TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments

April 30, 2020

Reference Number: 2020-40-025

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HIGHLIGHTS: Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments

Final Audit Report issued on April 30, 2020
Reference Number 2020-40-025

Why TIGTA Did This Audit

This audit was initiated because TIGTA is required to assess the IRS's compliance with the reporting requirements contained in the Improper Payments Elimination and Recovery Act of 2010; Executive Order 13520, Reducing Improper Payments; and the Improper Payments Elimination and Recovery Improvement Act of 2012. The objective of this review was to determine whether the IRS complied with the annual improper payment reporting requirements for Fiscal Year 2019.

Impact on Taxpayers

The Improper Payments Elimination and Recovery Act of 2010 and subsequent legislation strengthened agency reporting requirements and redefined "significant improper payments" in Federal programs. The Office of Management and Budget has declared the Earned Income Tax Credit (EITC) Program a high-priority program that is subject to reporting in the Department of the Treasury Agency Financial Report. The IRS estimates 25.3 percent ($17.4 billion) of the total EITC payments of $68.7 billion made in Fiscal Year 2019 were improper.

What TIGTA Found

The IRS provided all required EITC improper payment information for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2019.* The IRS has not reduced the overall EITC improper payment rate to less than 10 percent; however, it has been approved for this exception to the annual reduction target reporting requirement. As an alternative, the Office of Management and Budget advised that a reduction target may remain constant given the complexities of the program, as long as the complexities are clearly explained in a footnote.

For Fiscal Year 2019, in response to TIGTA recommendations, the IRS correctly rated the Additional Child Tax Credit (ACTC), the American Opportunity Tax Credit (AOTC), and the Net Premium Tax Credit (PTC) as being susceptible to significant improper payments, *i.e.*, high risk, similar to the EITC. However, the IRS did not report the Net PTC improper payment estimates in the Agency Financial Report and will begin reporting in Fiscal Year 2020, as required by the Office of Management and Budget. The IRS estimates that 27.4 percent ($540.9 million) of the total Net PTC payments in Fiscal Year 2019 were improper.

In addition, the IRS does not use the tools provided by Congress to the extent possible to address erroneous credit payments. For example, erroneous refund penalties are not being assessed, the majority of taxpayers who are recertified to receive a refundable credit do not meet eligibility requirements, and bans are not being used effectively. Furthermore, limited resources result in the majority of refundable credit claims with income discrepancies not being addressed.

Finally, revising the nonwork Social Security Number case selection methodology could increase revenue protected. Our review of Processing Year 2019 tax returns identified that the IRS could have increased the amount of revenue it is protecting by approximately $3.1 million if it included the ACTC in its selection criteria and prioritized its case selection.

What TIGTA Recommended

TIGTA recommended that the IRS work with the Department of Health and Human Services to develop a comprehensive risk assessment of improper PTC payments, which includes the risk of the Advanced PTC improper payments. In addition, the IRS should continue to refine its selection criteria to ensure that the tax returns with the greatest potential are selected and worked, and implement a process to systemically identify and evaluate tax returns filed by individuals with nonwork dependent Social Security Numbers to prevent erroneous refunds of the ACTC.

IRS management agreed with all three recommendations and plans to take appropriate corrective actions.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

April 30, 2020

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments (Audit # 202040010)

This report presents the results of our review to determine whether the Internal Revenue Service complied with the annual improper payment reporting requirements for Fiscal Year 2019. This review is part of our Fiscal Year 2020 Annual Audit Plan and addresses the major management and performance challenge of *Reducing Fraudulent Claims and Improper Payments*.

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

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

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Background

The Office of Management and Budget (OMB) defines an improper payment as any payment that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient. Agency Inspectors General have responsibility for evaluating agency information related to improper payments. The Improper Payments Information Act (IPIA) of 2002[1] requires Federal agencies, including the Internal Revenue Service (IRS), to estimate the amount of improper payments and report to Congress annually on the causes of and the steps taken to reduce improper payments. The IPIA also requires agencies to address whether they have the information systems and other infrastructure needed to reduce improper payments. The annual report must also describe steps the agency has taken to ensure that agency managers are held accountable for reducing improper payments. The following Executive Order and legislation clarified and expanded IPIA requirements:

- **Executive Order 13520, *Reducing Improper Payments*** – signed by the President on November 20, 2009, it increased Federal agencies' accountability for reducing improper payments while continuing to ensure that Federal programs serve and provide access to intended beneficiaries. It requires Federal agencies to provide agency Inspectors General with detailed information on efforts to identify and reduce the number of improper payments in Federal programs with the highest dollar value of improper payments.
- **Improper Payments Elimination and Recovery Act (IPERA) of 2010**[2] – enacted on July 22, 2010, it amended the IPIA by strengthening agency reporting requirements and redefining "significant improper payments" in Federal programs. For Fiscal Year[3] 2014 and beyond, significant improper payments are defined as gross annual improper payments, *i.e.*, the total amount of overpayments and underpayments. The gross annual improper payments is the total amount of overpayments plus underpayments made in the program during the fiscal year reported that a) exceeded both 1.5 percent of program outlays and $10 million of all program or activity payments or b) exceeded $100 million at any percent of program outlays.
- **Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012**[4] – enacted on January 10, 2013, it further expanded agency improper payment requirements to foster greater agency accountability. Like Executive Order 13520, the IPERIA requires the OMB Director to identify a list of high-priority Federal programs. For those high-priority programs, the IPERIA requires agencies to develop additional or supplemental measures to track progress in reducing improper payments and submit an annual report to the Inspector General of the agency on the steps the agency has taken and plans to take to recover past and prevent future improper payments. The report is also required to be posted on a website accessible to the public.

On June 26, 2018, the OMB issued revisions to Circular A-123 Appendix C, *Requirements for Payment Integrity Improvement*. Circular A-123 Appendix C provides agencies and Inspectors

[1] Pub. L. No. 107-300, 116 Stat. 2350.
[2] Pub. L. No. 111-204, 124 Stat. 2224.
[3] 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.
[4] Pub. L. No. 112-248, 126 Stat. 2390.

