Additional Actions Are Needed to Reduce Alimony Reporting Discrepancies on Income Tax Returns

August 7, 2019

Reference Number: 2019-40-048

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ADDITIONAL ACTIONS ARE NEEDED TO REDUCE ALIMONY REPORTING DISCREPANCIES ON INCOME TAX RETURNS

Highlights

Final Report issued on August 7, 2019

Highlights of Reference Number: 2019-40-048 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

Alimony is a payment to or for a spouse or former spouse under a divorce or separation instrument. The Tax Cuts and Jobs Act of 2017 repealed the deduction for alimony as well as the requirement to report alimony payments received as income for any divorce or separation instrument executed after December 31, 2018. However, it did not repeal the deduction and income reporting requirement for individuals who pay or receive alimony in accordance with agreements executed prior to January 1, 2019. In Tax Year 2016, 569,978 tax returns claimed alimony deductions that totaled more than $12.9 billion.

WHY TIGTA DID THE AUDIT

This audit was initiated to evaluate the IRS's use of systemic processes to identify and address alimony income reporting discrepancies. An alimony income reporting discrepancy occurs when individuals claim deductions for alimony that they did not pay or individuals do not report alimony income they received. This could result in taxpayers paying less tax than owed.

WHAT TIGTA FOUND

Apart from examining a small number of tax returns involving alimony, the IRS has yet to adequately address the substantial compliance gap that results from alimony income reporting discrepancies. TIGTA analyzed Tax Year 2016 tax returns with an alimony deduction processed as of February 8, 2018, and found that alimony income reporting discrepancies increased 38 percent from $2.3 billion in Tax Year 2010 to more than $3.2 billion in Tax Year 2016.

Although the IRS identifies both electronically filed and paper tax returns with a missing or incomplete Taxpayer Identification Number (TIN), the processes still do not ensure that all individuals who claim an alimony deduction provide a valid TIN of the recipient as required. Our analysis of the 569,978 Tax Year 2016 tax returns with an alimony deduction claim identified 2,168 tax returns that claimed more than $38.5 million in alimony deductions in which the recipient TIN was invalid and the IRS allowed the deduction.

In addition, penalties are not being assessed when valid recipient TINs are not provided. Our review of the 2,168 tax returns in which the recipient TIN was invalid found that the IRS assessed penalties on only 66 tax returns (3 percent) totaling $3,300.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division, modify the IRS's existing compliance strategy to include specific actions to be taken to reduce the billions of dollars associated with alimony reporting discrepancies. The Commissioner, Wage and Investment Division, should validate alimony recipient TINs and reject electronically filed tax returns with TINs identified as not being issued by the Social Security Administration or the IRS. The IRS should also modify Error Resolution System programming to send tax returns that contain an invalid recipient TIN to the Error Resolution function for review, correspondence with the taxpayer, and assessment of the penalty when necessary.

IRS management agreed with three of the four recommendations and partially agreed with the other recommendation. The IRS plans to monitor and revise alimony selection filters as needed, request programming to verify the alimony recipient TIN was issued by the Social Security Administration or the IRS, and modify programming to send all tax returns with an invalid recipient TIN to the Error Resolution Function. However, the IRS does not believe corresponding with taxpayers for a valid alimony recipient's TIN is a prudent use of its resources.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

August 7, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Additional Actions Are Needed to Reduce Alimony Reporting Discrepancies on Income Tax Returns (Audit # 201840019)

This report presents the results of our review to evaluate the Internal Revenue Service's (IRS) use of systemic processes to identify and address alimony deduction claims when taxpayers do not comply with reporting requirements. This audit was conducted to follow up on conditions identified in a previous Treasury Inspector General for Tax Administration audit[1] in which we reported that processes have not been developed to address the majority of discrepancies between alimony deductions claimed and income reported. In addition, we found that processes do not identify all alimony deduction claims with a missing or invalid recipient Taxpayer Identification Number and that penalties were not always assessed when a valid recipient Taxpayer Identification Number was not provided. This audit evaluated the corrective actions taken by the IRS to address those issues. This audit is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Improving Tax Compliance.

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

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

[1] TIGTA Ref. No. 2014-40-022, *Significant Discrepancies Exist Between Alimony Deductions Claimed by Payers and Income Reported by Recipients* (Mar. 2014).

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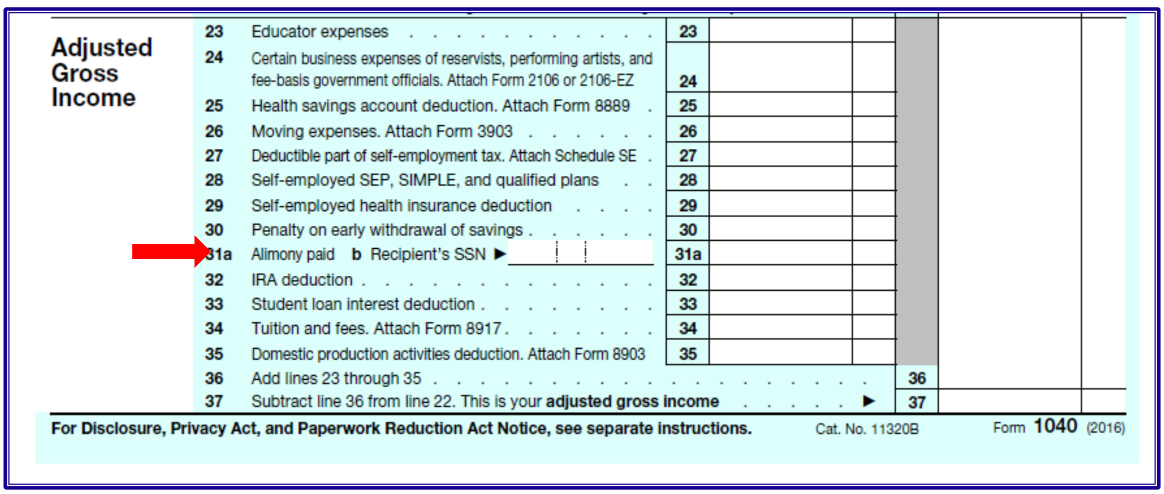
Abbreviations

e-file(d)	Electronically file(d)
ERS	Error Resolution System
IMF	Individual Master File
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
IRTF	Individual Return Transaction File
SSA	Social Security Administration
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number

Background

Alimony is a payment to or for a spouse or former spouse under a divorce or separation instrument.[1] For divorces ***prior to December 31, 2018***, the Internal Revenue Code[2] states that alimony is deductible by the payer and must be included in the spouse's or former spouse's income. For Tax Year[3] 2016, individuals who paid alimony report the amount paid as a deduction on Line 31a (Alimony paid) on Form 1040, *U.S. Individual Income Tax Return*. These individuals are required to include the Taxpayer Identification Number[4] (TIN) of the recipient on Line 31b of their tax return. Figure 1 provides an illustration of Form 1040 Line 31a.

