, the implementation of requisite programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS cannot provide an implementation date at this time.

IMPLEMENTATION DATE

NA

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

The Deputy Commissioner for Services and Enforcement should:

RECOMMENDATION 6

Revise computer programming to use the LLC indicator on the business tax account to ensure individual tax refunds are not offset to the associated LLC's business tax debt.

CORRECTIVE ACTION

We agree with this recommendation. The requisite programming changes were requested on December 15, 2015, to add the appropriate exclusion criteria. The implementation of such programming changes to accomplish this objective are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS cannot provide an implementation date at this time.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

The Commissioner, Wage and Investment Division, should:



Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program

4

RECOMMENDATION 7

Identify and transfer the incorrect offsets totaling \$780,474 from the 502 LLC accounts back to the individual taxpayer accounts. In addition, identify other accounts with incorrect offsets subsequent to the time frame of our TY 2013 analysis until programming is corrected and transfer incorrectly offset refunds back to the individual taxpayer accounts.

CORRECTIVE ACTION

We agree with this recommendation. We will review current procedures and modify as needed to manually reverse the offsets from the Limited Liability Company (LLC) accounts. We will also identify other accounts with incorrect offsets for manual reversals until the current programming is corrected. The IRS will send a letter to taxpayers explaining why they are now receiving a refund.

IMPLEMENTATION DATE

October 15, 2017

RESPONSIBLE OFFICIAL

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