General with guidance on the implementation of the IPIA as amended by the IPERA, the IPERIA, and Executive Order 13520. According to the OMB, the goal of the revised Appendix C is to transform the improper payment compliance framework to create a more unified, comprehensive, and less burdensome set of requirements. For example, agencies are compliant with most improper payments reporting requirements through the Agency Financial Report.[5] The IPERA adds an important component of accountability to the entire spectrum of improper payment efforts. Every year, each agency Inspector General reviews its agency's improper payment reporting in the agency's Agency Financial Report and any accompanying material, such as that provided on paymentaccuracy.gov, to determine if the agency complies with IPERA and OMB guidance.

Process to identify IRS programs for improper payment risk assessment

The Department of the Treasury (Treasury Department) identifies the programs that the IRS must assess for the risk of improper payments. For Fiscal Year 2019, the Treasury Department selected 21 IRS program fund groups. These funds were selected for assessment based on each fund groups' materiality to IRS financial statements. On March 20, 2014, the OMB issued additional supplemental improper payment guidance to the Treasury Department clarifying the requirement for annual risk assessments for most refundable tax credits. In addition, the OMB's revised guidance allows agencies to conduct improper payment risk assessments at least once every three years for programs that are deemed to be a low risk for susceptibility to significant improper payments. The IRS received approval from the Treasury Department to conduct these risk assessments on a three-year rotational schedule starting in Fiscal Year 2018. Appendix III provides a list of the 12 IRS programs for which the IRS completed an improper payment risk assessment for Fiscal Year 2019.

The IRS used *Quantitative Risk Assessment Summaries* and *Qualitative Risk Assessment Questionnaires* for Fiscal Year 2019 and related guidance the Treasury Department provided to assess the level of risk for each identified program. A Quantitative Risk Assessment Summary is a review of a sample of disbursements to formulate the overall estimated improper payment rate. A Qualitative Risk Assessment Questionnaire is a questionnaire used to assess a program's internal controls, which could lead to susceptible improper payments. The Treasury Department updated the *Qualitative Risk Assessment* ratings to susceptible or not susceptible.

The IRS is required to forward the results and documentation supporting the risk assessments performed to the Treasury Department. For any program identified as susceptible to significant improper payments (hereafter referred to as high risk), the IRS must also provide the following information for inclusion in the Treasury Department's annual Agency Financial Report in the following fiscal year:

- The rate and amount of improper payments.
- The root causes of the improper payments.
- Actions taken to address the root causes.
- Annual improper payment reduction targets.
- Discussion of any limitations to the IRS's ability to reduce improper payments.

[5] The Agency Financial Report presents the Treasury Department's financial and performance information for the fiscal year with comparative prior year data, where appropriate.

Results of Review

For Fiscal Year 2019, in response to Treasury Inspector General for Tax Administration (TIGTA) recommendations,[6] the IRS correctly rated the Additional Child Tax Credit (ACTC) and the American Opportunity Tax Credit (AOTC) as also being susceptible to significant improper payments (hereafter referred to as high risk) similar to the Earned Income Tax Credit (EITC). The specific dollar amount and percentage rate of improper payments the IRS calculated for these programs is as follows:

- EITC - The IRS estimates 25.3 percent ($17.4 billion) of the total EITC payments of $68.7 billion made in Fiscal Year 2019 were improper.
- ACTC - The IRS estimates 15.2 percent ($7.2 billion)[7] of the total ACTC payments of $47.7 billion in Fiscal Year 2019 were improper.
- AOTC – The IRS estimates 26.0 percent ($2.1 billion)[8] of the total AOTC payments of $7.9 billion in Fiscal Year 2019 were improper.

However, the IRS still did not include the Net Premium Tax Credit (PTC) improper payment rate and amount in the Agency Financial Report. The lacking of reporting is despite IRS estimates that 27.4 percent ($540.9 million) of the total Net PTC payments in Fiscal Year 2019 were improper. Per OMB guidance, the IRS is required to begin reporting the Net PTC improper payment estimates in Fiscal Year 2020.

Finally, the IRS has made little progress to reduce the improper payments associated with the refundable credit programs it administers. However, there are actions that the IRS can take that include more effectively using authorities provided by the Internal Revenue Code. In addition to using existing authorities more effectively, Congress could also assist the IRS by expanding the IRS's authority (referred to as correctable error authority or math error authority) to correct tax returns with identified erroneous refundable credit claims during processing.

Assessment of Fiscal Year 2019 Compliance With Improper Payment Reporting Requirements

The OMB has identified the EITC as a high-priority program. As such, the IRS is required to report annually on its efforts to reduce EITC improper payments. Our review confirmed that the IRS provided all required EITC improper payment information to the Treasury Department for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2019*. The IRS has not reduced the overall EITC improper payment rate to less than 10 percent. However, the IRS has been approved for an exception to the annual reduction target reporting requirement. As an alternative, the OMB advised that a reduction target may remain constant given the complexities of the program, as long as the complexities are clearly explained in a footnote.

[6] TIGTA, Ref. No. 2016-40-036, *Without Expanded Error Correction Authority, Billions of Dollars of Identified Potentially Erroneous Earned Income Credit Claims Will Continue to Go Unaddressed Each Year* (Apr. 2016) and TIGTA, Ref. No. 2014-40-093, *Existing Compliance Processes Will Not Reduce the Billions of Dollars in Improper Earned Income Tax Credit and Additional Child Tax Credit Payments* (Sept. 2014).

[7] Percentage does not calculate due to rounding.

[8] Percentage does not calculate due to rounding.

Figure 1 provides a summary of our evaluation of the IRS's compliance with the various improper payment reporting requirements.

Figure 1: IRS Compliance With Improper Payment Requirements for the EITC Program for Fiscal Year 2019

Improper Payment Requirement	Source of Requirement	Provided by the IRS
Conduct a program-specific risk assessment for each program or activity identified by the Treasury Department.	IPERA	Yes
Publish an improper payment estimate for the EITC.	IPERA	Yes
Report an improper payment rate of less than 10 percent for the EITC.	IPERA	No
Provide the methodology for identifying and measuring EITC improper payments.	Executive Order	Yes
Publish improper payment reduction targets.[9]	IPERA	Yes
Publish a programmatic corrective action plan.	IPERA	Yes
Report on actions the IRS intends to take to prevent future EITC improper payments.	IPERIA	Yes
Report on efforts taken or planned to recapture EITC improper payments.	IPERIA	Yes
Provide plans and supporting analysis for ensuring that the initiatives undertaken do not unduly burden program access and participation by eligible beneficiaries.	Executive Order	Yes
Provide required EITC information for posting to the paymentaccuracy.gov website.	Executive Order/IPERIA	Yes

Source: TIGTA's review of the IRS's Compliance with EITC improper payment reporting requirements for Fiscal Year 2019.