Figure 1: Tax Year 2016 Form 1040 Line 31a – Alimony Paid



Adjusted Gross Income	23	Educator expenses	23		
	24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24		
	25	Health savings account deduction. Attach Form 8889 .	25		
	26	Moving expenses. Attach Form 3903	26		
	27	Deductible part of self-employment tax. Attach Schedule SE .	27		
	28	Self-employed SEP, SIMPLE, and qualified plans . .	28		
	29	Self-employed health insurance deduction	29		
	30	Penalty on early withdrawal of savings	30		
	31a	Alimony paid **b** Recipient's SSN ▶	31a		
	32	IRA deduction	32		
	33	Student loan interest deduction	33		
	34	Tuition and fees. Attach Form 8917	34		
	35	Domestic production activities deduction. Attach Form 8903	35		
	36	Add lines 23 through 35		36	
	37	Subtract line 36 from line 22. This is your **adjusted gross income** . . . . . . ▶		37	

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2016)

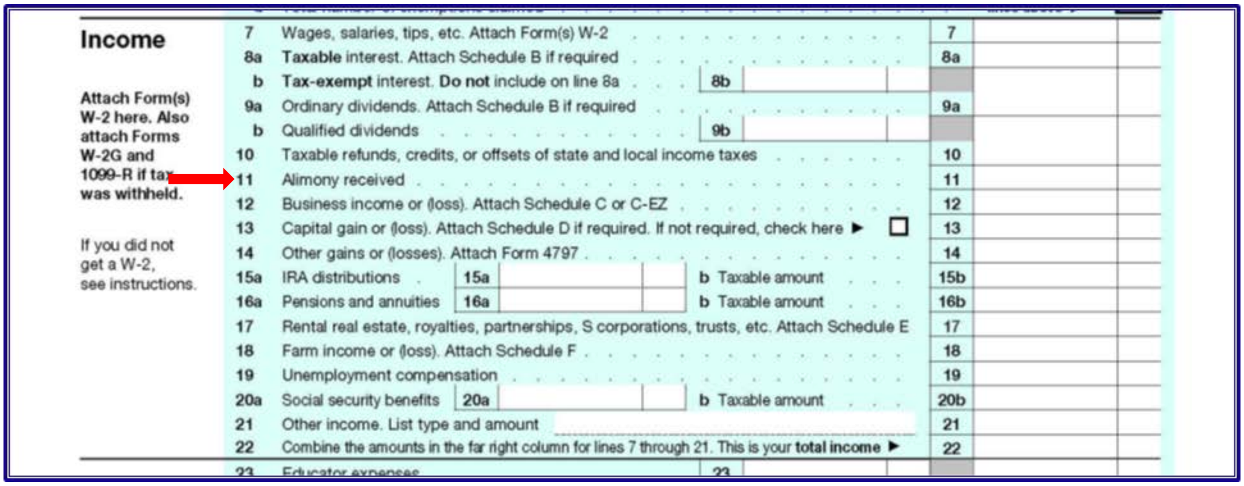
Source: Excerpt from IRS.gov Tax Year 2016 Form 1040.

Conversely, individuals who receive alimony must claim the amount received as income on their tax return.[5] For Tax Year 2016, individuals who received alimony and are required to file a tax

[1] Divorce or separation instrument includes a decree of divorce, a written separation agreement, or a decree or any type of court order that requires a spouse to make payments for the support or maintenance of the other spouse.
[2] I.R.C. §215.
[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] A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN is an Employer Identification Number, a Social Security Number (SSN), or an Individual TIN.
[5] Individuals who receive alimony income are not required to file a tax return if their total income is below the minimum income required to have a tax return filing requirement. In Tax Year 2016, individuals who had less than $10,350 in income ($20,700 if married filing jointly) were not required to file a tax return.

return report the income received on Line 11 on Form 1040. Figure 2 provides an illustration of Form 1040 Line 11.

Figure 2: Tax Year 2016 Form 1040 Line 11 – Alimony Received



Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

7	Wages, salaries, tips, etc. Attach Form(s) W-2		7
8a	**Taxable** interest. Attach Schedule B if required		8a
b	**Tax-exempt** interest. **Do not** include on line 8a	8b	
9a	Ordinary dividends. Attach Schedule B if required		9a
b	Qualified dividends	9b	
10	Taxable refunds, credits, or offsets of state and local income taxes		10
11	Alimony received		11
12	Business income or (loss). Attach Schedule C or C-EZ		12
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐		13
14	Other gains or (losses). Attach Form 4797		14
15a	IRA distributions	15a	b Taxable amount 15b
16a	Pensions and annuities	16a	b Taxable amount 16b
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17
18	Farm income or (loss). Attach Schedule F		18
19	Unemployment compensation		19
20a	Social security benefits	20a	b Taxable amount 20b
21	Other income. List type and amount		21
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22

Source: Excerpt from IRS.gov Tax Year 2016 Form 1040.

For Tax Years 2015 and 2016, more than 1.1 million tax returns claimed alimony deductions that totaled more than $25.7 billion. Of those, more than 1 million returns (88.5 percent) were electronically filed (e-filed) and approximately 135,000 (11.5 percent) were paper tax returns. Figure 3 provides the number of individuals who claimed an alimony deduction and the amount claimed for Tax Years 2015 and 2016.

Figure 3: Alimony Deductions – Tax Years 2015 and 2016

	Tax Year 2015	Tax Year 2016	Total
Tax Returns	600,689	569,978	1,170,667
Alimony Deduction Claimed	$12.83 billion	$12.92 billion	$25.75 billion

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the Internal Revenue Service (IRS) Individual Return Transaction File (IRTF)[6] for Tax Years 2015 through 2016.

[6] A database the IRS maintains that contains information on the individual tax returns it receives.

Processing tax returns with alimony deductions

The IRS will reject an e-filed tax return that claims an alimony deduction if the recipient TIN is missing, incomplete, or is the same as the primary TIN on the tax return.[7] For Processing Year[8] 2018, the IRS rejected 383 e-filed tax returns that either had a recipient TIN that was the same as the primary TIN or was missing or incomplete. Individuals who do not provide a recipient TIN can also be assessed a $50 penalty for failure to provide the requested number.

For paper tax returns with a recipient TIN the same as the primary or secondary TIN, missing, or incomplete, the return will be sent to the Error Resolution function where a tax examiner will perform research to identify a good TIN. If a good TIN is found, the return will continue processing. If a good TIN is not found, the taxpayer will be assessed the $50 penalty, the TIN will be replaced with 999-99-9991 and, if the tax return meets certain criteria, it will be identified for audit consideration.

The Tax Cuts and Jobs Act of 2017 repealed the alimony deduction and the associated reporting requirement for alimony payments

The Tax Cuts and Jobs Act of 2017,[9] signed on December 22, 2017, repealed the deduction for alimony as well as the requirement to report alimony payments received as income for any divorce or separation instrument ***executed after December 31, 2018***. This effective date also applies for any divorce or separation instrument executed on or before December 31, 2018, but modified after that date, if the modifications expressly provide that the new law applies. However, the Tax Cuts and Jobs Act did not repeal the alimony deduction and income reporting requirement for individuals who pay or receive alimony in accordance with agreements executed prior to January 1, 2019.

Individuals who are currently paying alimony as well as individuals who enter into an agreement that requires alimony payments during Calendar Year[10] 2018, can continue to take the deduction. In addition, individuals who currently receive alimony or who begin to receive alimony during Calendar Year 2018 must continue to report alimony as income on their tax returns.

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[7] An incomplete recipient TIN is fewer than nine digits or does not fall within the valid range of numbers issued by the Social Security Administration.
[8] The calendar year in which the tax return or document is processed by the IRS.
[9] Pub L. 115-97, 131 Stat. 2054.
[10] The 12-consecutive-month period ending on December 31.

A prior TIGTA review found that processes had not been implemented to address the significant discrepancies between alimony deductions claimed by payers and income reported by recipients

In March 2014, we reported[11] that processes have not been developed to address the majority of discrepancies between alimony deductions claimed and income reported. An alimony income reporting discrepancy occurs when individuals claim deductions for alimony that they did not pay and/or individuals do not report alimony income they received. Erroneous deduction claims reduce the amount of income reported and ultimately the tax owed. Individuals who do not report alimony income are also reducing the amount of tax owed. Our analysis of the 567,887 Tax Year 2010 returns with an alimony deduction claim identified 266,190 (47 percent) tax returns in which it appeared that individuals claimed alimony deductions for which income was not reported on a corresponding recipient's tax return or the amount of alimony income reported did not agree with the amount of the deduction taken. This resulted in a discrepancy of more than $2.3 billion in deductions claimed without corresponding income reported. Apart from examining a small number of these tax returns, the IRS had no processes or procedures to address this substantial compliance gap.

In addition, we identified that IRS processes did not ensure that individuals provide a valid recipient TIN as required when they claim an alimony deduction. TIGTA's analysis of the 567,887 Tax Year 2010 returns identified an estimated 6,500 tax returns that claimed an alimony deduction for which the IRS did not identify that the recipient TIN was missing or invalid. In addition, because of errors in IRS processing instructions, the IRS did not assess penalties totaling $324,900 on those individuals who did not provide a valid recipient TIN as required. Figure 4 presents our recommendations along with management's response.

Figure 4: Prior TIGTA Recommendations and IRS Management's Response

Recommendation	IRS Response
Evaluate current examination selection filters to ensure that the filters do not inappropriately exclude potentially high-risk tax returns with questionable alimony deduction claims.	IRS management agreed with this recommendation.

[11] TIGTA Ref. No. 2014-40-022, *Significant Discrepancies Exist Between Alimony Deductions Claimed by Payers and Income Reported by Recipients* (Mar. 2014).

Recommendation	IRS Response
Develop a strategy that adequately addresses the significant alimony compliance gap. This strategy should include determining the net benefit of using soft notices[12] as an alternative approach to address this issue, as well as actions the IRS plans to take with regard to individuals who continue to misreport alimony deductions or income.	IRS management agreed with this recommendation. IRS management also agreed that sending soft notices may be a valid approach in certain circumstances. However, the IRS stated that resource constraints limited the IRS's ability to test their impact at that time.
Revise processes and procedures to ensure that all tax returns are verified for a required valid recipient TIN when an alimony deduction is claimed. These processes should include rejecting e-filed tax returns and sending paper tax returns to the IRS Error Resolution function for correspondence with the taxpayer.	IRS management disagreed with this recommendation. The IRS stated that because the IRS does not possess the authority to deny the alimony deduction outside of deficiency procedures, the validation process is more efficiently performed within its Compliance function. The IRS also stated that the IRS Error Resolution function would either correspond with the taxpayer to obtain the TIN when the deduction meets certain criteria or assess a penalty for failure to provide the recipient TIN.
Revise IRS processing instructions to ensure that penalties are assessed on applicable tax returns with an alimony deduction claim where a valid recipient TIN was not provided and ensure that the penalty is assessed in the correct amount.	IRS management agreed with this recommendation.

Source: TIGTA, Ref. No. 2014-40-022 available at https://www.treasury.gov/tigta/oa.shtml.

This review was performed with information obtained from Wage and Investment Division, Submission Processing function in Cincinnati, Ohio, and the Small Business/Self-Employed Division, Examination function, located in Washington, D.C., during the period February through December 2018. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a

[12] Soft notices are issued to taxpayers for informational purposes only and inform the taxpayers they may have an error on their tax returns.

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

Management Has Not Taken Adequate Actions to Address More Than $3.2 Billion in Annual Alimony Reporting Discrepancies

Since we last reported on this issue in March 2014, apart from examining a small number of tax returns involving alimony, the IRS has yet to adequately address the substantial compliance gap that results from alimony income reporting discrepancies. In March 2014, we recommended that the IRS develop a strategy to address alimony reporting discrepancies. As part of the development of this strategy, we recommended that the IRS determine the net benefit of using soft notices as an alternative approach to address the issue. For example, soft notices could alert individuals to potential errors on their tax return related to claims for alimony deductions or not reporting alimony income as required.

Although the IRS agreed with our recommendation and indicated it would continue to improve the current strategy by making changes to the examination filters, IRS management has not evaluated the use of soft notices. IRS management indicated that the focus of compliance activities since our last review has been on refundable tax credits.

When we met with IRS management to discuss why soft notices have not been tested, they indicated that there are unique concerns with the use of soft notices to address alimony reporting discrepancies because the discrepancy is identified from matching one taxpayer return to another taxpayer return. The IRS does not have the authority to provide specific information regarding the source of the discrepancy if the receipient raises concerns. The IRS's ability to disclose tax information is limited, but we believe the IRS can use a soft notice for alimony income reporting discrepancies without disclosing how the discrepancy was identified.

IRS management also informed us that it is reluctant to use soft notices for alimony income discrepancies because the notice is not the result of an administrative proceeding. The IRS defines an administrative proceeding as:

> "*…a proceeding to determine a taxpayer's liability under the Code or related statutes, including* (but not limited to*) examination procedures, the Appeals process, the rulings and pre-filing processes regarding potential future liability, and collection matters.*"

We do not agree with the IRS's conclusion that the soft notice we recommended does not result from an administrative proceeding. The Internal Revenue Code requires certain alimony recipients to report alimony as income on their tax return. In addition, the identification of individuals who do not accurately report alimony income is a direct result of the IRS's examination selection process. Each year subsequent to the processing of tax returns, the IRS

Examination function performs a match to identify alimony reporting discrepancies. The IRS uses the results from this match to select returns for examination. The soft notice supplements the IRS's examination process by providing compliance treatment for individuals the IRS would not otherwise be able to address due to limited resources.

Finally, IRS management's decision to not send soft notices for alimony reporting discrepancies is inconsistent with the IRS's use of soft notices to address reporting discrepancies in other areas of the tax system. For example, the IRS sent soft notices to taxpayers to alert them of discrepancies with interest, dividends, gambling winnings, Social Security, and Railroad Retirement income. These notices alerted taxpayers to potential errors on their tax returns. The taxpayers could then file an amended tax return to address the income discrepancy identified or provide additional information to explain the discrepancy.

Reporting discrepancies increased 38 percent to more than $3.2 billion since our last review

We analyzed 569,978 Tax Year 2016 tax returns with alimony deductions that were processed as of February 8, 2018, and found that 284,053 tax returns reporting alimony income resulted in an alimony income reporting discrepancy totaling more than $3.2 billion. This is an increase of 38 percent[13] from the $2.3 billion in Tax Year 2010 when we first reported this concern. We further reviewed 232,548 of the 284,053 tax returns[14] with an alimony reporting discrepancy and found they included:

- 175,820 tax returns with discrepancies that totaled more than $1.6 billion. These returns involve a difference between the amount of alimony deducted and what was reported as income on a tax return associated with the TIN provided by the alimony deduction claimant. The unreported alimony income resulted in an understated tax liability of more than $248 million on the alimony recipients' Tax Year 2016 tax returns. A previous IRS study examined tax returns with similar characteristics and determined that 13 percent required no adjustments; therefore, we reduced the number of tax returns to 152,963 tax returns that potentially would have resulted in a tax adjustment of approximately $216 million. Over five years, this could result in more than $1.1 billion in unreported tax.[15] IRS management raised the concern that the number of taxpayers reporting alimony could decrease due to the Tax Cuts and Jobs Act which eliminated alimony

[13] Percentage based on actual numbers rather than the rounded numbers.
[14] We did not include returns in which the alimony income was greater than the deduction or the taxpayer indicated he or she could be claimed by another taxpayer. Other returns excluded from our review were those that were unable to be accurately recalculated and those in which the tax return was changed during processing, which resulted in a different amount posting to the Master File.
[15] See Appendix IV. The five-year forecast is based on multiplying the base year by five. The actual amount depends on the duration of the agreements in place prior to the passage of the Tax Cuts and Jobs Act and on the IRS implementing an effective process to identify alimony reporting discrepancies. Only an examination would be able to identify whether the deduction claimed and/or income not reported was accurate.

reporting requirements for agreements entered into after December 31, 2018. We agree that the number of taxpayers with alimony reporting requirements will not increase; however, the taxpayers with agreements prior to December 31, 2018, will continue to report alimony until their agreements expire. Our forecast is presented to show the potential significance of the issue over time.

- 54,560 tax returns that claimed approximately $1.5 billion in alimony deductions.[16] These involve no associated tax return being filed under the TIN provided by the alimony deduction claimant. As such, we are unable to compute the tax effect because the recipient tax return was not filed.
- 2,168 tax returns that claimed an alimony deduction of $38.5 million. These involve deductions for which we could not determine if the alimony deducted was reported on an associated filed tax return as the TIN provided by the alimony deduction claimant was invalid.[17] As such, we are unable to compute the tax effect because the alimony recipient could not be identified.

The dollar amount of reporting discrepancies has increased; however, audits of alimony discrepancy returns have decreased

IRS management informed us that the examination of tax returns continues to be the only compliance activity used to address discrepancies between alimony deductions claimed and income reported. Each year subsequent to the processing of tax returns, the IRS Examination function performs a match to identify alimony reporting discrepancies. The IRS uses the results from this match to select returns for examination. If the examiner determines the deduction is valid, then the associated recipient tax return is analyzed for audit potential to determine if alimony income was reported correctly.