Use of quantitative assessment confirmed the risk of improper payment associated with the ACTC and the AOTC is high and will require reporting in subsequent fiscal years

We previously recommended that the IRS ensure that risk assessments accurately report the ACTC and the AOTC as high risk, and revise the methodology used to conduct the Annual Improper Payment Risk Assessment for refundable tax credits to include a quantitative assessment. In response, in Fiscal Year 2019, the IRS performed Quantitative Risk Assessments on the ACTC and the AOTC, resulting in its reporting of these refundable credits as high risk. Ranking the ACTC and the AOTC as high risk requires the IRS to describe its actions or plans to prevent and reduce improper payments associated with these credits. However, the reporting

[9] The IRS is required to submit quarterly scorecards to show progress made in lieu of reduction targets. In addition, if the reduction target is a constant, a footnote should clearly explain the complexities surrounding the program.

requirements for the ACTC and the AOTC differ from the EITC because this program is identified by the OMB as high-priority. Figure 2 provides a summary of our evaluation of the IRS's compliance with improper payment reporting requirements for the ACTC and the AOTC. Similar to the EITC, the IRS did not report an improper payment rate of less than 10 percent for either the ACTC or the AOTC.

Figure 2: IRS Compliance With Improper Payment Requirements for the ACTC and AOTC Programs for Fiscal Year 2019

Improper Payment Requirement	Source of Requirement	Provided by the IRS
Conduct a program-specific risk assessment for each program or activity identified by the Treasury Department.	IPERA	Yes
Publish an improper payment estimate.	IPERA	Yes
Report an improper payment rate of less than 10 percent.	IPERA	No
Publish improper payment reduction targets.[10]	IPERA	Yes
Publish a programmatic corrective action plan.	IPERA	Yes

Source: TIGTA's review of the IRS's compliance with ACTC and AOTC improper payment reporting requirements for Fiscal Year 2019.

The risk of Net PTC improper payments is not included in the Agency Financial Report

The IRS estimates 27.4 percent ($540.9 million) of the total Net PTC payments in Fiscal Year 2019 were improper. This amount confirms that the improper payments, as defined by OMB guidance, meet IPERA guidelines for rating as a high risk. The IRS is required to begin reporting these estimates in Fiscal Year 2020 per OMB guidance. Programs are to be rated as high risk when they are susceptible to significant improper payments under the IPIA. Per the OMB, significant improper payments are defined as gross annual improper payments in the program exceeding a) both 1.5 percent of program outlays and $10 million of all program or activity payments made during the fiscal year reported or b) $100 million regardless of the improper payment percentage of total program outlays.

IRS management cautioned that the Net PTC error rates may change as additional compliance data become available. In addition, IRS management indicated that the Fiscal Year 2019 Net PTC improper payment estimates do not meet OMB statistical requirements due to the lack of compliance data available. Although additional compliance data may change the Net PTC error rates and the IRS's improper payment estimates, we continue to identify significant risks associated with improper PTC payments. For example, our analysis of Processing Year 2019 tax returns as of May 2, 2019, found that the IRS processed 4.8 million tax returns that self-reported nearly $37.7 billion in the PTCs that were either received in advance or claimed at the time of filing.[11] A total of $4.5 billion in Advanced PTCs (APTC) claimed by these filers was in excess of

[10] If reduction targets are a constant, the IRS is required to clearly explain, in a footnote, the complexities surrounding the program.
[11] TIGTA, Ref. No. 2020-44-007, *Results of the 2019 Filing Season* (Jan. 2020).

the amount of the PTCs to which they were entitled, an increase from $3.7 billion in Processing Year 2018. A total of $1.3 billion of the amount of excess APTCs was not required to be repaid, which increased from $1 billion in Processing Year 2018.[12] Figure 3 provides a comparison of PTC statistics for Processing Years 2017 through 2019, which continues to show the risk associated with improper PTC payments is high.

Figure 3: PTC Statistics for Processing Years 2017 Through 2019

	Processing Year 2017 as of May 4, 2017	Processing Year 2018 as of May 3, 2018	Processing Year 2019 as of May 2, 2019
Total Tax Returns With the PTC	**5.1 million**	**4.9 million**	**4.8 million**
Total PTC Amount (includes the APTC and the PTC)	$23.9 billion	$27.0 billion	$37.7 billion
Total APTC Amount	$22.5 billion	$25.6 billion	$36.4 billion
Total PTC Claimed at Filing in Excess of the APTC	$1.4 billion	$1.4 billion	$1.3 billion
Tax Returns With Excess APTC Payments – *(taxpayer receives more APTC than the PTC entitled to and has to repay)*			
Total Tax Returns	2.8 million	2.7 million	2.6 million
Total PTC Amount	$7.5 billion	$9.8 billion	$13.5 billion
Total APTC Amount	$13.4 billion	$13.5 billion	$18 billion
Total APTC Reported in Excess of the PTC	$5.8 billion	$3.7 billion	$4.5 billion
Tax Returns With Excess APTC Payments – *(taxpayer receives more APTC than the PTC entitled to and has to repay)*			
Total APTC Above the Repayment Limit (not repaid)	$3.5 billion	$1.0 billion	$1.3 billion
Total APTC Below the Repayment Limit (repaid)	$2.3 billion	$2.7 billion	$3.2 billion

Source: TIGTA's analysis of Individual Master File posted tax return information as of May 4, 2017, May 3, 2018, and May 2, 2019. Totals may not add due to rounding.