For Fiscal Year[18] 2016, the IRS selected 7,492 returns with alimony deduction claims for examination and assessed more than $18.5 million in additional tax for 3,461 returns. The remaining 4,031 (54 percent) resulted in no tax assessment. IRS management noted that their review of the 4,031 no-change returns identified that the selection filters ********2**********
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[16] This population reflects only those recipients who would have had at least $10,350 in alimony income and wages to ensure that they would have had a filing requirement.
[17] For the purpose of our analysis, a TIN is invalid when it is not on the IRS National Account Profile file.
[18] Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

IRS management noted that they revised the filters ****************2****************** *************************************2************. For Fiscal Year 2018, the IRS selected 6,858 returns for examination and assessed more than $36 million in additional tax for 3,594 returns. The remaining 3,264 returns (47.6 percent) resulted in no tax assessment.

***Since Fiscal Year 2010 there has been a reduction in the number of tax returns with an alimony deduction selected for examination*.** The IRS examined 13,594 tax returns in Fiscal Year 2010 and 7,492 tax returns in Fiscal Year 2016. We identified 266,190 Tax Year 2010 returns and 232,548 Tax Year 2016 returns with an alimony discrepancy. This shows that the IRS audits 5 percent or less of the number of cases identified with a reporting discrepancy. IRS management indicated that the correspondence examination staff levels have decreased by almost 300 full-time equivalents since Fiscal Year 2014. These staff decreases lead to decreased audits, particularly those that have a higher reply rate[19] that require tax examiner action. Figure 5 shows the number of examinations conducted and the associated dollars assessed in Fiscal Years 2010 through 2018.

[19] Alimony examinations have a higher response rate to the correspondence issued by the IRS compared to other examination issues.

Figure 5: Tax Returns Examined in Fiscal Years 2010 Through 2018 for Alimony Related Issues

Fiscal Year	Returns Examined	Dollars Assessed
2010	13,594	$37,405,687
2011	9,789	$30,913,749
2012	13,232	$36,699,592
2013	14,659	$40,490,720
2014	12,229	$29,770,206
2015	8,069	$20,320,379
2016	7,492	$18,508,797
2017	5,902	$58,119,852
2018	6,858	$36,178,425

Source: IRS query of the Audit Inventory and Management System-Centralized Information System Closed Case Database.

Based on our prior recommendation, the IRS evaluated and discontinued certain filters that excluded high-risk returns from examination

In our prior review, we identified three filters that excluded tax returns from being selected for examination. The filters excluded tax returns in which the payer ************2************ **************************************2************************************ ************************************2********************. We recommended that the IRS evaluate examination selection filters to ensure that the filters do not exclude potentially high-risk tax returns with questionable alimony deduction claims from being selected for examination. When we discussed actions taken to address the exclusionary filters that we identified in our prior review, management provided us with the following information:

- *************************2************************** – The IRS tested this filter in February 2016 and determined it was not a productive source of cases for review. Therefore, this filter is no longer being used to identify tax returns for examination selection.
- ******************2******************** – This filter is not being used as part of the Alimony program to identify tax returns for examination selection; however, it was included in the *****2****** in Fiscal Years 2017 and 2018.
- *************************2************************** – The IRS is testing the productivity of this filter in Fiscal Year 2017 through Fiscal Year 2019. To date, the IRS has selected approximately 600 returns for review. We obtained the results to date

which identified 543 tax returns were examined with assessments that totaled more than $3 million.

IRS management indicated they are constantly adjusting existing examination selection filters and creating new filters to address alimony noncompliance. For example, the IRS developed a ************************************2************************************ **********************2*****************.

Recommendation

Recommendation 1*:* The Commissioner, Small Business/Self-Employed Division, should modify the IRS's existing compliance strategy to include specific actions to be taken to reduce the billions of dollars associated with alimony reporting discrepancies.

> ***Management's Response:*** The IRS agreed with this recommendation and plans to continue to monitor its alimony selection filters and revise as needed. IRS management plans to also review its recent communication and outreach efforts on alimony and determine if there are any additional education opportunities.
>
> ***Office of Audit Comment:*** Although IRS management agreed with our recommendation, they disagreed with our outcome measures of approximately $216 million in potential revenue protected and $3 million in increased revenue. IRS management stated that our computation of the $216 million in potential unassessed income tax resulting from noncompliance with alimony reporting requirements assumes all discrepancies are a compliance issue. As noted in Appendix IV of our report, we applied the no change rate identified by the IRS in its study of examined alimony claims to our outcome measure to account for cases in which an examination does not result in an additional tax assessment. We also asked the IRS for the number of alimony agreements it expects will expire each year so that we could further adjust our outcome measure. However, the IRS was unable to provide us with this information. In addition, the $3 million in additional income tax we reported was provided to us by the IRS.

Due to the Lack of a Consistent Validation Process for Alimony Recipient Taxpayer Identification Numbers, Tax Returns Are Not Being Identified for Additional Review

Although the IRS identifies both e-filed and paper tax returns with a missing or incomplete recipient TIN, the processes do not ensure that all individuals who claim an alimony deduction provide a *valid* TIN of the recipient as required. For example, our analysis of the 569,978 Tax Year 2016 tax returns with an alimony deduction claim identified 2,168 tax returns that claimed more than $38.5 million in alimony deductions in which the recipient TIN provided by the alimony deduction claimant was invalid, yet the IRS allowed the deduction. A previous IRS study examined tax returns with similar characteristics and determined that 46 percent required no adjustments; therefore, we reduced the number of tax returns to 1,001[20] tax returns that potentially would have resulted in a tax adjustment of $2.4 million. These individuals may have inappropriately reduced their Tax Year 2016 tax liability by approximately $2.4 million. Over five years, this could result in more than $11.8 million in unpaid tax.[21] Specifically, the TIN provided did not match an SSN issued by the Social Security Administration (SSA) or a TIN issued by the IRS, *i.e.*, Individual TIN or Adoption TIN. On its public website, the IRS defines a TIN as an "identification number used by the IRS in the administration of tax laws. It is issued either by the SSA or by the IRS."

When verifying an alimony recipient TIN, the IRS uses validity criteria that is inconsistent with what it uses to verify all other TINs on a tax return. As a result, the IRS allowed alimony deduction claims in which the recipient TIN provided by the alimony deduction claimant was invalid. For example, for all other TINs verified on a return, such as those used to claim refundable credits and dependent exemptions, the IRS defines a valid TIN as an SSN issued by the SSA or an Individual TIN or Adoption TIN issued by the IRS. Not only is the IRS's alimony recipient TIN verification inconsistent with the process used to verify all other TINs on a tax return, but the IRS also uses inconsistent processes to verify alimony deduction claims on e-filed tax returns verses paper tax returns. For example:

- E-filed tax returns with an alimony deduction claim are verified using Modernized e-File business rules. This verification is *******2**********************************
**********************************2***********************************
**********************************2***********************************
**********************************2***********************************
**********************************2***********************************
***********2**********. The IRS will reject tax returns that do not meet the verification criteria.

- Paper tax returns are verified through reviews by the IRS Returns and Document Analysis and Error Resolution functions. This verification is ************2*********
**********************************2***********************************
**********************************2***********************************
**********************************2***********************************
***********2**********. For paper tax returns that do not meet IRS verification criteria, the Error Resolution function employee will attempt to identify the correct TIN, and if it cannot, it will assess a penalty. However, ***************2***************
*******************2*****************.

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[20] We reduced the 2,168 tax returns by 315 tax returns that we were unable to calculate an accurate tax effect and multiplied the resulting 1,853 tax returns by 54 percent to estimate those that would be adjusted.

[21] See Appendix IV. The five-year forecast is based on multiplying the base year by five. The actual amount depends on the duration of the agreements that were in place prior to the passage of the Tax Cuts and Jobs Act and on the IRS implementing an effective process to identify alimony reporting discrepancies.

Further inconsistency arises as Discretionary Exam Business Rules use criteria to ensure that the reported recipient TIN is an SSN issued by the SSA when it selects cases for examination.

Management cites the lack of math error[22] authority as justification to allow deductions to taxpayers who provide invalid recipient TINs

In response to our prior audit, IRS management stated that they would not implement processes and procedures to ensure that the TIN is valid because the IRS does not have the authority to deny the alimony deduction outside of deficiency procedures. IRS Chief Counsel determined that the IRS does not have the authority to deny an alimony deduction outside of deficiency procedures, *i.e.*, an examination, when an invalid recipient TIN is provided. Although the IRS does not have the authority to deny a claim outside of deficiency procedures, it does not prevent the IRS from rejecting e-filed tax returns or corresponding with taxpayers who file a paper tax return to obtain a valid TIN. Of the 2,168 tax returns, we identified 1,542 (71 percent) were e-filed returns and 626 (29 percent) were paper tax returns. The IRS rejects e-filed tax returns and sends paper tax returns to its Error Resolution function when an alimony recipient TIN is not provided.

IRS management stated that limited resources and competing priorities present significant obstacles to adding the validation of the alimony recipient TIN to its current systemic TIN validation process performed at the time tax returns are processed. IRS management indicated that programming would be required to modify the TIN validation to include the alimony recipient TIN. We asked the IRS about the work involved in programming for National Account Profile[23] validation and IRS management responded that the Form 1040 would need to be modified to add the name control of the alimony recipient. Furthermore, programming would be needed within the processing system to evaluate the results of the validity check to determine the next step the return would take. This would mean a change for paper returns, e-filed returns, and Error Resolution System (ERS) revalidation.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 2***:*** Include the validation of the alimony recipient TINs as part of IRS's tax return processing systemic TIN validation process. For those TINs identified as not being issued by the SSA or the IRS, reject the e-filed tax returns.

> ***Management's Response:*** The IRS agreed with this recommendation and plans to request programming that will determine if the alimony recipient's TIN was issued by the SSA or the IRS. IRS management will take appropriate actions when recipient TINs not

[22] A program in which the IRS contacts taxpayers through the mail or by telephone when it identifies mathematical errors or mismatches of taxpayer information that would result in a tax change.
[23] The National Account Profile is a compilation of selected entity data from various IRS Master Files and the SSA.

issued by SSA or the IRS are detected. The requested programming will apply to both paper and electronic returns. Consequently, it will not be necessary to reject returns filed electronically.

Office of Audit Comment: Although IRS management agreed with our recommendation, we are unable to determine whether the planned corrective action fully addresses our concern. Specifically, IRS management does not indicate what actions they consider appropriate when the IRS determines the recipient TIN provided was not issued by the SSA or the IRS.

IRS management also disagreed with our outcome measure of $2.4 million in potential unpaid tax the IRS could receive as a result of improved processes to address the use of invalid recipient TINs. IRS management stated that resolving the use of an invalid recipient TIN can only be through an examination. However, as noted in our report, the IRS can reject e-filed tax returns that contain an invalid alimony recipient TIN without performing an examination. Rejecting an e-filed return provides the taxpayer the opportunity to correct their tax return voluntarily thus eliminating the need to conduct an examination. Our outcome measure quantifies the additional tax the IRS could potentially receive by rejecting and preventing alimony deduction claims with an invalid recipient TIN from entering the return processing system or by corresponding with taxpayers on paper returns with invalid recipient TINs (see Recommendation 3 below).

Recommendation 3***:*** Modify ERS programming to send both e-filed and paper tax returns that contain an invalid recipient TIN to the Error Resolution function for review and correspondence with the taxpayer.

Management's Response: The IRS partially agreed with this recommendation. IRS management plans to include, in its programming request for Recommendation 2, requirements to send paper tax returns to ERS to identify and correct any invalid alimony recipient TIN conditions caused by data transcription errors. However, IRS management disagrees that corresponding with taxpayers for a valid alimony recipient's TIN is a prudent use of its resources. The IRS does not have the necessary statutory authority to address invalid alimony recipient TINs at the time of return processing beyond assessing the $50 failure to comply with information reporting requirements under Internal Revenue Code Section 6723. Any further review of the alimony deduction must be performed under deficiency procedures. The IRS programming request will also include requirements to systemically assess the $50 penalty on electronically filed returns with invalid alimony recipient TINs.

Office of Audit Comment: An IRS research project showed that 41 percent of the sampled taxpayers who used an invalid recipient TIN provided a correct TIN after they received correspondence from the IRS. In addition, as discussed in our comment in Recommendation 2, implementing processes to reject e-filed returns will provide taxpayers the opportunity to correct their return before the return is accepted for processing, thus reducing the number of taxpayers with whom the IRS would need to correspond.

Penalties Are Not Assessed When Valid Recipient Taxpayer Identification Numbers Are Not Provided As Required

Our review of the 2,168 tax returns in which the recipient TIN was invalid found that the IRS assessed penalties on only 66 tax returns (3 percent) that totaled $3,300. For the remaining 2,102 tax returns, the IRS could have assessed $105,100 in penalties. The purpose of penalties is to encourage voluntary compliance by imposing consequences for noncompliance. Internal Revenue Code Section 6723 allows for a penalty assessment of $50 when a taxpayer fails to comply with a specified information-reporting requirement. This allows the IRS to assess a $50 penalty when an individual does not provide a valid alimony recipient's TIN as required. Internal Revenue Code Section 6723, Failure to comply with other information reporting requirements, states:

> *In the case of a failure by any person to comply with a specified information reporting requirement on or before the time prescribed therefor, such person shall pay a penalty of $50 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $100,000.*

We reported similar concerns in our prior audit. We identified that penalties for missing or invalid alimony recipient TINs were rarely assessed and, when the penalty was assessed, it was assessed for $5 instead of $50.[24] We notified the IRS that the penalty was not being assessed and the IRS agreed. Incorrect processing instructions did not direct employees to code the tax return to be forwarded to the Error Resolution function for correspondence and assessment of the penalty, if warranted. The IRS revised the processing instructions, but additional testing performed in the prior audit showed that the newly revised processing instructions had not corrected the problem.

We raised our concerns about this to IRS management on October 10, 2018. The IRS indicated that not all of the tax returns met the criteria to go to the Error Resolution function for review. To go to the Error Resolution function for review, ****************2********************* ************************************2****************************. Tax returns will also be reviewed when the ************2************************************** ************************************2*********. For those that were sent to the Error Resolution function, the tax examiner should have assessed the penalty.

We analyzed the 2,168 cases and found that 139 (6 percent) cases would have met the criteria to go to the Error Resolution function; therefore, the examiner should have assessed the penalty.

[24] IRS corrected the programming associated with the incorrect penalty amount on January 4, 2018.

IRS management indicated that not assessing the required penalty was due to examiner error. The remaining 2,029 (94 percent) of the 2,168 cases did not meet the criteria to go to the Error Resolution function for review. As desribed in Recommendation 3, we recommend that the IRS modify computer programming to send tax returns that contain an invalid alimony recipient TIN to the Error Resolution function. Once these additional cases are routed to the Error Resolution function for review, the examiner should follow existing internal guidelines to search for a valid TIN. When the examiner is unable to find a valid recipient TIN, he or she should assess the penalty and send the tax return for deficiency procedures. We forecast that the IRS may not assess $525,500 in applicable penalties over the next five years as a result of weaknesses in its processes to identify invalid recipient TINs.[25]

IRS programming incorrectly replaced recipient TINs when the alimony deduction was less than $5,000

Our review found that the IRS replaced alimony recipient TINs with "999-99-9991" when the alimony deduction was less than $5,000. IRS management informed us that they do not recall why the procedure was in place. However, they stated it was not intended to avoid sending cases to the Error Resolution function and would not have had any bearing on Examination selection filters. Although the alimony recipient TIN was replaced with "999-99-9991" during processing, the alimony recipient TIN as originally submitted on the tax return is still available in other IRS files. On March 29, 2018, we notified IRS management that our analysis of 237,880 Tax Year 2015 and Tax Year 2016 e-filed tax returns that claimed an alimony paid deduction of less than $5,000, showed that except for 15 recipients the TINs all reflected 999-99-9991.[26] Our research also showed this continued for Tax Year 2017 tax returns. This occurred because the IRS did not update programming from Tax Year 2013 when the IRS intentionally replaced the alimony SSNs for claims less than $5,000. In response to our concern, IRS management implemented programming to correct the issue on January 1, 2019.