According to the IRS, it will not report improper payment rates for Net PTC because it is the Treasury Department's position that reporting improper payment estimates for the PTC requires coordination with the Department of Health and Human Services, which shares responsibility for administering this credit.[13] In April 2017,[14] we reported that the OMB established an interagency working group in Fiscal Year 2015 that included representatives from the IRS, the Treasury Department, the Centers for Medicare and Medicaid Services, and the Department of

[12] The Affordable Care Act limits the amount of tax that individuals with income between 100 percent and 400 percent of the Federal Poverty Line will have to repay.
[13] The Department of Health and Human Services Centers for Medicare and Medicaid Services is responsible for determining the amount of the APTC the taxpayer is eligible to receive.
[14] TIGTA, Ref. No. 2017-40-030, *Revised Refundable Credit Risk Assessments Still Do Not Provide an Accurate Measure of the Risk of Improper Payments* (Apr. 2017).

Health and Human Services. The group was established as a collaborative effort to develop an assessment of improper payment risk across all payments made from the PTC budget fund account; *i.e.,* to define the improper rate for the PTC that includes both the APTC and the Net PTC. However, a definition of a PTC improper payment has not been agreed upon. According to IRS management, discussions have started again between the IRS and the Centers for Medicare and Medicaid Services to resolve how to define a PTC improper payment. IRS management indicated that the goal is to have something in place by summer 2020.

Recommendation 1: The Chief Financial Officer and the Commissioner, Wage and Investment Division, should work with the Department of Health and Human Services to develop a comprehensive risk assessment of improper PTC payments, including the risk of APTC improper payments.

> **Management's Response:** The IRS agreed with the spirit and intention of this recommendation and plans to continue supporting the interagency work group mentioned in the report. The group will continue to develop an assessment of improper payment risk for PTC payments and define the improper rate for the PTC that includes the APTC and the Net PTC.

Authorities Provided by the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credits

In February 2020, we reported[15] on the results of our audit to evaluate the IRS's use of available tools to deter taxpayers from repeatedly claiming erroneous or fraudulent refundable tax credits. Our review identified that the IRS does not use the tools provided by Congress to the extent possible to address erroneous credit payments. For example:

- **Erroneous refund penalties[16] are not being assessed on the majority of taxpayers with reduced or disallowed refundable credit claims.** For example, for Tax Years 2015, 2016, and 2017, the IRS disallowed more than $1.7 billion in refundable credit claims but did not assess more than $341 million in erroneous refund penalties. Congress provided the IRS with this penalty as a tool to deter aggressive claims for tax refunds and credits by increasing the cost to individuals who attempt to claim erroneous refunds.
- **The majority of taxpayers who are recertified[17] do not meet eligibility requirements.** Our review identified 311,883 tax returns in which the taxpayers' tax accounts had a recertification indicator that either were processed during Calendar Year 2018[18] or had an examination that was closed during Fiscal Year 2018. We identified 289,059 (93 percent) returns for which the IRS did not verify the taxpayers' eligibility before recertifying them to receive a refundable credit. These taxpayers received more than $532 million in refundable credits.

[15] TIGTA, Ref. No. 2020-40-008, *Authorities Provided by the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims* (Feb. 2020).
[16] The Small Business and Work Opportunity Tax Act of 2007 provides the IRS with the ability to assess the erroneous claim for refund or credit penalty (referred to as the erroneous refund penalty).
[17] The Internal Revenue Code requires individuals whose EITC, ACTC, or AOTC claim has been reduced or disallowed to recertify their eligibility before they can receive the credit again.
[18] As of July 31, 2018.

- **Bans are not being used effectively to address refundable credit noncompliance and ensure efficient use of limited examination resources.** Our analysis of 1.9 million taxpayers who claimed the EITC, the ACTC, or the AOTC in Tax Year 2017 and did not have a ban on their tax accounts identified 3,934 taxpayers[19] who were allowed to claim more than $12.9 million in credits despite having the same credit disallowed in the two prior tax years (Tax Years 2015 and 2016). We estimate it costs the IRS nearly $1.1 million to re-audit taxpayers who had already been denied the EITC, the ACTC, or the AOTC in two prior audits.

The ineffective use of the various authorities provided in the Internal Revenue Code is a contributing factor in the high rate of improper payments. These existing legislatively granted tools include the authority to assess the erroneous refund penalty and require taxpayers to recertify that they meet refundable credit eligibility requirements for credits claimed on a return filed subsequent to disallowance of a credit, and the ability to apply two-year or 10-year bans on taxpayers who disregard credit eligibility rules. However, the IRS does not use these tools to the extent possible to address erroneous credit payments.

TIGTA made eight recommendations to the IRS Commissioner, Wage and Investment Division, in its February 2020 report. The IRS agreed or partially agreed with five recommendations. The IRS did not agree to examine all tax returns with a recertification indicator, modify systemic processes to apply the two-year ban after two audits result in the disallowance of a refundable credit, or develop a plan to obtain and use information from the Social Security Administration of individuals who admit to falsely reporting self-employment income to receive refundable credits.

Increased Correctable Error Authority Could Reduce the Number of Potentially Erroneous Refundable Credit Payments

To give the IRS the ability to identify improper refundable credit claims based on incorrect income reporting, Congress included provisions in the Protecting Americans From Tax Hikes Act of 2015[20] that changed the date for third parties to file Form W-2, *Wage and Tax Statement*, and report nonemployee income on Form 1099-MISC, *Miscellaneous Income*, to January 31. The Act also prohibits the IRS from issuing tax refunds prior to February 15 when the tax return includes the EITC or the ACTC to provide adequate time to verify income reported on these returns. However, the Protecting Americans From Tax Hikes Act does not provide the IRS with expanded correctable error authority to address these discrepancies. Without this authority, the IRS must still audit each tax return to prevent or recover the unsupported refundable credits. As a result of limited resources, the majority of refundable credit claims with income discrepancies are not addressed.

This in turn contributes to the IRS's inability to make any significant reduction in refundable credit improper payments via the use of earlier reporting of income information. For example, as of May 2, 2019, our analysis of Tax Year 2018 tax returns identified more than 3.5 million tax returns with an income discrepancy of $1,000 or greater between what was reported on the tax returns and what was reported on Forms W-2, and the IRS did not select these returns for

[19] The 3,934 taxpayers are limited to those taxpayers who the IRS audited at least twice during Tax Years 2015 through 2017, and two or more of the audits were closed with a status other than undeliverable, *i.e.*, the taxpayer received the audit letter.

[20] Pub. L. No. 114-113, 129 Stat. 2242 (2015).

further review. Refunds associated with these tax returns totaled more than $16.6 billion, which included more than $8.3 billion in the EITC and more than $4.3 billion in the ACTC. For 963,618 of the tax returns, we identified that the IRS received no third-party Forms W-2 supporting the wages reported on the returns (for which more than $3.3 billion in the EITCs and/or the ACTCs was paid). Figure 4 shows the number of Tax Years 2016 through 2018 tax returns that received the EITC and the ACTC and did not have a Form(s) W-2 to support reported wages.

Figure 4: Tax Years 2016 Through 2018 Returns Without Form(s) W-2 to Support Wages Reported on Returns

Tax Year	Number of Returns	EITC/ACTC Received
2016[21]	660,141	$2.6 billion
2017[22]	278,174	$1.0 billion
2018[23]	963,618	$3.3 billion
Totals	**1,901,933**	**$6.9 billion**

Source: Previous TIGTA audit reports.

The IRS continues to request additional authority that would allow it to correct tax returns claiming a refundable credit with an income discrepancy. The IRS requested this authority to address returns during processing when the information provided by the taxpayer does not match the information contained in Government databases, *e.g.*, income information reported on the tax return does not match Form W-2 information the IRS receives from the Social Security Administration.

Revising the Nonwork Social Security Number Case Selection Could Increase Revenue Protected

In July 2017,[24] we reported that the IRS had not established processes to prevent individuals who have a nonwork Social Security Number (SSN)[25] from receiving the EITC.[26] In response, the IRS initiated a pilot program to identify 500 tax returns with EITC claims during processing in which claimants were issued a nonwork SSN and, as such, do not qualify for the EITC. The claimant is asked to provide documentation that he or she no longer has a nonwork SSN (now has one that is valid for work) and as such qualifies for the EITC claimed. If the claimant cannot

[21] TIGTA, Ref. No. 2020-44-007, *Results of the 2019 Filing Season* (Jan. 2020).

[22] TIGTA, Ref. No. 2019-40-039, *Some Refundable Credits Are Still Not Classified and Reported Correctly as a High Risk for Improper Payment by the Internal Revenue Service* (May 2019).

[23] TIGTA, Ref. No. 2018-40-015, *Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds Are Paid* (Feb. 2018).

[24] TIGTA, Ref. No. 2017-40-042*, Processes Do Not Maximize the Use of Third-Party Income Documents to Identify Potentially Improper Refundable Credit Claims* (July 2017).

[25] A nonwork SSN is issued to obtain Federal benefits, *e.g.*, Medicaid or food stamps, and is not valid for work. The Social Security Administration has issued almost eight million "*NOT VALID FOR EMPLOYMENT*" SSNs since 1972 to individuals who do not have authorization to work in the United States.

[26] The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, enacted August 22, 1996, requires individuals claiming the EITC to have a SSN that is valid for work and authorizes the IRS to deny claims to those individuals who file using an invalid SSN.

provide the documentation or fails to respond to the notice, the IRS will disallow the credit. Figure 5 provides a breakdown, for Processing Years 2018 and 2019, of the number of returns filed by nonwork SSN individuals the IRS selected for review, the number of the returns with reversed EITC, and the amount of revenue protected associated with the erroneous returns.

Figure 5: Returns With Nonwork SSNs Selected by the IRS

Processing Year	Number of Returns Selected	Number of Returns with Reversed EITC	Revenue Protected
2018	500	341	$1.3 million
2019	1,142	782	$3.2 million
Totals	**1,642**	**1,123**	**$4.5 million**

Source: Return Integrity and Compliance Services function management. Filing Season 2018 data as of October 27, 2018, and Filing Season 2019 data as of February 6, 2020.

The Tax Cuts and Jobs Act,[27] enacted in December 2017, changed the requirements for the ACTC, similar to EITC claims, to require an SSN that is valid for work for each qualifying dependent to claim the credit. As such, similar to EITC claims, ACTC claims in which dependent(s) were issued a nonwork SSN do not qualify for the ACTC. In our prior report, and in response to the provision included in the Tax Cuts and Jobs Act,[28] we also recommended that the IRS, based on the results of the nonwork SSN pilot conducted in Processing Years 2018 and 2019, implement a process to systemically identify and evaluate tax returns filed by individuals who have nonwork SSNs to prevent erroneous refunds of the EITCs and the ACTCs. The IRS agreed with this recommendation.

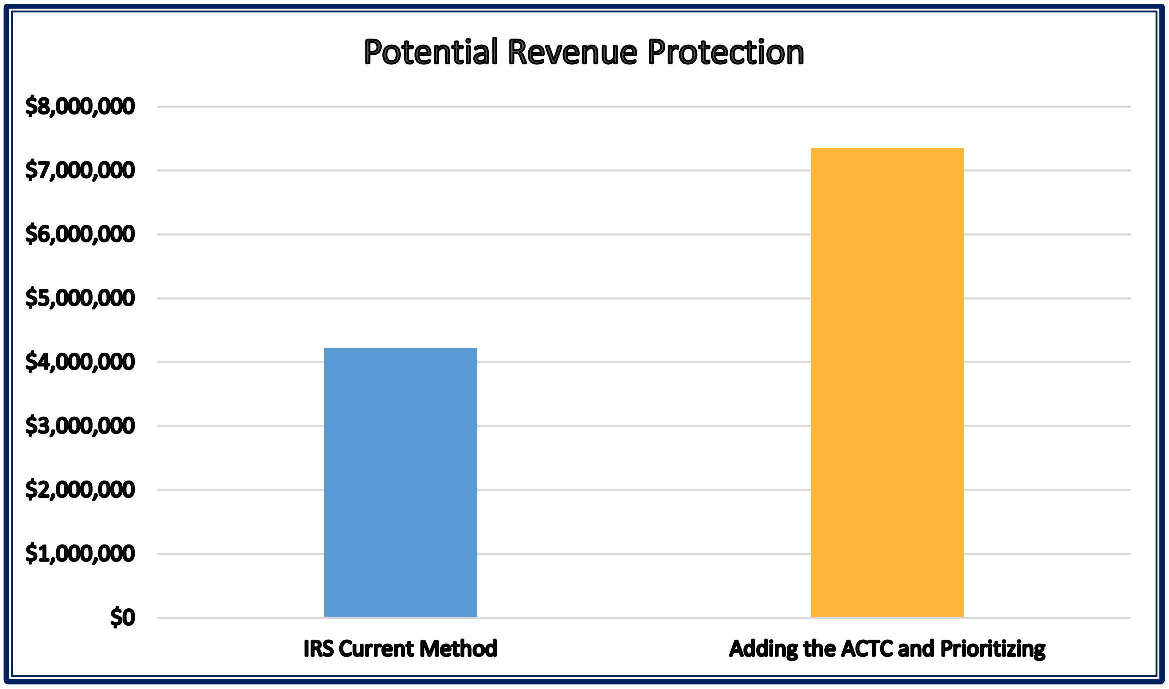
Selecting cases with both EITC and ACTC claims increases the amount of revenue the IRS can protect