Recommendation

Recommendation 4*:* The Commissioner, Wage and Investment Division, should ensure that IRS employees understand and comply with procedures to assess a penalty on taxpayers who do not provide a valid recipient TIN when they claim an alimony deduction.

> ***Management's Response:*** The IRS agreed with this recommendation and plans to reiterate the criteria for penalty assessment with the Error Resolution function employees who address the invalid alimony recipient TIN condition on returns claiming deductions

[25] See Appendix IV. The five-year forecast is based on multiplying the base year by five. The actual amount depends on the duration of the agreements that were in place prior to the passage of the Tax Cuts and Jobs Act and on the IRS implementing an effective process to identify alimony reporting discrepancies.

[26] When this occurred for the cases we reviewed, we obtained the actual TIN from the tax return as it was originally submitted.

for alimony paid. IRS management also plans to review pertinent training and procedural materials to identify where improvements or clarifications can be made.

Office of Audit Comment: Although IRS management agreed with our recommendation, they did not agree with our outcome measure of $105,100 in potential increased revenue resulting from unassessed penalties. IRS management stated that our computation of the $105,100 in potential unassessed penalties does not account for the additional resources required by the IRS including information technology and procedural changes to pursue the potential penalties. IRS management also stated that our five-year forecast does not account for the impact of a penalty on future voluntary compliance, which would decrease each year. We asked the IRS for the estimated costs of information technology and procedural changes, as well as any estimates of the percentage of taxpayers who improve their compliance after a penalty assessment, so that we could adjust our outcome measure. However, the IRS was unable to provide us with this information.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the IRS's use of systemic processes to identify and address alimony deduction claims when taxpayers do not comply with reporting requirements. To accomplish our objective, we:

I. Determined if the corrective actions to the prior audit's recommendations helped address the alimony reporting compliance gap.

   A. Obtained the Processing Year[1] 2018 Discretionary Exam Business Rules used to identify questionable alimony tax returns.

      1. Reviewed the filters to determine if they no longer excluded potentially high-risk tax returns with questionable alimony claims. We quantified the additional income assessed due to examination filters recommended in our prior review.

      2. Obtained examination statistics for alimony cases worked for Tax Year[2] 2010 through Tax Year 2018 and determined if they had improved.

   B. Obtained the IRS's current strategy to address alimony reporting noncompliance.

      1. Determined if the IRS strategy adequately addresses the alimony compliance gap by including the use of soft notices.[3]

      2. Determined if the IRS has taken any steps to use math error[4] authority to correct the alimony deduction on tax returns when the taxpayer omits a valid alimony recipient TIN.[5]

   C. Obtained the IRS's current processes and procedures to ensure that all tax returns are verified for a required valid alimony recipient TIN when an alimony deduction is claimed.

[1] The calendar year in which the tax return or document is processed by the IRS.
[2] 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.
[3] Soft notices are issued to taxpayers for informational purposes only and inform the taxpayers they may have an error on their tax returns.
[4] A program in which the IRS contacts taxpayers through the mail or by telephone when it identifies mathematical errors or mismatches of taxpayer information that would result in a tax change.
[5] A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN is an Employer Identification Number, an SSN, or an Individual TIN.

1. Reviewed e-file reject codes to determine if a tax return will reject when a valid alimony recipient TIN is not provided.
2. Reviewed Error Resolution function procedures to determine if the IRS corresponds with the taxpayer when a valid alimony recipient TIN is not provided.
3. Reviewed and compared the Returns and Document Analysis Internal Revenue Manual (IRM), the ERS IRM, e-file reject codes, and examination filter criteria used to identify invalid recipient TINs.
4. Determined if there is a dollar tolerance that needs to be met before a tax return will be sent to the Error Resolution function.
5. Determined e-filed and paper tax return percentages for taxpayers filing tax returns that claim an alimony deduction without a valid alimony recipient TIN.

D. Verified that Error Resolution function procedures allow appropriate penalties to be assessed for the correct amount when the alimony recipient's TIN is not provided or is invalid.

II. Quantified the tax impact of alimony compliance discrepancies that still exist from our prior audit.

A. Analyzed Tax Year 2016 tax returns in which the taxpayer claimed an alimony deduction and the alimony recipient did not file a tax return.

1. Validated tax returns to the Integrated Data Retrieval System[6] and determined the data were sufficiently reliable to use for our audit.
2. Determined if the alimony recipient would have had a filing requirement by adding the amount of any wages reported for them on a Form W-2, *Wage and Tax Statement*, to the alimony income.

B. Reviewed cases that were recalculated by the tax simulator tool[7] and compared them to the Individual Master File[8] (IMF).

1. Compared the original balance due or refund amount from the IRTF[9] captured by the tax simulator tool to the IMF's balance due or refund amount.

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[6] IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
[7] The Tax Simulator Tool was developed to recalculate a batch of individual tax returns when adjustments are made to certain line items. TIGTA uses this tool to identify the tax impact of the adjustments to the Form 1040, *U.S. Individual Income Tax Return*, such as reducing wages or excluding credits, on both a "per return" and a batch level.
[8] The IRS database that maintains transactions or records of individual tax accounts.
[9] A database the IRS maintains that contains information on the individual tax returns it receives.

2. Analyzed the records in which there was a match from the IRTF that indicated the taxpayer owed or received the alimony amount.
3. Analyzed the difference between the IMF amount and the tax simulator tool recalculated amount for the balance due or refund to estimate the potential outcome.
4. Validated tax returns to the Integrated Data Retrieval System to verify that the alimony deduction or alimony income was correctly recorded and that the alimony discrepancy was correctly identified.
5. Recalculated 50 tax returns, compared the results to the tax simulator tool, and determined the data were sufficiently reliable to use for our audit.

C. Reviewed the 2,168 Tax Year 2016 tax returns that claimed an alimony deduction with an invalid alimony recipient TIN.

1. Validated records to the Integrated Data Retrieval System and determined the data were sufficiently reliable to use for our audit.
2. Determined if the taxpayer was assessed the $50 penalty if required information was not provided.

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 IRM, the Discretionary Exam Business Rules, and the Modernized e-File business rules as they relate to identifying discrepancies between alimony deductions claimed and alimony income reported and identifying alimony deduction claims with a missing or invalid alimony recipient TIN. To evaluate these controls, we reviewed IRS procedures and business rules, obtained information from IRS management, and analyzed individual tax returns that claimed alimony deductions and alimony income.

Appendix II

Major Contributors to This Report

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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, Customer Account Services, Wage and Investment Division
Director, Examination, Small Business/Self-Employed Division
Director, Exam Case Selection, Small Business/Self-Employed Division
Director, Submission Processing, Wage and Investment Division
Director, Office of Audit Coordination

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 $216 million in additional income tax assessed for 152,963 tax returns during Tax Year[1] 2016 due to noncompliance with alimony reporting requirements; approximately $1.1 billion over five years[2] (see page 7).

Methodology Used to Measure the Reported Benefit:

We identified tax returns with an alimony reporting discrepancy. An alimony reporting discrepancy occurs when individuals claim deductions for alimony, which they did not pay, or individuals do not report alimony income they received. While our audit assumes the taxpayer who claimed the alimony deduction is correctly reporting the deduction, only an examination of the tax returns can determine the actual amount of the reporting discrepancy.

We identified 606,795 tax returns with an alimony deduction claimed and 469,962 tax returns with alimony income reported from the Processing Year[3] 2017 IRTF.[4] If more than one tax return reported paying alimony to the same individual, we added the deduction amount to enable matching to the alimony income reported by the recipient. We limited our population of tax returns with an alimony deduction to Tax Year 2016 returns resulting in 569,978 tax returns with an alimony deduction.

We matched the alimony recipient TIN[5] from the alimony deduction file to both the primary and secondary TINs in the alimony income file. We identified:

- 229,210 – Alimony income reported is equal to the alimony deduction claimed.

[1] 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.
[2] The five-year forecast is based on multiplying the base year by five. The actual amount depends on the duration of the agreements in place prior to the passage of the Tax Cuts and Jobs Act remaining in effect and on the IRS implementing an effective process to identify alimony reporting discrepancies.
[3] The calendar year in which the tax return or document is processed by the IRS.
[4] A database the IRS maintains that contains information on the individual tax returns it receives.
[5] A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN is an Employer Identification Number, an SSN, or an Individual TIN.

- 83,773 – Alimony income reported was less than the alimony deduction claimed.
- 30,414 – Alimony income reported was more than the alimony deduction claimed.
- 2,168 – Alimony recipient TIN was not valid.

We identified 111,012 alimony recipient TINs that were not found on a filed a tax return. In addition, we identified 113,138 recipients that filed a tax return but did not report any alimony income.

We focused our reviews on the 83,773 tax returns reporting alimony income less than the deduction claimed and the 113,138 tax returns that did not include any alimony income. We used a tax simulator tool that enabled us to recalculate a tax return based on adjustments to specific line items on a tax return. For example, for tax returns on which the alimony recipient did not report alimony income, we input the amount of the alimony deduction claimed by the payer to the alimony recipient's alimony income line. This allowed us to recalculate the tax returns to show the effect of adding the additional alimony income. Likewise, for those tax returns reporting alimony income less than the alimony deductions claimed, we increased the income amount to equal the deduction. The tax simulator tool recalculates the recipient's tax return with the increased income.

The tax simulator tool performs two iterations. The first attempts to recalculate the tax as shown on the original return (before auditor adjustments) to determine if the tax simulator tool can accurately recreate the tax and summary items on the original return. An accurate recalculation consists of the tax simulator tool being within $1.00 on nine summary lines. If the tax simulator tool cannot produce an accurate recalculation, the tax return is removed and will not continue to the second iteration. This first iteration reduced our population of alimony recipients that should have reported more alimony income than they did from 83,773 to 78,512 tax returns. In addition, it reduced the number of alimony recipients that did not include alimony income on their tax return from 113,138 to 107,005 tax returns.

The second iteration recalculates the tax effect based on adjustments to the alimony income. We determined the potential outcome of additional income tax that should have been assessed as the difference between the total income tax on the recipient's original tax return to the total income tax calculated by the tax simulator tool. This is the difference in Form 1040, *U.S. Individual Income Tax Return*, Line 63.

The tax simulator tool recalculates significant summary lines on the Form 1040. The simulator records the original amount and the adjusted amount. When the tax return does not have amounts reported for qualified dividends or capital gains, the tax simulator tool will apply the tax table to tax returns with taxable income less than $100,000 and will apply the Tax Computation Worksheet when taxable income is greater than or equal to $100,000. The tax simulator tool does have limitations. For example:

- The tax simulator tool does not recalculate every line item on the tax return.

- If an amount was not included on the original return the tax simulator tool will not create an amount.
- The tax simulator tool does not recalculate every line item based on the adjustments and in these instances; it will accept the taxpayer's figures from the original return.

To be conservative in our outcome measure, we considered only tax returns that were not adjusted during normal tax return processing. We compared the refund/balance due from the IRTF to the amounts that posted to the IMF. We also eliminated tax returns in which the taxpayer indicated someone else could claim them as a dependent. This resulted in the following populations:

- 72,434 alimony recipients who reported less alimony income than the alimony deduction claimed.
- 103,386 alimony recipients who filed a tax return but reported no alimony income.

For the 175,820 (72,434 + 103,386) tax returns, we compared the Form 1040 Line 63 total tax amount of $954,236,789 to the recalculated amount of $1,202,438,534 from the tax simulator tool resulting in a difference of $248,201,745. A previous IRS study examined tax returns with similar characteristics and determined that 13 percent required no adjustments. In order to account for the returns with no adjustments, we multiplied the number of tax returns by 87 percent to get 152,963 tax returns that potentially would have resulted in a tax adjustment (175,820 x 87 percent = 152,963). We determined the average amount of our recalculated tax difference was $1,412 (248,201,745/175,820 = $1,412). We took the average amount of recalculated tax times the 152,963 tax returns to come up with our adjusted outcome of $215,983,756. We forecast that taxpayers could be assessed $1,079,918,780 in additional income tax over the next five years ($215,983,756 x 5) due to noncompliance with alimony reporting requirements.

Type and Value of Outcome Measure:

- Increased Revenue – Actual; $3,015,339 in additional income tax assessed for 543 tax returns that were audited because of examination filters recommended in our past review (see page 7).

Methodology Used to Measure the Reported Benefit:

The IRS provided the examination results of the two Discretionary Exam Business Rules filters implemented due to our prior audit recommendation. ****************2****************** ***************************************2************************. The IRS closed 543 examinations in Fiscal Year[6] 2017 through Fiscal Year 2019 that were selected for

[6] Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

examination due to these filters. The 543 closed examinations had assessments that totaled $3,015,339.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; $2.4 million in unpaid tax from questionable alimony deductions made on 1,001 tax returns during Tax Year 2016 that did not include a valid recipient TIN; approximately $11.8 million over five years[7] (see page 12).

Methodology Used to Measure the Reported Benefit:

We identified 606,795 tax returns with an alimony deduction claimed from the Processing Year 2017 IRTF. We limited our population of tax returns with an alimony deduction to Tax Year 2016 returns resulting in 569,978 tax returns with an alimony deduction. We identified 2,168 taxpayers who claimed an alimony deduction and reported an invalid alimony recipient TIN.

We used the same tax simulator tool that we describe in the first outcome measure on pages 25 through 26. The difference is that for tax returns on which the alimony payer did not report a valid alimony recipient TIN we removed the amount of the alimony deduction from the tax return. The tax simulator tool enabled us to recalculate the tax to show the effect of removing the alimony deduction.

This first iteration of the tax simulator tool reduced our population of alimony payers that should not have reported a deduction from 2,168 to 2,001 tax returns. To be conservative in our outcome we only considered tax returns that were not adjusted during normal tax return processing. To accomplish this we compared the refund/balance due from the IRTF to the amounts that posted to the IMF. This resulted in the population of 1,853 tax returns.

For the 1,853 tax returns, we compared the Form 1040 Line 63 total tax amount of $45,864,015 to the recalculated amount of $50,245,785 from the tax simulator tool resulting in a difference of $4,381,770. A previous IRS study examined tax returns with similar characteristics and determined that 46 percent required no adjustments. To account for the returns with no adjustments, we multiplied the number of tax returns by 54 percent to get 1,001 tax returns that potentially would have resulted in a tax adjustment (1,853 x 54 percent = 1,001). We determined the average amount of our recalculated tax difference was $2,365 ($4,381,770/1,853 = $2,365). We took the average amount of recalculated tax times the 1,001 tax returns to come up with our adjusted outcome of $2,367,365. We forecast that taxpayers could be assessed $11,836,825 in additional income tax over the next five years ($2,367,365 x 5) due to noncompliance with alimony reporting requirements.

[7] The five-year forecast is based on multiplying the base year by five. The actual amount depends on the duration of the agreements in place prior to the passage of the Tax Cuts and Jobs Act remaining in effect and on the IRS implementing an effective process to identify alimony reporting discrepancies.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $105,100 in unassessed penalties for 2,102 tax returns that claimed alimony deductions but did not provide a valid alimony recipient TIN during Tax Year 2016; $525,500 over five years[8] (see page 16).

Methodology Used to Measure the Reported Benefit:

We identified 606,795 tax returns with an alimony deduction from the Processing Year 2017 IRTF. We limited our population of tax returns with an alimony deduction to Tax Year 2016 returns resulting in 569,978 tax returns with an alimony deduction. From this population, we determined if the alimony recipient TIN was on the National Account Profile[9] or met a pattern identified in the IRS IRM and SSA Guidance as having an invalid format.

We identified 2,168 recipient TINs from the file of tax returns with alimony deductions claimed that were invalid per the National Account Profile or fit the pattern in the IRM.

We created a file of tax returns with tax periods greater than or equal to 2015 that had a penalty assessed due to not providing the required information on the tax return. We created this file from the IMF on the Data Center Warehouse. We identified 3,849 tax returns with this penalty.