Our review of Processing Year 2019 tax returns identified that the IRS could have selected from 20,335 tax returns with potentially erroneous refundable credits and increased the amount of revenue it is protecting by approximately $3.1 million if it included the ACTC in its selection criteria and prioritized its case selection. Figure 6 shows the potential revenue protected using the IRS's current selection method and TIGTA's analysis using the ACTC and prioritizing case selection.

[27] Pub. L. No. 115-97.

[28] TIGTA, Ref. No. 2019-40-039, *Some Refundable Credits Are Still Not Classified and Reported Correctly as a High Risk for Improper Payment by the Internal Revenue Service* (May 2019).

Figure 6: Revenue Protection of IRS Nonwork SSN Selections



Source: TIGTA analysis of the Individual Return Transaction File as of December 12, 2019, and the National Account Profile as of September 26, 2019.

On January 23, 2020, we notified IRS management of our concerns with the nonwork SSN program. IRS management agreed that they should include the ACTC in their selection criteria and will review potentially erroneous ACTC claims as part of the cases selected during Processing Year 2020. In addition, the IRS will implement new selection criteria specifically for the ACTC for Processing Year 2021. However, the IRS did not agree with selecting cases with the largest EITC amounts stating the need to ensure coverage across all case types. The IRS cites a lack of resources as a reason why it cannot perform more examinations. Thus, prioritizing cases with the greatest potential for revenue protection allows the IRS to use its limited resources in the most efficient manner.

The Commissioner, Wage and Investment Division, should

Recommendation 2: Continue to refine the selection criteria to ensure that returns with the greatest potential for revenue protection are selected and worked.

> **Management's Response:** The IRS agreed with this recommendation and has already begun this process by adding three subrules (automated controls) derived from a research effort to point to selections with the greatest potential for revenue protection. IRS management plans to continue this effort in 2020 with the goal of improving the accuracy in 2021.

Recommendation 3: Implement a process to systemically identify and evaluate tax returns filed by individuals who have a nonwork dependent SSN to prevent erroneous refunds of the ACTC.

> **Management's Response:** The IRS agreed with this recommendation and plans to work with its Information Technology function to deliver a subrule to address this issue.

In the interim, IRS management plans to add this as an issue when the return is selected for the EITC.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective is to determine whether the IRS complied with the annual improper payment reporting requirements for Fiscal Year 2019. To accomplish our objective, we:

- Determined if the IRS complied with the improper payment reporting requirements for Fiscal Year 2019.
- Reviewed the information the IRS provided to the Treasury Department for inclusion in the Agency Financial Report to determine if information was provided to satisfy the reporting requirements.
- Reviewed information that the IRS provided to the Treasury Department for posting to the paymentaccuracy.gov website.
- Determined if the information included in the Fiscal Year 2019 Treasury Agency Financial Report relative to EITC improper payments accurately reflects the underlying information from the IRS and was posted to paymentaccuracy.gov or other Internet locations as required.
- Evaluated the adequacy of the IRS's updated methodology to calculate ACTC and AOTC improper payment rate and dollar amounts.
- Determined the potential ACTC and AOTC improper payment rate for Fiscal Year 2019. We ensured that the IRS's determination of improper payment risk was consistent with the potential improper payment rate.
- Determined the potential PTC improper payment rate for Fiscal Year 2019. We ensured that IRS determination of improper payment risk was consistent with the potential improper payment rate. We evaluated the IRS's efforts to evaluate the risk of PTC improper payments.
- Evaluated the adequacy of the IRS's Fiscal Year 2019 risk assessment for the Treasury Department-identified revenue program funds.
- Followed up on select prior audit findings to ensure that the IRS has taken the agreed upon action to resolve the issues.
- Determined if the IRS has taken action to analyze the available nonwork SSN data and valuate its usefulness to identify potentially fraudulent EITC claims.
- Determined if the IRS has taken actions to use income documents to identify discrepancies to prevent the issuance of EITC and ACTC claims when the income reported on the tax return is not supported by Form W-2, *Wage and Tax Statement*, on the Information Return Master File.

Performance of This Review

This review was performed with information obtained from the Office of the Chief Financial Officer and the Office of Research, Applied Analytics, and Statistics located at the IRS Headquarters in Washington, D.C., and the Office of Return Integrity and Correspondence Services in Atlanta, Georgia, during the period October 2019 through February 2020. 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.

Major contributors to the report were Russell P. Martin, Assistant Inspector General for Audit Returns Processing and Account Services; Diana M. Tengesdal, Director; Linna K. Hung, Audit Manager; and Brieane K. Hamaoka, Lead Auditor.

Validity and Reliability of Data From Computer-Based Systems

During this review, we relied on data received from the IRS for the National Research Program on the ACTC, the AOTC, the PTC, and the EITC for Tax Year 2015. We also obtained extracts from the IRS's Individual Master File, the Individual Return Transaction File databases for Processing Year 2019, and the National Account Profile that were available on TIGTA's Data Center Warehouse. We evaluated the data by 1) performing electronic testing of required data elements, 2) reviewing existing information about the data and the system that produced them, and 3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for purposes of this report.