We matched the file of 2,168 recipient TINs to the 3,849 tax returns that had the penalty to identify those with and without the penalty. We identified 66 tax returns that had the penalty assessed and 2,102 tax returns that should have been assessed penalties totaling $105,100. We forecast this could result in $525,500 in penalties assessed over the next five years ($105,100 x 5) because of noncompliance with alimony reporting requirements.

[8] The five-year forecast is based on multiplying the base year by five. The actual amount depends on the duration of the agreements in place prior to the passage of the Tax Cuts and Jobs Act remaining in effect and on the IRS implementing an effective process to identify alimony reporting discrepancies.
[9] The National Account Profile is a compilation of selected entity data from various IRS Master Files and the SSA.

Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

July 3, 2019

MEMORANDUM FOR MICHAEL E. McKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mary Beth Murphy for Lisa Beard-Niemann
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Additional Actions are Needed to Reduce Alimony Reporting Discrepancies on Income Tax Returns (Audit #201840019)

Thank you for the opportunity to review the above subject draft audit report. Alimony is a payment to or for a spouse or former spouse under a separation agreement or divorce decree. Historically, alimony payments were deductible by the payer and required to be reported as income by the recipient. The Tax Cuts and Jobs Act (TCJA) of 2017 eliminated the payer's deduction for alimony and the recipient's requirement to include alimony in income. This change went into effect for all divorce decrees or separation agreements executed after December 31, 2018, as well as certain instruments modified after that date.

Your report focused on situations where the alimony deductions claimed by payers and the alimony income reported by recipients did not match. These discrepancies, in and of themselves, are not necessarily compliance issues. There are multiple reasons discrepancies can exist including, but not limited to, alimony paid to multiple recipients, alimony paid to a foreign recipient, no filing requirement for the recipient, invalid TINs, and transcription errors. As noted in your report, only an examination of the tax returns can determine the actual amount, if any, of the discrepancy that represents non-compliance.

Annually, we apply business rules to identify alimony reporting discrepancies and select a portion of those returns for examination. In response to the TCJA, we have refined our filters to identify those individuals subject to the new law who may inappropriately deduct alimony. We plan to change the Form 1040, Schedule 1, to capture dates of divorce agreements and prepare programming requirements to permit systemic identification of potentially improper deductions. We will maintain our business rules for taxpayers who have agreements in place that are subject to pre-TCJA provisions. We will also continue to conduct case reviews, analyze results, and adjust and/or create new filters to detect and address non-compliance.

Your report includes several recommendations and outcome measures. We agree or partially agree with all your recommendations. However, we do not agree with any of your outcome measures.

Attached is our detailed response to your recommendations and outcome measures. If you have any questions, please contact me or Brenda Dial, Director, Examination Operations, Small Business/Self-Employed Division.

Attachment

Attachment

RECOMMENDATION 1:
The Commissioner, Small Business/Self-Employed Division, should modify the IRS's existing compliance strategy to include specific actions to be taken to reduce the billions of dollars associated with alimony reporting discrepancies.

CORRECTIVE ACTION:
We agree with this recommendation. We will continue to monitor our alimony selection filters and revise as needed. We will review our recent communication and outreach efforts on alimony and determine if there are any additional education opportunities.

IMPLEMENTATION DATE:
March 15, 2020

RESPONSIBLE OFFICIAL:
Director, Examination Case Selection, Small Business/Self Employed Division

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

RECOMMENDATION 2:
The Commissioner, Wage and Investment, should include the validation of the alimony recipient TINs as part of IRS's tax return processing systemic TIN validation process. For those TINs identified as not being issued by the SSA or the IRS, reject the e-filed tax returns.

CORRECTIVE ACTION:
We agree with this recommendation. Programming will be requested that will determine if the alimony recipient's Taxpayer Identification Number (TIN) was issued by the Social Security Administration (SSA) or the IRS. When recipient TINs not issued by SSA or the IRS are detected, appropriate measures will be taken to address them. The requested programming will apply to both paper and electronic returns. Consequently, it will not be necessary to reject returns filed electronically. Information Technology resources needed to complete the requisite programming are impacted by budgetary constraints and competing priorities. Therefore, we cannot provide an implementation date.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
Director, Submission Processing, Customer Account Services, Wage and Investment Division

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

RECOMMENDATION 3:
The Commissioner, Wage and Investment, should modify ERS programming to send both e-filed and paper tax returns that contain an invalid recipient TIN to the Error Resolution function for review and correspondence with the taxpayer.

CORRECTIVE ACTION:
We partially agree with this recommendation. In conjunction with the programming requested for Recommendation 2, we will include requirements to send paper tax returns to ERS, to identify and correct any invalid alimony recipient TIN conditions caused by data transcription errors. We disagree that corresponding with taxpayers for a valid alimony recipient's TIN is a prudent use of IRS resources. It should be noted that the IRS does not have the necessary statutory authority to address invalid alimony recipient TINs, at the time of return processing, beyond assessing the $50 failure to comply with information reporting requirements under Internal Revenue Code section 6723. Any further review of the alimony paid deduction must be performed under deficiency procedures. Our programming request, however, will include requirements to systemically assess the $50 penalty on electronically filed returns with invalid alimony recipient TINs. Information Technology resources needed to complete the requisite programming are impacted by budgetary constraints and competing priorities. Therefore, we cannot provide an implementation date.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
Director, Submission Processing, Customer Account Services, Wage and Investment Division

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

RECOMMENDATION 4:
The Commissioner, Wage and Investment, should ensure that IRS employees understand and comply with procedures to assess a penalty on taxpayers who do not provide a valid recipient TIN when they claim an alimony deduction.

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CORRECTIVE ACTION:
We agree with this recommendation. We will reiterate the criteria for penalty assessment with the Error Resolution Unit employees that address the invalid alimony recipient Taxpayer Identification Number condition on returns claiming deductions for alimony paid. We will also review pertinent training and procedural materials to identify where improvements or clarifications can be made.

IMPLEMENTATION DATE:
December 15, 2019

RESPONSIBLE OFFICIAL:
Director, Submission Processing, Customer Account Services, Wage and Investment Division

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

OUTCOME MEASURE 1:
Revenue Protection – Potential; approximately $216.0 million in additional income tax assessed for 152,963 tax returns during Tax Year 2016 due to noncompliance with alimony reporting requirements; approximately $1.1 billion over five years.

IRS RESPONSE:
We disagree with this figure. This measure assumes that all discrepancies are a compliance issue but there are legitimate reasons a discrepancy may occur. We already have business rules in place to identify the returns with non-compliance risk. The five-year projection does not consider the impact of a compliance activity to future voluntary compliance. Each year would have diminishing value rather than the same value attributable to all five years. Additionally, as alimony agreements expire, the number of returns with discrepancies is expected to decrease over time.

OUTCOME MEASURE 2:
Increased Revenue – Actual; $3,015,339 in additional income tax assessed for 543 tax returns that were audited because of examination filters recommended in our past review.

IRS RESPONSE:
We disagree. The actual revenue of $3,015,339 is overstated as it does not account for Appeals' decisions or audit reconsiderations.

OUTCOME MEASURE 3:
Revenue Protection – Potential; $2.4 million in unpaid tax from questionable alimony deductions made on 1,001 tax returns during Tax Year 2016 that did not include a valid recipient TIN; approximately $11.8 million over five years.

IRS RESPONSE:
We disagree. As stated in your report, only an examination can determine if an alimony deduction is valid. This measure also fails to account for the opportunity costs of pursuing this type of return rather than other returns with higher potential non-compliance.

OUTCOME MEASURE 4:
Increased Revenue – Potential; $105,100 in unassessed penalties for 2,102 tax returns that claimed alimony deductions but did not provide a valid alimony recipient TIN during Tax Year 2016; $525,500 over five years.

IRS RESPONSE:
We disagree. The outcome measure does not account for the additional resources required by the IRS including information technology and procedural changes to pursue this potential $105,100 in penalties. The five-year projection does not account for the impact of a penalty to future voluntary compliance. Each year would have diminishing value rather than the same value attributable to all five years. Additionally, as alimony agreements expire the amount of returns with an invalid TIN is expected to decrease over time.