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: controls in place to ensure that the IRS met the annual improper payment reporting requirements established in the IPERA, Executive Order 13520, and the IPERIA. We tested these controls by reviewing and analyzing relevant documents, data, and calculations related to the preparation of EITC improper payment estimate information.

Appendix II

Outcome Measure

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

Type and Value of Outcome Measure:

- Revenue Protection – Potential; approximately $11 million of potentially erroneous refundable credits identified with nonwork SSNs (see Recommendations 2 and 3).

Methodology Used to Measure the Reported Benefit:

We identified 2,514,301 individuals with a nonwork SSN in the National Account Profile. We matched nonwork SSNs to the IRS's Individual Master File for Tax Year 2018 to identify the tax returns claiming the ACTC that used these nonwork SSNs as dependents. Next, we applied a similar IRS selection criteria outlined in Rule 7T to identify 7,729 nonwork returns with $10,531,617.40 in potentially erroneous ACTC based on the number of nonwork dependents. Our analysis also identified 1,553 tax returns that claimed both the EITC and the ACTC with dependents who had nonwork SSNs totaling $2,057,001.95 of potentially erroneous ACTC.

We included the 9,282 tax returns we identified with potentially erroneous ACTC to the 11,053 tax returns that the IRS identified with potentially erroneous EITC and selected and prioritized the selection of tax returns with the greatest amount of revenue protected in Processing Year 2019. Our analysis showed that the IRS could have reviewed tax returns with $3,128,918.50 more in potentially erroneous credits.

In Processing Year 2020, the IRS plans to increase its selection from the planned 1,000 cases to 4,000 cases. This represents a 350 percent increase (4,000 estimated Processing Year 2020 cases/1,142 actual Processing Year 2019 cases = 3.502626970 * 100) from Processing Year 2019. Therefore, in order to calculate the potential amount of revenue protected in Processing Year 2020, we multiplied the amount of revenue protected from the IRS's Processing Year 2019 selections ($3,128,918.50) to estimate the potential revenue protected for Processing Year 2020. ($3,128,918.50 x 3.502626970 = $10,959,434.33).

Appendix III

Internal Revenue Service Programs Identified for Improper Payment Risk Assessments

The following IRS programs were identified by the Treasury Department for improper payment risk assessments for Fiscal Year 2019.

IRS Program	Type of Program	Level of Risk Identified	Total Non-Federal Disbursements
Headquarters Disbursement Earned Income Credit[1]	Revenue	High	$58.6 billion
Additional Child Tax Credit	Revenue	High	$18.6 billion
American Opportunity Credit	Revenue	High	$3.1 billion
Premium Tax Credit	Revenue	High	$54.1 billion
Build America Bonds	Revenue	Low	$3.5 billion
Zone Academy Bonds	Revenue	Low	$57.1 million
School Construction Bonds	Revenue	Low	$680.3 million
Renewable Energy Bonds	Revenue	Low	$46.0 million
Energy Conservation Bonds	Revenue	Low	$40.5 million
Payment to USVI and PR for Disaster Tax Relief	Revenue	Low	$250.0 million
Private Collection Agent Program	Administrative	Low	$14.2 million
Special Compliance Personnel Program Account	Administrative	Low	$3.3 million

Source: IRS Office of the Chief Financial Officer.

[1] The EITC Program has been declared a high-priority program for improper payments by the OMB; therefore, no formal risk assessment is required for this revenue fund.

Appendix IV

Management's Response to the Draft Report

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

CHIEF FINANCIAL OFFICER

April 14, 2020

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Ursula S. Gillis
Chief Financial Officer

Ursula S. Gillis Digitally signed by Ursula S. Gillis Date: 2020.04.14 17:31:14 -04'00'

SUBJECT: Response to Audit Report – Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments (Audit #202040010)

Thank you for the opportunity to review and comment on your audit report entitled, *Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments*. We appreciate your acknowledgement of the challenges of administering complex social benefit programs, such as the Earned Income Tax Credit (EITC), the American Opportunity Tax Credit (AOTC), the Additional Child Tax Credit (ACTC), and the Premium Tax Credit (PTC) component of the Affordable Care Act (ACA) through the tax administration system. We also welcome your ongoing emphasis on the role that resource shortfalls and a lack of statutory authority have on the IRS's ability to prevent improper payments in a pre-refund environment or to recover them during audits.

Congress enacted refundable tax credits (RTC) to achieve specific economic and social objectives, such as reducing poverty and increasing the affordability of higher education. These programs and their eligibility rules are very complex, which can result in errors when taxpayers self-assess whether they qualify for the credit and the amount they may properly claim. Factors such as the number of eligible dependents, residency, custodial arrangements, income, and other variables all affect these determinations. Unfortunately, the IRS generally does not have access to independent information to validate taxpayer submissions and in many cases lacks the statutory authority to stop or correct returns before issuing a refund. Therefore, we are limited to addressing incorrect returns through the audit process after the return is filed and the refund is paid.

2

The IRS identified Net PTC (NPTC) as susceptible to significant improper payments during the fiscal year (FY) 2019 risk assessment process. Per Office of Management and Budget (OMB) guidance, the IRS was not required to report an NPTC improper payment estimate or rate until FY 2020. The IRS did perform a quantitative risk assessment for NPTC; however, the estimated rate, although statistically valid, does not meet OMB's precision objectives. To achieve OMB's objectives, the IRS needs multiple years of tax data. We reported improper payment estimates for ACTC and AOTC given that we had enough data to do so.

With respect to the joint rate, the ACA created the current process for claiming and reconciling the Advanced Premium Tax Credit (APTC). Taxpayers must request APTC through the Centers for Medicare and Medicaid Services (CMS), which processes taxpayer claims and disburses funds to the appropriate insurers. APTC recipients are then required, during the subsequent filing season, to reconcile their APTC claims on their tax returns using Form 8962, *Premium Tax Credit*. Taxpayers who received less than the amount of APTC for which they were eligible can receive an additional credit. Taxpayers who received more are generally required to repay the difference. The IRS is statutorily limited in recovering excess APTC because the amount taxpayers are required to repay is based on the taxpayer's Federal Poverty Line. A taxpayer's allowable APTC can fluctuate based on changes to income and family size. IRS's involvement in determining the correct APTC amount is limited to providing income information to the Marketplace website for purchasing health insurance.

Since 2014, the IRS and CMS have been developing independent improper payment estimates for NPTC and APTC since these programs are managed independently by separate federal entities. The IRS has calculated a preliminary improper payment estimate for NPTC with National Research Program data, using a methodology consistent with that used for the other refundable tax credits. However, in August 2019, the IRS and CMS began discussions to determine whether it would be feasible to leverage independent calculations from each bureau to produce a joint program improper payment estimate. As of March 2020, the IRS and CMS have held several discussions regarding the potential for a joint rate but have identified technical challenges with this approach. Representatives from the IRS and CMS continue to work together to ascertain whether these challenges could be overcome.

Regardless of our reporting efforts, the IRS believes that improper payment estimates do not accurately reflect the challenges of administering the RTC programs. Improper payment estimates are developed from statistically valid samples but are subject to constraints imposed by statute and guidance.

Directly related to the report's section: *Authorities Provided by the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credits* (page 7); IRS notes that the Protecting Americans from Tax Hikes (PATH) Act of 2015 made significant changes to IRC §6676, including making the penalty applicable to claims for refund involving the EITC where the refund was held and not paid out. The legislation was effective for returns filed after December 18, 2015. Given the PATH Act enactment date, tax year 2015 implementation was not realistic. Changes to IRC §6676 made by the PATH Act required the IRS to establish a new implementation strategy. Most refundable credit audits are worked in a pre-refund environment. Consequently, this legislation had the potential to affect a significant number of those audits. The new strategy required establishing a policy on how and when the penalty should be asserted. The strategy also involved securing programming to apply the penalty on IRS systems, such as Report Generation Software (RGS). IRS revised RGS programming to allow the manual assertion of the penalty in June 2016. We implemented actions as timely as possible considering the policy decisions and programming requirements surrounding this penalty.

Attached are proposed actions to your recommendations. If you have any questions, please contact me at 202-317-6400, or a member of your staff may contact Jonathan Edelson, Acting Associate Chief Financial Officer for Internal Controls, at 202-803-9206.

Attachment

Attachment

Internal Revenue Service
Chief Financial Officer – Corrective Action Plan
Draft Audit Report - Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments (TIGTA #202040010)

RECOMMENDATION 1: The Chief Financial Officer and the Commissioner, Wage and Investment Division, should work with the Department of Health and Human Services to develop a comprehensive risk of improper Premium Tax Credit (PTC) payments, including the risk of Advanced Premium Tax Credit (APTC) improper payments.

IRS RESPONSE: The IRS agrees with the spirit and intention of this recommendation and will continue to support the inter-agency work group mentioned in the report. The group will continue to develop an assessment of improper payment risk for PTC payments and define the improper rate for the PTC that includes both the APTC and Net Premium Tax Credit (NPTC). To implement this recommendation, we will complete our definition for PTC improper payment and evaluate reporting related to NPTC.

The Government Accountability Office (GAO) issued a recommendation in its report #GAO-17-467 that states, in part, that if PTC "meets the Improper Payment Information Act (IPIA) of 2002 definition for being susceptible to significant improper payments … [the IRS should] estimate and report improper payments associated with the PTC program consistent with IPIA requirements." GAO maintains this recommendation as an open priority recommendation, indicating it would be satisfied by publication of an improper payment estimate for NPTC. In August 2019, the IRS and the Centers for Medicare and Medicaid Services began discussions regarding the feasibility of a joint program improper payment estimate; discussions have continued through March 2020. GAO has acknowledged that publication of a joint rate will also satisfy this recommendation. Therefore, due to existing and ongoing efforts to produce an improper payment estimate for this program and technical uncertainty regarding whether a joint rate can be achieved, it is not practical to develop additional corrective actions for this recommendation.

IMPLEMENTATION DATE: September 30, 2020

RESPONSIBLE OFFICIAL: Associate Chief Financial Officer for Internal Controls and Director, Refundable Credits Program Management, Wage and Investment Division

RECOMMENDATION 2: The Commissioner, Wage and Investment Division, should continue to refine the selection criteria to ensure that returns with the greatest potential for revenue protection are selected and worked.

Attachment

IRS RESPONSE: We agree with this recommendation. Our Wage & Investment, Return Integrity and Compliance Services (RICS), Automated Questionable Credit program has already begun this process by adding three sub rules (automated controls) derived from a research effort to point to selections with the greatest potential for Revenue Protection. We will continue this effort in 2020 with the goal of improving the accuracy in 2021. The RICS Exam program uses filters to identify the potential non-compliant taxpayers, including those with the recertification indicator to select for audit. In order to ensure a balanced compliance strategy, we select recertification cases along with cases from other project codes that our filters identify to ensure coverage on all programs. Solely selecting Exam recertification cases may not result in selecting the most egregious returns.

IMPLEMENTATION DATE: March 15, 2021

RESPONSIBLE OFFICIAL: Director, Return Integrity Verification Program Management, Return Integrity and Compliance Services, Wage and Investment Division

RECOMMENDATION 3: The Commissioner, Wage and Investment Division, should implement a process to systemically identify and evaluate tax returns filed by individuals who have a nonwork dependent Social Security Number to prevent erroneous refunds of ACTC.

IRS RESPONSE: We agree with this recommendation and will work with IT to deliver a sub rule to address this issue. In the interim, we will add this as an issue when the return is selected for EITC.

IMPLEMENTATION DATE: March 15, 2021

RESPONSIBLE OFFICIAL: Director, Return Integrity Verification Program Management, Return Integrity and Compliance Services, Wage and Investment Division

Appendix V

Abbreviations

ACTC	Additional Child Tax Credit
AOTC	American Opportunity Tax Credit
APTC	Advanced Premium Tax Credit
EITC	Earned Income Tax Credit
IPERA	Improper Payments Elimination and Recovery Act
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IPIA	Improper Payments Information Act
IRS	Internal Revenue Service
OMB	Office of Management and Budget
PTC	Premium Tax Credit
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration